



COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Financial Statements

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

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KPMG LLP
Suite 800
1225 17th Street
Denver, CO 80202-5598

Independent Auditors' Report

The Board of Directors
Compassion International, Incorporated:

We have audited the accompanying consolidated financial statements of Compassion International, Incorporated and its affiliates, which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Compassion International, Incorporated and its affiliates as of June 30, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Denver, Colorado
August 30, 2016

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Statements of Financial Position

June 30, 2016 and 2015

Assets	2016	2015
Current assets:		
Cash and cash equivalents	\$ 95,061,822	80,259,524
Investments	66,407,194	85,670,184
Receivables from Global Partner Alliance	8,529,271	10,399,291
Accounts receivable	1,418,484	452,339
Prepaid expenses and supplies	7,642,314	6,666,322
Gifts in-kind inventory, net	71,735	339,705
Foreign exchange contracts, at fair value	7,011,974	—
Total current assets	<u>186,142,794</u>	<u>183,787,365</u>
Noncurrent assets:		
Property, plant, and equipment, net	100,720,785	89,142,194
Intangibles, net	1,585,133	1,790,567
Total noncurrent assets	<u>102,305,918</u>	<u>90,932,761</u>
Restricted assets:		
Investments restricted for trust and annuity obligations	2,772,874	2,601,085
Investments restricted for long-term purposes	10,468,802	10,151,055
Total restricted assets	<u>13,241,676</u>	<u>12,752,140</u>
Total assets	\$ <u><u>301,690,388</u></u>	\$ <u><u>287,472,266</u></u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 22,388,989	24,472,561
Funds committed to sponsorship projects	58,293,856	46,448,528
Accrued severance/retirement benefits for national employees	210,253	1,390,260
Trust obligations	31,491	35,508
Gift annuities payable	19,084	26,556
Revocable trust agreements	13,733	69,238
Foreign exchange contracts, at fair value	3,134,429	358,722
Total current liabilities	<u>84,091,835</u>	<u>72,801,373</u>
Long-term liabilities:		
Funds committed to sponsorship projects, less current portion	368,565	381,524
Accrued severance/retirement benefits for national employees, less current portion	2,263,675	15,674,569
Trust obligations, less current portion	763,601	773,179
Gift annuities payable, less current portion	825,924	443,391
Custodial funds held	316,163	325,997
Total long-term liabilities	<u>4,537,928</u>	<u>17,598,660</u>
Total liabilities	<u>88,629,763</u>	<u>90,400,033</u>
Commitments and contingencies		
Net assets:		
Unrestricted	100,955,301	91,265,524
Temporarily restricted	102,334,709	96,662,942
Permanently restricted	9,770,615	9,143,767
Total net assets	<u>213,060,625</u>	<u>197,072,233</u>
Total liabilities and net assets	\$ <u><u>301,690,388</u></u>	\$ <u><u>287,472,266</u></u>

See accompanying notes to consolidated financial statements.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Statements of Activities

Years ended June 30, 2016 and 2015

	2016				2015			
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenue, gains, and other support:								
Contributions	\$ 15,216,406	576,498,740	490,771	592,205,917	11,374,547	528,226,326	341,433	539,942,306
Gifts in-kind	22,564	236,536	—	259,100	—	935,931	—	935,931
Contributions from Global Partner Alliance	31,914,445	173,693,718	—	205,608,163	35,752,399	188,386,929	—	224,139,328
Interest, dividends, and other income	1,884,792	72,868	46,782	2,004,442	1,698,427	62,944	41,937	1,803,308
Net realized and unrealized (losses) gains on investments and disposition of assets	(1,240,049)	238,786	89,295	(911,968)	(400,638)	470,378	49,797	119,537
Net unrealized gain (loss) on foreign exchange contracts	4,236,267	—	—	4,236,267	(358,722)	—	—	(358,722)
Changes in value of split-interest agreements	(83,316)	(75,192)	—	(158,508)	(20,305)	(177,889)	—	(198,194)
Net assets released from restrictions in satisfaction of program restrictions	744,993,689	(744,993,689)	—	—	730,573,497	(730,573,497)	—	—
Total revenue, gains, and other support	<u>796,944,798</u>	<u>5,671,767</u>	<u>626,848</u>	<u>803,243,413</u>	<u>778,619,205</u>	<u>(12,668,878)</u>	<u>433,167</u>	<u>766,383,494</u>
Expenses:								
Program services:								
Child development program	621,351,904	—	—	621,351,904	602,424,362	—	—	602,424,362
Sponsor/donor ministries	27,447,227	—	—	27,447,227	32,714,754	—	—	32,714,754
Total program services	<u>648,799,131</u>	<u>—</u>	<u>—</u>	<u>648,799,131</u>	<u>635,139,116</u>	<u>—</u>	<u>—</u>	<u>635,139,116</u>
Supporting activities:								
Fund-raising	76,104,825	—	—	76,104,825	83,926,854	—	—	83,926,854
Administration	62,351,065	—	—	62,351,065	57,437,751	—	—	57,437,751
Total supporting activities	<u>138,455,890</u>	<u>—</u>	<u>—</u>	<u>138,455,890</u>	<u>141,364,605</u>	<u>—</u>	<u>—</u>	<u>141,364,605</u>
Total expenses	<u>787,255,021</u>	<u>—</u>	<u>—</u>	<u>787,255,021</u>	<u>776,503,721</u>	<u>—</u>	<u>—</u>	<u>776,503,721</u>
Change in net assets	9,689,777	5,671,767	626,848	15,988,392	2,115,484	(12,668,878)	433,167	(10,120,227)
Net assets, beginning of year	91,265,524	96,662,942	9,143,767	197,072,233	89,150,040	109,331,820	8,710,600	207,192,460
Net assets, end of year	<u>\$ 100,955,301</u>	<u>102,334,709</u>	<u>9,770,615</u>	<u>213,060,625</u>	<u>91,265,524</u>	<u>96,662,942</u>	<u>9,143,767</u>	<u>197,072,233</u>

