ECOLOGY & ENVIRONMENT INC
Form 10-Q
December 13, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended October 29, 2016

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from __________ to __________

Commission File Number 1-9065

ECOLOGY AND ENVIRONMENT, INC.
(Exact name of registrant as specified in its charter)

New York	16-0971022
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
368 Pleasant View Drive	
Lancaster, New York	14086
(Address of principal executive offices)	(Zip code)

(716) 684-8060
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Exchange Act Rule 12b-2). (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

At November 30, 2016, 3,000,956 shares of Registrant's Class A Common Stock (par value $.01) and 1,293,146 shares of Class B Common Stock (par value $.01) were outstanding.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Ecology and Environment, Inc.
Condensed Consolidated Balance Sheets
Unaudited
(amounts in thousands, except share data)

	Balance at October 29, 2016	July 31, 2016
Assets		
Current assets:		
Cash, cash equivalents and restricted cash	$10,950	$ 10,161
Investment securities available for sale	1,489	1,499
Contract receivables, net of allowance for doubtful accounts and contract adjustments of $6,019 and $5,929, respectively	32,384	34,319
Income tax receivable	655	916
Other current assets	2,879	2,104
Assets held for sale	1,335	-
Total current assets	49,692	48,999
Property, buildings and equipment, net of accumulated depreciation of $18,587 and $18,324, respectively	4,665	6,094
Deferred income taxes	2,413	2,650
Other assets	1,775	1,769
Total assets	$58,545	$ 59,512
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$6,995	$ 6,874
Lines of credit	365	312
Accrued payroll costs	4,796	6,590
Current portion of long-term debt and capital lease obligations	232	240
Billings in excess of revenue	3,747	3,297
Other accrued liabilities	2,752	3,445
Total current liabilities	18,887	20,758
Income taxes payable	107	107
Deferred income taxes	532	525
Long-term debt and capital lease obligations	184	217
Commitments and contingencies (Note 15)	-	-
Shareholders' equity:		

Preferred stock, par value $.01 per share (2,000,000 shares authorized; no shares issued)	-	-
Class A common stock, par value $.01 per share (6,000,000 shares authorized; 3,035,778 shares issued)	30	30
Class B common stock, par value $.01 per share; (10,000,000 shares authorized; 1,357,947 shares issued)	14	14
Capital in excess of par value	16,595	16,606
Retained earnings	23,102	22,237
Accumulated other comprehensive loss	(2,146)	(2,143)
Treasury stock, at cost (Class A common: 34,822 and 39,272 shares; Class B common: 64,801 shares)	(1,122)	(1,172)
Total Ecology and Environment, Inc. shareholders' equity	36,473	35,572
Noncontrolling interests	2,362	2,333
Total shareholders' equity	38,835	37,905
Total liabilities and shareholders' equity	$58,545	$ 59,512

The accompanying notes are an integral part of these condensed consolidated financial statements.

Ecology and Environment, Inc.
Condensed Consolidated Statements of Operations
Unaudited
(amounts in thousands, except share data)

	Three Months Ended October 29, 2016	October 31, 2015
Revenue, net	$25,605	$ 30,062
Cost of professional services and other direct operating expenses	9,410	10,684
Subcontract costs	4,301	5,595
Administrative and indirect operating expenses	7,382	7,967
Marketing and related costs	2,865	2,953
Depreciation and amortization	234	296
Income from operations	1,413	2,567
Interest income	30	11
Interest expense	(28)	(24)
Gain on sale of assets and investment securities	9	-
Net foreign exchange gain	(12)	13
Other income	7	53
Income before income tax provision	1,419	2,620
Income tax provision	569	2,037
Net income	850	583
Net loss attributable to noncontrolling interests	38	81
Net income attributable to Ecology and Environment, Inc.	$888	$ 664
Net income per common share: basic and diluted	$0.21	$ 0.15
Weighted average common shares outstanding: basic and diluted	4,292,733	4,288,404

The accompanying notes are an integral part of these condensed consolidated financial statements.

Ecology and Environment, Inc.
Condensed Consolidated Statements of Comprehensive Income
Unaudited
(amounts in thousands)

	Three Months Ended October 29, 2016	October 31, 2015
Net income including noncontrolling interests	$ 850	$ 583
Foreign currency translation adjustments	54	(514)
Unrealized investment gains, net	(11)	3
Comprehensive income	893	72
Comprehensive (income) loss attributable to noncontrolling interests	(8)	225
Comprehensive income attributable to Ecology and Environment, Inc.	$ 885	$ 297

The accompanying notes are an integral part of these condensed consolidated financial statements.