See accompanying notes to consolidated financial statements.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Statement of Functional Expenses

Year ended June 30, 2016

	Program services			Supporting activities			Total expenses
	Child development program	Sponsor/donor ministries	Total program expenses	Fund-raising	Administration	Total supporting activities	
Program grants	\$ 536,595,394	24,500	536,619,894	—	—	—	536,619,894
Salaries and related taxes	39,817,354	9,746,128	49,563,482	26,037,335	28,514,655	54,551,990	104,115,472
Employee benefits	8,023,725	2,263,935	10,287,660	5,571,284	8,417,836	13,989,120	24,276,780
Professional services	11,967,403	6,242,600	18,210,003	16,028,736	8,297,538	24,326,274	42,536,277
Travel and training	11,373,714	858,627	12,232,341	4,987,319	1,493,256	6,480,575	18,712,916
Office and related expenses	7,588,447	2,665,608	10,254,055	5,587,060	6,088,357	11,675,417	21,929,472
Occupancy	4,922,942	320,844	5,243,786	1,356,747	2,338,266	3,695,013	8,938,799
Advertising and promotion	4,632	27,292	31,924	11,708,798	115,229	11,824,027	11,855,951
Postage and printing	540,435	5,261,361	5,801,796	3,799,488	2,288,890	6,088,378	11,890,174
Other	517,858	36,332	554,190	1,028,058	4,797,038	5,825,096	6,379,286
Total	\$ 621,351,904	27,447,227	648,799,131	76,104,825	62,351,065	138,455,890	787,255,021

See accompanying notes to consolidated financial statements.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Statement of Functional Expenses

Year ended June 30, 2015

	Program services			Supporting activities			Total expenses
	Child development program	Sponsor/donor ministries	Total program expenses	Fund-raising	Administration	Total supporting activities	
Program grants	\$ 513,328,156	—	513,328,156	—	—	—	513,328,156
Salaries and related taxes	41,011,559	11,377,510	52,389,069	28,744,004	26,534,917	55,278,921	107,667,990
Employee benefits	9,641,050	3,217,725	12,858,775	6,759,161	7,942,953	14,702,114	27,560,889
Professional services	12,703,906	8,120,692	20,824,598	16,454,735	8,609,533	25,064,268	45,888,866
Travel and training	13,207,229	1,034,587	14,241,816	5,676,066	1,410,429	7,086,495	21,328,311
Office and related expenses	6,729,007	2,700,077	9,429,084	4,434,741	3,974,763	8,409,504	17,838,588
Occupancy	4,453,223	567,337	5,020,560	1,203,642	2,010,519	3,214,161	8,234,721
Advertising and promotion	54,359	138,809	193,168	14,386,673	123,120	14,509,793	14,702,961
Postage and printing	768,648	5,456,316	6,224,964	4,519,120	2,284,717	6,803,837	13,028,801
Other	527,225	101,701	628,926	1,748,712	4,546,800	6,295,512	6,924,438
Total	\$ 602,424,362	32,714,754	635,139,116	83,926,854	57,437,751	141,364,605	776,503,721

See accompanying notes to consolidated financial statements.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ 15,988,392	(10,120,227)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,278,813	6,772,747
Net loss (gain) on disposition of equipment	968,060	(31,012)
Net realized and unrealized gain on investments	(208,312)	(88,525)
Net loss on gifts in-kind inventory	152,220	—
Change in gifts in-kind inventory, net	115,750	(285,228)
Net unrealized (gain) loss on foreign exchange contracts	(4,236,267)	358,722
Decrease in value of split-interest agreements	158,508	198,194
Funds received restricted for endowments	(626,848)	(433,167)
Changes in assets and liabilities:		
Decrease in receivables	903,875	845,661
Increase in prepaid expenses and supplies	(975,992)	(32,483)
(Decrease) increase in accounts payable and accrued liabilities	(2,083,572)	5,649,946
Increase in funds committed to sponsorship projects	11,832,369	1,633,745
(Decrease) increase in accrued severance/retirement benefits for national employees	(14,590,901)	1,091,948
Net cash provided by operating activities	18,676,095	5,560,321
Cash flows from investing activities:		
Purchases of investments	(23,928,977)	(30,015,761)
Proceeds from sales of investments	42,752,235	28,875,085
Proceeds from sales of property and equipment	133,170	157,879
Purchases of intangibles	—	—
Purchases of property and equipment	(23,753,200)	(21,305,423)
Net cash used in investing activities	(4,796,772)	(22,288,220)
Cash flows from financing activities:		
Funds received restricted for endowments	626,848	433,167
Increase in gift annuities payable	375,061	29,276
Decrease in revocable trust agreements	(55,505)	(5,976)
Decrease in trust obligations	(13,595)	(159,200)
Decrease in custodial funds held	(9,834)	(2,397)
Net cash provided by financing activities	922,975	294,870
Net increase (decrease) in cash and cash equivalents	14,802,298	(16,433,029)
Cash and cash equivalents, beginning of year	80,259,524	96,692,553
Cash and cash equivalents, end of year	\$ 95,061,822	80,259,524

See accompanying notes to consolidated financial statements.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

(1) Organization

(a) General

Compassion International, Incorporated is a Christian organization that exists as an advocate for children to release them from their spiritual, economic, social, and physical poverty, and enable them to become responsible and fulfilled Christian adults. Compassion International, Incorporated's principal services provide life-changing opportunities for education and skills training, social development, health and nutrition, and most importantly, to learn about Christ and develop a lifelong relationship with God. Compassion International, Incorporated's program services are concentrated in certain countries of Africa, Asia, Central America, the Caribbean, and South America.

(b) Consolidation

The consolidated financial statements include the accounts of Compassion International, Incorporated, a not-for-profit corporation created under the laws of the state of Illinois, and its wholly owned and controlled affiliates (collectively, Compassion). All material interaffiliate accounts and transactions have been eliminated in the consolidated financial statements. Compassion is headquartered in Colorado Springs, Colorado and has international branch offices and affiliates (field offices) with child programs in 26 countries.

Compassion's international affiliates are consolidated based on the level of control exercised by the parent company and the presence of an economic interest. Compassion's consolidated international affiliates include Compassion International Ghana, Compassion International Togo, Shohanobhuti Bangladesh Trust, Adhane Management Consultants Private Limited (India), Caruna Bal Vikas (India), Compassion East India, Yayasan Bantuan Kasih (Indonesia), Compassion International Lanka (Sri Lanka), Compassion (Darunatorn) Foundation (Thailand), Compassion do Brasil, Corporación Compassion International Filial Ecuador, Compassion de Mexico Asociacion Civil, Compassion International de Peru, Compassion International (East Asia) Limited, and Compassion International (Singapore) Limited.

Compassion Productions, LLC (CP, LLC) is a limited liability company created under the laws of the state of Tennessee with Compassion International, Incorporated as its only member and is consolidated based on level of control exercised by the parent company and the presence of an economic interest. CP, LLC produces concert events, which serve as a platform for Compassion's fund-raising activities.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying consolidated financial statements have been prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP). The net assets, revenue, gains, and other support and expenses in the accompanying consolidated financial statements are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Compassion and changes therein are classified and reported as follows:

Unrestricted Net Assets – Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets may be designated by the board of directors for specific purposes at any time.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

Temporarily Restricted Net Assets – Net assets subject to donor-imposed restrictions that may or will be met with either actions of Compassion and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions.

Permanently Restricted Net Assets – Permanently restricted net assets represent resources subject to donor-imposed restrictions to be invested in perpetuity, and only the income may be available for program operations. The income realized from the permanently restricted net assets is temporarily restricted for use in the child development and leadership development programs.

(b) *Cash and Cash Equivalents*

Cash and short-term investments with maturities of three months or less from the date of acquisition are considered cash and cash equivalents. Compassion maintains cash accounts in the U.S. and internationally. Cash accounts in the U.S. may exceed federally insured amounts at times. Cash balances maintained internationally are not insured. Management believes no significant risk exists due to the size and financial wherewithal of the financial institutions where accounts are held.

(c) *Investments*

Investments are recorded at fair value. Gains or losses, whether realized or unrealized, are recognized when they occur.