Ecology and Environment, Inc.
Condensed Consolidated Statements of Cash Flows
Unaudited
(amounts in thousands)

	Three Months Ended October 29, 2016	October 31, 2015
Cash flows from operating activities:		
Net income	$ 850	$ 583
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	234	296
Deferred income tax	247	979
Share based compensation expense	-	15
Tax impact of share-based compensation	(6)	-
Gain on sale of assets and investment securities	(9)	-
Net recovery of contract adjustments and doubtful accounts	(692)	(361)
Net bad debt (recovery) expense	121	(29)
Changes in:		
- contract receivables	1,975	3,790
- other current assets	(694)	(891)
- income tax receivable	261	297
- other non-current assets	(5)	53
- accounts payable	964	(967)
- accrued payroll costs	(1,823)	(1,816)
- income taxes payable	3	684
- billings in excess of revenue	412	200
- other accrued liabilities	(54)	25
Net cash provided by operating activities	1,784	2,858
Cash flows from investing activities:		
Proceeds from sale of subsidiary	-	150
Purchase of property, building and equipment	(128)	(317)
Proceeds from sale of property, building and equipment	9	-
Purchase of investment securities	(2)	(6)
Net cash used in investing activities	(121)	(173)
Cash flows from financing activities:		
Dividends paid	(861)	(1,033)
Repayment of debt	(42)	(308)
Net borrowing repayments of under lines of credit	47	(352)
Distributions to noncontrolling interests	(3)	(94)
Net cash used in financing activities	(859)	(1,787)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(15)	(205)
Net increase in cash, cash equivalents and restricted cash	789	693
Cash, cash equivalents and restricted cash at beginning of period	10,161	8,703
Cash, cash equivalents and restricted cash at end of period	$ 10,950	$ 9,396

Supplemental disclosure of cash flow information:		
Cash paid (received) during the period for:		
Interest	$ 26	$ 22
Income taxes	164	390
Supplemental disclosure of non-cash items:		
Sale of subsidiary (loans receivable)	75	150

The accompanying notes are an integral part of these condensed consolidated financial statements.

Ecology and Environment, Inc.
Condensed Consolidated Statements of Shareholders' Equity

	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Shares	Treasury Stock Amount	Noncontrolling Interest
Balance at July 31, 2015 (audited)	3,023,206	$ 30	1,370,519	$ 14	$ 16,575	$ 23,246	$ (1,726)	107,046	$ (1,224)	$ 3,570
Net income (loss)	-	-	-	-	-	887	-	-	-	(278)
Foreign currency translation adjustment	-	-	-	-	-	-	(438)	-	-	(119)
Cash dividends declared ($0.44 per share)	-	-	-	-	-	(1,895)	-	-	-	-
Unrealized investment gains, net	-	-	-	-	-	-	21	-	-	-
Conversion of Class B common stock to Class A common stock	12,572	-	(12,572)	-	-	-	-	-	-	-
Issuance of stock under stock award plan	-	-	-	-	(6)	-	-	(4,533)	52	-
Share-based compensation expense	-	-	-	-	37	-	-	-	-	-
Distributions to noncontrolling interests	-	-	-	-	-	-	-	-	-	(530)
Sale of majority-owned subsidiary	-	-	-	-	-	-	-	-	-	(310)
Purchase of additional noncontrolling interests	-	-	-	-	-	-	-	-	-	-
Stock award plan forfeitures	-	-	-	-	-	-	-	1,560	-	-
Balance at July 31, 2016	3,035,778	$ 30	1,357,947	$ 14	$ 16,606	$ 22,238	$ (2,143)	104,073	$ (1,172)	$ 2,333

(audited)										
Net income (loss)	-	-	-	-	-	888	-	-	-	(38)
Foreign currency translation adjustment	-	-	-	-	-	-	8	-	-	46
Unrealized investment gains, net	-	-	-	-	-	-	(11)	-	-	-
Issuance of stock under stock award plan	-	-	-	-	(5)	-	-	(4,450)	50	-
Tax impact of share based compensation	-	-	-	-	(6)	-	-	-	-	-
Tax impact of noncontrolling interests	-	-	-	-	-	(24)	-	-	-	24
Distributions to noncontrolling interests	-	-	-	-	-	-	-	-	-	(3)
Balance at October 29, 2016 (unaudited)	3,035,778	$ 30	1,357,947	$ 14	$ 16,595	$ 23,102	$ (2,146)	99,623	$ (1,122)	$ 2,362

The accompanying notes are an integral part of these condensed consolidated financial statements.