(d) *Property, Plant, and Equipment*

Land, buildings and building improvements, furniture, equipment, software, and vehicles are recorded at cost when purchased or at estimated fair value if received by donation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, with no salvage value. Buildings and building improvements are depreciated over 5 to 30 years, furniture and equipment are depreciated over 3 to 10 years, vehicles are depreciated over 3 to 5 years, and software and other are amortized over 3 to 5 years.

(e) *Intangibles*

Intangibles are recorded at cost when purchased or at estimated fair value if received by donation. Amortization is computed using the straight-line method over the estimated useful lives of the related assets. Intangibles are amortized over 3 to 10 years.

(f) *Long-Lived Assets*

Long-lived assets are reviewed for impairment and, if such impairment is identified, written down to their fair value. Identified impairment losses are charged to operations in the consolidated statements of activities.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

(g) *Gift Annuities Payable*

Under gift annuity contracts, Compassion receives irrevocable title to contributed assets and agrees to make fixed period payments to the donor(s) for life. Contributed assets are recorded at fair value at the date of receipt, and a liability is established for the present value of future annuity payments based on a discount rate of 5.6%. The excess of contributed assets over the annuity liability is recorded as unrestricted revenue. Any actuarial gain or loss resulting from the computation of the liability for the present value of future annuity payments is recorded as an unrestricted change in the value of split-interest agreements. Upon the donor's death, the remaining liability is recognized as revenue.

(h) *Revocable Trust Agreements*

Assets received and held under revocable trust agreements are recorded at fair value at the date of receipt and as corresponding liabilities. Investment income is paid to the income beneficiaries and is not recorded as revenue or expense by Compassion. Upon the donor's death, the assets are distributed to the beneficiaries of the trust, which may include Compassion. Assets of revocable trusts in which Compassion is named as a beneficiary but that are not held or controlled by Compassion are not recorded in the consolidated statements of financial position.

(i) *Irrevocable Trust Agreements*

Under irrevocable trust agreements, Compassion receives contributed investments and agrees to maintain the principal of the investment and make annual payments to the donor(s) or other named beneficiaries for life. The annual payments are based on a fixed rate of return or on related investment income, as stipulated in the trust agreement. Amounts received under irrevocable trust agreements, net of the present value of future payments to beneficiaries, are recorded as temporarily restricted support upon receipt. Investment income and payments made to donors in accordance with the terms of the trust agreements are recorded as increases and decreases to the liability for trust obligations, respectively. A liability for trust obligations is recorded for the present value of future payments to beneficiaries based on a rate of return appropriate for the expected term of the promise to give. Any actuarial gain or loss resulting from the computation of the liability for the present value of future payments to beneficiaries is recorded as temporarily restricted changes in the value of split-interest agreements. Upon the death of the donor, the assets are transferred from temporarily restricted net assets as designated by the trust agreement. Certain trusts name other charitable organizations as partial remaindermen.

(j) *Contributions and Contributed Services*

Contributions are recorded as received and pledged. Compassion reports contributions of cash and other assets as restricted support if they are received with donor-imposed restrictions that limit the use of the donated assets. The majority of Compassion's contributions are received from individuals and the Global Partner Alliance (see note 4).

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

Contributed services for specialized skills are recognized at the fair value of the services received. Compassion received and recorded contributed services of \$169,598 and \$126,646 for the years ended June 30, 2016 and 2015, respectively, in the consolidated statements of activities. Additionally, a substantial number of volunteer workers have donated significant amounts of time to Compassion's programs, administration, and fund-raising activities that are not reflected in the accompanying consolidated financial statements, as the services provided do not meet the required accounting criteria to be recognized.

(k) Functional Expense Allocation

The cost of providing the various programs and supporting services has been summarized on a functional basis in the consolidated statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

The child development program represents costs to assist over 1,870,000 (unaudited) and 1,730,000 (unaudited) children in Compassion's child survival, child sponsorship, and leadership development programs in 2016 and 2015, respectively. These programs are paid for through grants that engage children in activities to develop them spiritually, economically, socially, and physically. Other grants are provided to beneficiaries in the child development program for specific interventions such as, disaster relief, medical, and educational needs. Compassion also uses program funds to oversee and enhance the program effectiveness, develop and train church workers at new projects, and to extend its expertise in holistic child development to international churches and organizations that do not currently implement Compassion's programs, but have a deep passion and concern for children.

Sponsor/donor ministries represent costs used to enhance the sponsor/child relationship to challenge the U.S. Christian public to expand their activities to include ministry to children. Funds are used to gather and disseminate information to sponsors concerning their sponsored child, process correspondence between the sponsor and the child, and educate on the importance and challenges of child development.