Ecology and Environment, Inc.
Notes to Condensed Consolidated Financial Statements

1. Organization and Basis of Presentation

Ecology and Environment, Inc., ("EEI" or the "Parent Company") was incorporated in 1970 as a global broad-based environmental consulting firm whose underlying philosophy is to provide professional services worldwide so that sustainable economic and human development may proceed with acceptable impact on the environment. Together with its subsidiaries (collectively, the "Company"), EEI has direct and indirect ownership in 7 active wholly-owned and majority-owned operating subsidiaries in 5 countries. The Company's staff is comprised of individuals representing more than 80 scientific, engineering, health, and social disciplines working together in multidisciplinary teams to provide innovative environmental solutions. The Company has completed thousands of projects for a wide variety of clients in more than 120 countries, providing environmental solutions in nearly every ecosystem on the planet.

The condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of such information. All such adjustments are of a normal recurring nature. Certain prior year amounts were reclassified to conform to the condensed consolidated financial statement presentation for the three months ended October 29, 2016.

Although the Company believes that the disclosures herein are adequate to make the information presented not misleading, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), including a description of significant accounting policies, have been condensed or omitted pursuant to SEC rules and regulations. Therefore, these financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2016 filed with the Securities and Exchange Commission (the "2016 Annual Report"). The accounting policies followed by the Company for preparation of the consolidated financial statements included in the 2016 Annual Report were also followed for this interim report. The condensed consolidated results of operations for the three months ended October 29, 2016 are not necessarily indicative of the results for any subsequent period or the entire fiscal year ending July 31, 2017.

2. Recent Accounting Pronouncements

Accounting Pronouncements Adopted During the Three Months Ended October 29, 2016

In September 2015, FASB issued ASU No. 2015-16, Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments ("ASU 2015-16"). ASU 2015-16 requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. In addition, the amendments in ASU 2015-16 require an acquirer to record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in ASU 2015-16 also require an entity to present separately on the face of the income statement, or disclose in the notes to the financial statements, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized at the acquisition date. The amendments in ASU 2015-16 are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years, and are to be applied prospectively to adjustments to provisional amounts that occur after the effective date. Earlier application is permitted for financial statements that have not yet been made available for issuance. The Company adopted the provisions of ASU 2015-16 effective August 1, 2016. Adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In May 2015, FASB issued ASU No. 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value Per Share (Or its Equivalent) (“ASU 2015-07”). ASU 2015-07 removes the requirements to: 1) categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value (“NAV”) per share practical expedient; and 2) make certain disclosures for all investments that are eligible to be measured at fair value using the NAV per share practical expedient. The amendments in ASU 2015-07 are effective for public entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The amendment is required to be applied retrospectively and early adoption is permitted. The Company adopted ASU 2015-07 effective August 1, 2016. Other than the changes to disclosures noted above, adoption of this standard did not have a material impact on the Company’s consolidated financial statements. Refer to Note 4 of these condensed consolidated financial statements for additional disclosures regarding the Company’s investments in available for sale securities that are valued using the NAV practical expedient.

In August 2014, FASB issued ASU No. 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-40) ("ASU 2014-15"). ASU 2014-15 requires an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). ASU 2014-15 provides guidance for management's evaluation, including guidance regarding when substantial doubt about an entity's ability to continue as a going concern exists, and when such doubt may be alleviated by management's plans that are intended to mitigate those relevant conditions or events. ASU 2014-15 also provides guidance regarding appropriate financial statement disclosures regarding conditions or events that raised substantial doubt about the entity's ability to continue as a going concern, management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, and management's plans that are intended to mitigate those conditions or events. The provisions of ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Earlier application is permitted. The Company adopted ASU 2014-15 effective August 1, 2016. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In November 2016, FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230) – Restricted Cash – a consensus of the FASB Emerging Issues Task Force ("ASU 2016-18"). The amendments included in this update require that amounts described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. For public entities, the amendments included in ASU 2016-18 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company adopted the provisions of ASU 2016-18 effective August 1, 2016. Adoption of this standard did not have a material impact on the Company's consolidated financial statements. Refer to Note 3 of these condensed consolidated financial statements for additional disclosures regarding the Company's cash, cash equivalents and restricted cash.