(l) Income Taxes

Compassion has been recognized as exempt from federal income taxes on income related to its exempt purposes under Section 501(a) of the Internal Revenue Code of 1986 (IRC) as an organization described in Section 501(c)(3) of the IRC. Compassion generated no significant net unrelated business income during the years ended June 30, 2016 and 2015. As an Association of Churches, Compassion is classified as a public charity and not a private foundation under Section 509(a)(1) and 170(b)(1)(A)(i) of the IRC.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

(m) Self-Funded Medical Insurance

As of January 1, 2008, Compassion established a plan for self-funding medical claims of employees in the United States of America. Through its broker, Compassion has contracted with a third party to administer the health plan. Compassion has also purchased stop loss coverage, which provides for an annual specific deductible per individual of \$250,000 for the years ended June 30, 2016 and 2015. Compassion has estimated potential incurred, but unreported claims to be approximately \$1,261,000 and \$1,216,000 for the years ended June 30, 2016 and 2015, respectively, which have been accrued in the accompanying consolidated financial statements.

(n) Foreign Currency

Substantially all assets and liabilities of consolidated foreign field offices have been translated at foreign exchange rates in effect at June 30, 2016 and 2015. All foreign office revenue and expense amounts are converted at the rate in effect on the date of the transaction. Foreign currency transaction gains and losses are included in the determination of the change in net assets.

(o) Fair Value Measurement

Compassion evaluates fair value of assets and liabilities according to the following:

- **Cash and cash equivalents** – Fair value is estimated to be the same as the carrying (book) value because of their short maturities.
- **Investments** – Investments are recorded at fair value in accordance with the fair value hierarchy. See further discussion at note 3.
- **Receivables from Global Partner Alliance** – Fair value is estimated to be the same as the carrying (book) value because of their short maturities.
- **Accounts receivable** – Fair value is estimated to be the same as the carrying (book) value because of their short maturities.
- **Foreign exchange contracts** – Foreign exchange contracts are recorded at fair value in accordance with the fair value hierarchy. See further discussion at note 3.
- **Accounts payable and accrued liabilities** – Fair value is estimated to be the same as the carrying (book) value due to the short maturities of accounts payable; included in accrued liabilities is the present value of future obligations for gift annuities and trusts, which is adjusted annually. The carrying (book) value approximates fair value because of their short maturities.
- **Accrued severance/retirement benefits for national employees** – Fair value is estimated to be the same as carrying (book) value.
- **Funds committed to sponsorship projects** – Fair value is estimated to be the same as the carrying (book) value due to the majority of the funds committed to sponsorship projects having short maturities.

COMPASSION INTERNATIONAL, INCORPORATED AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2016 and 2015

(p) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue, gains, and other support and expenses during the reporting period. Actual results could differ significantly from those estimates.

(q) Reclassifications

Certain amounts in the 2015 consolidated financial statements have been reclassified for comparative purposes to conform to the presentation in the 2016 consolidated financial statements.

(3) Investments and Fair Value Measurements

Compassion applies the fair value measurements of assets and liabilities that are recognized and disclosed at fair value in the consolidated financial statements on a recurring basis. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy that prioritizes the inputs to valuation techniques is used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 – Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that Compassion has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active.

Level 3 – Inputs that are unobservable and supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by Compassion. Compassion considers observable data to be that market data, which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to Compassion's perceived risk of that instrument.

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Notes to Consolidated Financial Statements

June 30, 2016 and 2015

The following table represents investments that are measured at fair value on a recurring basis at June 30, 2016:

	Cost basis June 30, 2016	Fair value June 30, 2016	Level 1	Level 2	Level 3
Investments:					
Corporate bonds	\$ 30,326,149	30,653,469	—	30,653,469	—
Government obligations	28,394,606	28,801,618	—	28,801,618	—
Corporate stocks	5,594,231	6,846,185	6,846,185	—	—
Other	105,922	105,922	—	96,272	9,650
Total investments	\$ 64,420,908	66,407,194	6,846,185	59,551,359	9,650
Restricted investments:					
Cash and cash equivalents	\$ 1,142,133	1,142,133	1,142,133	—	—
Corporate bonds	1,175,129	1,204,881	—	1,204,881	—
Government obligations	2,324,013	2,384,713	—	2,384,713	—
Corporate stocks	4,868,332	5,656,765	5,656,765	—	—
Mutual funds	1,958,093	1,941,845	1,941,845	—	—
Exchange traded funds	832,449	911,339	911,339	—	—
Total restricted investments	\$ 12,300,149	13,241,676	9,652,082	3,589,594	—
Current assets:					
Foreign exchange contracts	\$ 7,011,974	7,011,974	—	7,011,974	—
Current liabilities:					
Foreign exchange contracts	3,134,429	3,134,429	—	3,134,429	—

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The following table represents investments that are measured at fair value on a recurring basis at June 30, 2015:

	Cost basis June 30, 2015	Fair value June 30, 2015	Level 1	Level 2	Level 3
Investments:					
Corporate bonds	\$ 37,919,297	38,162,577	—	38,162,577	—
Government obligations	39,859,362	40,022,603	—	40,022,603	—
Corporate stocks	5,030,962	6,869,852	6,869,852	—	—
Mutual funds	347,480	524,456	524,456	—	—
Other	90,696	90,696	—	90,696	—
Total investments	\$ 83,247,797	85,670,184	7,394,308	78,275,876	—
Restricted investments:					
Cash and cash equivalents	\$ 986,519	986,519	986,519	—	—
Corporate bonds	1,091,953	1,079,013	—	1,079,013	—
Government obligations	2,496,459	2,510,962	—	2,510,962	—
Corporate stocks	4,432,682	5,611,166	5,611,166	—	—
Mutual funds	1,955,851	2,016,658	2,016,658	—	—
Exchange traded funds	509,312	547,822	547,822	—	—
Total restricted investments	\$ 11,472,776	12,752,140	9,162,165	3,589,975	—
Current liabilities:					
Foreign exchange contracts	\$ 358,722	358,722	—	358,722	—

Investments and restricted investments whose values are based on quoted market prices in active markets, and are, therefore, classified within Level 1, include actively listed equities, and certain mutual funds.

Investments and restricted investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources supported by observable inputs are classified within Level 2. The majority of these include U.S. government obligations, primarily U.S. Treasury bills, and investment grade U.S. corporate bonds. As Level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect liquidity and/or nontransferability, which are generally based on available market information.

Investments and restricted investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all. Level 3 instruments include privately held corporate stocks.

Foreign exchange contracts (contracts) are negotiated over the counter. The contracts are valued by Compassion using available market pricing models and the value depends upon the contractual terms of the instrument. The model has observable inputs other than quoted prices that can be corroborated by market data. The contracts are, therefore, classified within Level 2.

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(4) Global Partner Alliance

Compassion has entered into an alliance with unaffiliated international organizations to raise funds to release children from poverty. Together, Compassion and 11 unaffiliated international organizations form the Global Partner Alliance (GPA). Compassion maintains children's files, selects and monitors projects, provides field supervision, and distributes funds on behalf of the international organizations for those activities that are jointly conducted. Compassion is reimbursed for the costs incurred in providing these services. Because Compassion has control over the ultimate distribution of amounts received from the international organizations, such amounts are included as revenue and related program payments are included as expenses in the accompanying consolidated financial statements. The unaffiliated international organizations have separate fund-raising and administrative expenses that are not reflected in the accompanying consolidated financial statements. Receivables from the GPA consist of trade receivables and are carried at original invoice amount less an estimate made for doubtful receivables. Receivables from the unaffiliated international organizations were \$8,529,271 and \$10,399,291 as of June 30, 2016 and 2015, respectively. Management believes there are no uncollectible accounts for the years ended June 30, 2016 and 2015, respectively.

The GPA funded the start-up costs for Compassion Norden's operations in fiscal years 2016 and 2015. Compassion's share of the costs were recorded in the consolidated statements of activities as fund-raising expense in the amount of \$516,493 and \$986,983 for the years ended June 30, 2016 and 2015, respectively.

Contributions from the unaffiliated international organizations were reported as follows for the years ended June 30:

	2016	2015
Compassion Korea (South Korea)	\$ 48,840,651	54,420,647
Compassion United Kingdom	42,804,425	44,228,793
Compassion Australia	42,024,828	46,499,392
Compassion Canada	36,280,715	43,016,864
Compassion Netherlands	15,305,471	16,207,688
Compassion Deutschland (Germany)	5,279,423	4,579,378
Compassion Italia Onlus (Italy)	4,000,453	3,984,249
Tear Fund New Zealand	3,746,662	4,395,257
Compassion Schweiz (Switzerland)	3,534,806	3,459,544
Service d'Entraide et de Liaison (France)	2,968,153	2,816,021
Compassion Norden (Nordic countries)	822,576	531,495
	\$ 205,608,163	224,139,328

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(5) Property, Plant, and Equipment

Property, plant, and equipment consist of the following as of June 30:

	<u>2016</u>	<u>2015</u>
Land	\$ 11,928,683	11,928,683
Buildings and building improvements	80,328,302	79,218,914
Furniture and equipment	26,505,939	26,206,400
Vehicles	6,330,505	6,114,397
Software and other	37,266,833	25,841,083
Assets in progress	11,267,724	3,137,136
	<u>173,627,986</u>	<u>152,446,613</u>
Less accumulated depreciation	<u>(72,907,201)</u>	<u>(63,304,419)</u>
Property, plant, and equipment, net	<u>\$ 100,720,785</u>	<u>89,142,194</u>

Depreciation expense was \$11,073,379 and \$6,567,314 for the years ended June 30, 2016 and 2015, respectively.