Accounting Pronouncements Not Yet Adopted as of October 29, 2016

In March 2016, FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718) – Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). The objective of ASU 2016-09 is to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in ASU 2016-09 are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted in any interim or annual period, subject to transition requirements. The Company intends to adopt the provisions of ASU 2016-09 effective August 1, 2017. Management is currently assessing the provisions of ASU 2016-09 and has not yet estimated its impact on the Company's consolidated financial statements.

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 is the result of a joint project of FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for use in the U.S and internationally. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605 of FASB's Accounting Standards Codification (the "Codification") and most industry-specific guidance throughout the Industry Topics of the Codification. ASU 2014-09 enhances comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets, reduces the number of requirements an entity must consider for recognizing revenue, and requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized.

ASU 2014-09 was to be effective for annual reporting periods beginning after December 15, 2016, including interim periods within the annual reporting period. In August 2015, FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606), Deferral of the Effective Date ("ASU 2015-14"). The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. The Company intends to adopt the provisions of ASU 2014-09 effective August 1, 2018.

During the year ended July 31, 2016, FASB issued four additional ASUs that provide clarification for specific aspects of ASU 2014-09. The effective dates and transition requirements for these ASUs are the same as the effective dates and transition requirements included in ASU 2014-09 and ASU 2015-14.

ASU 2014-09 requires retrospective application by either restating each prior period presented in the financial statements, or by recording the cumulative effect on prior reporting periods to beginning retained earnings in the year that the standard becomes effective. Management is currently assessing the provisions of ASU 2014-09 and has not yet estimated its impact or selected a transition method.

In January 2016, FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). The amendments included in this update make targeted improvements to U.S. GAAP. Entities are required to apply the amendments included in ASU 2016-01 by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. For public entities, the amendments included in ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company intends to adopt the provisions of ASU 2016-01 effective August 1, 2018. Management is currently assessing the provisions of ASU 2016-01 and has not yet estimated its impact on the Company's consolidated financial statements.

In August 2016, FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). The amendments included in this update provide guidance regarding eight specific cash flow classification issues that are not specifically addressed in previous U.S. GAAP. For public entities, the amendments included in ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company intends to adopt the provisions of ASU 2016-01 effective August 1, 2018. Management is currently assessing the provisions of ASU 2016-15 and has not yet estimated its impact on the Company's consolidated financial statements.

In March 2016, FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the assets and liabilities that arise from most leases. The main difference between previous U.S. GAAP and ASU 2016-02 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. For lessors, the guidance included in ASU 2016-02 modifies the classification criteria and the accounting for sales-type and direct financing leases. ASU 2016-02 provides specific guidance for determining whether a contractual arrangement contains a lease, lease classification by lessees and lessors, initial and subsequent measurement of leases by lessees and lessors, sale and leaseback transactions, transition, and financial statement disclosures. ASU 2016-02 requires entities to use a modified retrospective approach to apply its guidance, and includes a number of optional practical expedients that entities may elect to apply. For public entities, the amendments included in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company intends to adopt the provisions of ASU 2016-02 effective August 1, 2019. Early adoption of the amendments included in ASU 2016-02 is permitted. Management is currently assessing the provisions of ASU 2016-02 and has not yet estimated its impact on the Company's consolidated financial statements.

In June 2016, FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) ("ASU 2016-13"). The amendments included in this update affect entities holding financial assets, including trade receivables and investment securities available for sale, that are not accounted for at fair value through net income. ASU 2016-13 requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments included in this update also provide guidance for measurement of expected credit losses and for presentation of increases or decreases of expected credit losses on the statement of operations. For public entities, the amendments included in ASU 2016-13 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company intends to adopt the provisions of ASU 2016-01 effective August 1, 2020. Management is currently assessing the provisions of ASU 2016-15 and has not yet estimated its impact on the Company's consolidated financial statements.

3. Cash, Cash Equivalents and Restricted Cash

Cash, cash equivalents and restricted cash are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Cash and cash equivalents	$10,683	$9,902
Restricted cash	267	259
Total cash, cash equivalents and restricted cash	$10,950	$10,161

Restricted cash is required to be maintained on deposit in Brazil as collateral for certain outstanding letters of credit.

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. The Company invests cash in excess of operating requirements in income-producing short-term investments. Money market funds of $0.6 million and $0.3 million were included in cash, cash equivalents and restricted cash in the accompanying condensed consolidated balance sheets at October 29, 2016 and July 31, 2016, respectively.