(6) Intangibles

Intangibles consist of the following as of June 30:

	<u>2016</u>	<u>2015</u>
Naming rights, noncompete, and customer list	\$ 1,996,000	1,996,000
Less accumulated amortization	<u>(410,867)</u>	<u>(205,433)</u>
Intangibles, net	<u>\$ 1,585,133</u>	<u>1,790,567</u>

Amortization expense was \$205,434 and \$205,433 for the years ended June 30, 2016 and 2015, respectively.

The estimated amortization expense at June 30, 2016 is as follows:

2017	\$ 205,433
2018	197,100
2019	197,100
2020	197,100
2021	197,100
Thereafter	<u>591,300</u>
	<u>\$ 1,585,133</u>

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(7) Foreign Exchange Contracts

To assist in the management of foreign currency risk, Compassion may enter into foreign currency forward (FOREX) contracts, which provide for the future exchange of funds at agreed-upon rates. These contracts are recorded at fair value in the accompanying consolidated statements of financial position at June 30, 2016 and 2015 and unrealized gains and losses are recognized in the accompanying consolidated statements of activities for the years ended June 30, 2016 and 2015.

For the years ended June 30, 2016 and 2015, Compassion recorded an unrealized gain of \$4,236,267 and an unrealized loss of \$358,722, respectively, on FOREX contracts.

At June 30, 2016 and 2015, Compassion had in place foreign exchange contracts for purchases of U.S. dollars with notional amounts totaling \$116,273,761 and \$25,559,493, respectively, and sales of U.S. dollars with notional amounts totaling \$146,228,908 and \$798,000, respectively.

(8) Funds Committed to Sponsorship Projects

Funds committed to sponsorship projects represent grants that are payable in future periods to program beneficiaries who are unaffiliated church groups. The vast majority of these amounts are funds that were remitted to field offices at year-end (June) and distributed to sponsorship projects in July. These committed program funds are accrued at year-end in the consolidated statements of financial position in accordance with the social and moral obligation to transfer resources.

Funds committed to sponsorship projects consist of the following amounts payable as of June 30:

	<u>2016</u>	<u>2015</u>
Funds committed to sponsorship projects:		
Year 1	\$ 58,293,856	46,448,528
Year 2	276,232	177,258
Year 3	91,333	133,758
Year 4	1,000	70,508
	<u>\$ 58,662,421</u>	<u>46,830,052</u>

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Notes to Consolidated Financial Statements

June 30, 2016 and 2015

(9) Net Assets Released from Restrictions

Net assets were released from donor-imposed restrictions by meeting purpose restrictions for the years ended June 30:

	2016	2015
Purpose restrictions accomplished:		
Child sponsorship program	\$ 586,730,597	581,867,334
Other child programs	157,130,477	147,450,556
Gift in-kind donations used	527,069	650,703
Child sponsorship endowment earnings used	332,454	321,014
Leadership development endowment earnings used	273,092	283,890
	\$ 744,993,689	730,573,497

(10) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of June 30:

	2016	2015
Child development programs:		
Child sponsorship program	\$ 68,615,220	59,194,257
Other child programs	32,916,611	36,541,470
Irrevocable trust agreements	802,878	927,215
	\$ 102,334,709	96,662,942

(11) Permanently Restricted Net Assets

Permanently restricted net assets are restricted to the following as of June 30:

	2016	2015
Investments in perpetuity, the income from which is expendable to support:		
Child sponsorship endowments	\$ 5,030,813	4,493,225
Leadership development endowments	4,739,802	4,650,542
	\$ 9,770,615	9,143,767

(12) Endowment Funds

Compassion has adopted the *Uniform Prudent Management of Institutional Funds Act* (UPMIFA or the Act) passed by the state of Colorado. In accordance with UPMIFA, Compassion appropriates for expenditure or accumulates as much of an endowment fund as Compassion determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument.

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As of June 30, 2016 and 2015, Compassion had two donor-restricted endowment funds. These permanently restricted endowment funds have donor-imposed restrictions, which classifies the original value of gifts donated as permanently restricted net assets. The net assets for child sponsorship and leadership development are invested to provide a long-term total return sufficient to support a number of sponsorships in third world countries. A portion of the earnings from the donor-restricted endowment funds may be used to keep the endowment principal at adequate levels to ensure perpetuity of funding. The remaining endowment earnings can be appropriated for expenditure in accordance with the donor's stipulations.

The child sponsorship endowment fund is established for the purpose of providing ongoing support for children participating in Compassion's child sponsorship program. The leadership development endowment fund is established for the purpose of providing ongoing support for students participating in Compassion's leadership development program.