4. Fair Value of Financial Instruments

The Company's financial assets or liabilities are measured using inputs from the three levels of the fair value hierarchy. The asset's or liability's classification within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. The Company has not elected a fair value option on any assets or liabilities. The three levels of the hierarchy are as follows:

Level 1 Inputs – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Generally, this includes debt and equity securities and derivative contracts that are traded on an active exchange market (e.g., New York Stock Exchange) as well as certain U.S. Treasury and U.S. Government and agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, credit risks, etc.) or can be corroborated by observable market data.

Level 3 Inputs – Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use.

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. The Company evaluated the significance of transfers between levels based upon the nature of the financial instrument. There were no transfers in or out of levels 1, 2 or 3, respectively during the three months ended October 29, 2016 or the fiscal year ended July 31, 2016.

The carrying amount of cash, cash equivalents and restricted cash approximated fair value at October 29, 2016 and July 31, 2016. These assets were classified as level 1 instruments at both dates.

Investment securities available for sale of $1.5 million at October 29, 2016 and July 31, 2016 primarily include mutual funds that are invested in U.S. municipal bonds, which may be immediately redeemed by the Company without prior notice. These mutual funds are valued at the net asset value ("NAV") of shares held by the Company at period end as a practical expedient to estimate fair value. These mutual funds are deemed to be actively traded, are required to publish their daily NAV and are required to transact at that price. As a result of the Company's adoption of ASU 2015-07 effective August 1, 2016 (refer to Note 2 above), investment securities available for sale are not reported within the fair value hierarchy noted above.

Unrealized gains or losses related to investment securities available for sale are recorded in accumulated other comprehensive income, net of applicable income taxes in the accompanying condensed consolidated balance sheets and condensed consolidated statements of changes in shareholders' equity. The cost basis of securities sold is based on the specific identification method. The Company had unrealized gains of less than $0.1 million recorded in accumulated other comprehensive income during the three months ended October 29, 2016 and October 31, 2015. Reclassification adjustments out of accumulated other comprehensive income are included within other income (expense) on the accompanying condensed consolidated statements of operations. The Company did not record any sales of investment securities during the three months ended October 29, 2016 or during the three months ended October 31, 2015.

Long-term debt consists of bank loans and capitalized equipment leases. Lines of credit consist of borrowings for working capital requirements. Based on the Company's assessment of the current financial market and corresponding risks associated with the debt and line of credit borrowings, management believes that the carrying amount of these liabilities approximated fair value at October 29, 2016 and July 31, 2016. These liabilities were classified as level 2 instruments at both dates. There were no financial instruments classified as level 3 at October 29, 2016 or July 31, 2016.

5. Revenue and Contract Receivables, net

Revenue Recognition

Substantially all of the Company's revenue is derived from environmental consulting work, which is principally derived from the sale of labor hours. The consulting work is performed under a mix of fixed price, cost-type, and time and material contracts. Contracts are required from all customers. Revenue is recognized as follows:

Contract Type	Work Type	Revenue Recognition Policy
Time and materials	Consulting	As incurred at contract rates.
Fixed price	Consulting	Percentage of completion, approximating the ratio of either total costs or Level of Effort (LOE) hours incurred to date to total estimated costs or LOE hours.
Cost-plus	Consulting	Costs as incurred plus fees. Fees are recognized as revenue using percentage of completion determined by the percentage of LOE hours incurred to total LOE hours in the respective contracts.

Revenues represent services rendered by employees for which the Company maintains a primary contractual relationship with its customers, as well as certain services that the Company has elected to subcontract to other contractors.

Time and material contracts are accounted for over the period of performance, in proportion to the costs of performance, predominately based on labor hours incurred. Revenue earned from fixed price and cost-plus contracts is recognized using the “percentage-of-completion” method, wherein revenue is recognized as project progress occurs. If an estimate of costs at completion on any contract indicates that a loss will be incurred, the entire estimated loss is charged to operations in the period the loss becomes evident.

Substantially all of the Company's cost-type work is with federal governmental agencies and, as such, is subject to audits after contract completion. Under these cost-type contracts, provisions for adjustments to accrued revenue are recognized on a quarterly basis and based on past audit settlement history. Government audits have been completed and final rates have been negotiated through fiscal year 2009. The Company records an allowance for project disallowances in other accrued liabilities for potential disallowances resulting from government audits (refer to Note 10 of these consolidated financial statements). Allowances for project disallowances are recorded when the amounts are estimable. Resolution of these amounts is dependent upon the results of government audits and other formal contract close-out procedures.