Compassion's net asset classifications by type of endowment and changes in endowment net assets as of June 30, 2016 are as follows:

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-designated:			
Child sponsorship endowments	\$ —	5,030,813	5,030,813
Leadership development endowments	698,187	4,739,802	5,437,989
	<u>\$ 698,187</u>	<u>9,770,615</u>	<u>10,468,802</u>
Changes in endowment net assets:			
Endowment net assets, beginning of year	\$ 1,007,288	9,143,767	10,151,055
Investment return:			
Investment income	57,659	46,782	104,441
Net realized and unrealized appreciation	238,786	89,295	328,081
Total investment return	296,445	136,077	432,522
Contributions	—	490,771	490,771
Appropriation of endowment assets	(605,546)	—	(605,546)
Endowment net assets, end of year	<u>\$ 698,187</u>	<u>9,770,615</u>	<u>10,468,802</u>

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Compassion's net asset classifications by type of endowment and changes in endowment net assets as of June 30, 2015 are as follows:

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-designated:			
Child sponsorship endowments	\$ —	4,493,225	4,493,225
Leadership development endowments	1,007,288	4,650,542	5,657,830
	<u>\$ 1,007,288</u>	<u>9,143,767</u>	<u>10,151,055</u>
Changes in endowment net assets:			
Endowment net assets, beginning of year	\$ 1,091,662	8,710,600	9,802,262
Investment return:			
Investment income	50,152	41,937	92,089
Net realized and unrealized appreciation	470,378	49,797	520,175
Total investment return	520,530	91,734	612,264
Contributions	—	341,433	341,433
Appropriation of endowment assets	(604,904)	—	(604,904)
Endowment net assets, end of year	<u>\$ 1,007,288</u>	<u>9,143,767</u>	<u>10,151,055</u>

(13) Commitments

Compassion has commitments related to operating leases for building facilities and equipment at June 30, 2016. All operating leases are noncancelable and expire on various dates through 2022. Lease and rent expenses for the years ended June 30, 2016 and 2015 were \$2,330,111 and \$2,435,949, respectively. Future minimum lease payments under noncancelable operating leases with initial or remaining terms of one year or more at June 30, 2016 are as follows:

2017	\$ 1,560,721
2018	925,564
2019	712,685
2020	541,520
2021	188,725
Thereafter	37,908
	<u>\$ 3,967,123</u>

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(14) Fund-raising Events

Compassion’s fund-raising event activities include the Rock and Worship Roadshow and other concerts and Walk with Compassion events. The direct benefits to sponsors and donors are limited to the amount of revenue associated with exchange transaction at the events, and any excess direct benefits to sponsors and donors are recorded as fund-raising expense in the consolidated financial statements. Fund-raising event activities for the years ended June 30 are as follows:

	2016	2015
Gross receipts from fund-raising events	\$ 11,447,020	5,413,456
Less contributions	(7,588,921)	(2,506,742)
Gross income from fund-raising events	3,858,099	2,906,714
Less direct benefits to sponsors and donors	(3,858,099)	(2,906,714)
Net income from fund-raising events	\$ —	—

(15) U.S. Pension Plan

Compassion has a defined-contribution pension plan covering substantially all U.S. paid employees. The plan is noncontributory for employees and has a five-year vesting period. Contributions are equal to 10% of each covered employee’s qualifying compensation. Pension contribution expense was \$6,489,079 and \$6,626,043 for the years ended June 30, 2016 and 2015, respectively.

(16) Severance/Retirement Benefits for National Employees

For the year ended June 30, 2015, Compassion maintained a self-funded benefit plan for national employees, which are employees outside of the United States paid by field offices. The liability recognized in the June 30, 2015 consolidated statement of financial position is the undiscounted accumulation of the amount that was agreed to be paid to an employee who left the organization in good standing after three years of service. Compassion accrued the higher of one month’s salary for each year worked or the amount required by local laws. National severance/retirement contribution expense was \$420,622 and \$2,921,314 for the years ended June 30, 2016 and 2015, respectively.

During the year ended June 30, 2016, Compassion terminated the self-funded benefit plan for national employees, and as a result Compassion made benefit payments of \$13,346,938. In addition, Compassion established a benefit plan structure in 2016 that is individualized for each field office depending on local laws and regulations or common market practices, some of which are defined contribution plans. The defined contribution plans cover all employees in the local office with which the plan is associated, are noncontributory for employees and have a three- to six-month probationary period. Contributions to the plans range from four to eight percent of each covered employee’s qualifying compensation. Contribution expense for these defined contribution plans established in the fiscal year ended June 30, 2016 was \$313,896.

Compassion accrues for severance expense when benefits are to be provided for virtually all departures. When severance expense cannot be calculated until the specific circumstances of an employee’s departure are known, payments are expensed as incurred.

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(17) Subsequent Events

Compassion has evaluated subsequent events through August 30, 2016, the date the consolidated financial statements were available to be issued, and there were none to be reported.