Change orders can occur when changes in scope are made after project work has begun, and can be initiated by either the Company or its clients. Claims are amounts in excess of the agreed contract price which the Company seeks to recover from a client for customer delays and /or errors or unapproved change orders that are in dispute. Costs related to change orders and claims are recognized as incurred. Revenues and profit are recognized on change orders when it is probable that the change order will be approved and the amount can be reasonably estimated. Revenues are recognized only up to the amount of costs incurred on contract claims when realization is probable, estimable and reasonable support from the customer exists.

All bid and proposal and other pre-contract costs are expensed as incurred. Out of pocket expenses such as travel, meals, field supplies, and other costs billed direct to contracts are included in both revenues and cost of professional services. Sales and cost of sales at the Company's South American subsidiaries exclude tax assessments by governmental authorities, which are collected by the Company from its customers and then remitted to governmental authorities.

Billed contract receivables represent amounts billed to clients in accordance with contracted terms, which have not been collected from clients as of the end of the reporting period. Billed contract receivables may include: (1) amounts billed for revenues from incurred costs and fees that have been earned in accordance with contractual terms; and (2) progress billings in accordance with contractual terms that include revenue not yet earned as of the end of the reporting period.

Unbilled contract receivables result from: (i) revenues from incurred costs and fees which have been earned, but are not billed as of period-end; and (ii) differences between year-to-date provisional billings and year-to-date actual contract costs incurred.

The Company reduces contract receivables by establishing an allowance for contract adjustments related to revenues that are deemed to be unrealizable, or that may become unrealizable in the future. Management reviews contract receivables and determines allowance amounts based on the adequacy of the Company's performance under the contract, the status of change orders and claims, historical experience with the client for settling change orders and claims, and economic, geopolitical and cultural considerations for the home country of the client. Such contract adjustments are recorded as direct adjustments to revenue in the consolidated statements of operations.

The Company also reduces contract receivables by recording an allowance for doubtful accounts to account for the estimated impact of collection issues resulting from a client's inability or unwillingness to pay valid obligations to the Company. The resulting provision for bad debts is recorded within administrative and indirect operating expenses on the consolidated statements of operations.

Contract Receivables, Net

Contract receivables, net are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Contract Receivables:		
Billed	$20,318	$19,552
Unbilled	18,085	20,696
	38,403	40,248
Allowance for doubtful accounts and contract adjustments	(6,019)	(5,929)
Total contract receivables, net	$32,384	$34,319

Billed contract receivables included contractual retainage balances of $0.9 million at October 29, 2016 and July 31, 2016. Management anticipates that the unbilled receivables and retainage balances outstanding at October 29, 2016 will be substantially billed and collected within one year.

Contract Receivable Concentrations

Significant concentrations of contract receivables and the allowance for doubtful accounts and contract adjustments are summarized in the following table.

	Balance at October 29, 2016		Balance at July 31, 2016	
Region	Contract Receivables	Allowance for Doubtful Accounts and Contract Adjustments	Contract Receivables	Allowance for Doubtful Accounts and Contract Adjustments
	(in thousands)			
United States, Canada and South America	$33,420	$ 1,124	$ 35,266	$ 1,034
Middle East and Africa	4,922	4,895	4,921	4,895
Asia	61	---	61	---
Totals	$38,403	$ 6,019	$ 40,248	$ 5,929

Combined contract receivables related to projects in the Middle East, Africa and Asia represented 13% and 12% of total contract receivables at October 29, 2016 and July 31, 2016, respectively, while the combined allowance for doubtful accounts and contract adjustments related to these projects represented 81% and 83% of the total allowance for doubtful accounts and contract adjustments at those same period end dates. These allowance percentages highlight the Company's experience of heightened operating risks (i.e., political, regulatory and cultural risks) within these foreign regions in comparison with similar risks in the United States, Canada and South America, which result in increased collection risks and the risk of the Company expending resources that it may not recover for several months, or at all.

Allowance for Doubtful Accounts and Contract Adjustments

Activity within the allowance for doubtful accounts and contract adjustments is summarized in the following table.

	Three Months Ended October 29, 2016	October 31, 2015
	(in thousands)	
Balance at beginning of period	$ 5,929	$ 5,954
Net increase (decrease) due to adjustments in the allowance for:		
Contract adjustments (1)	(46)	(29)
Doubtful accounts (2)	136	(6)
Balance at end of period	$ 6,019	$ 5,919

(1) Increases (decreases) to the allowance for contract adjustments on the condensed consolidated balance sheets are also recorded as (decreases) increases to revenue on the condensed consolidated statements of operations.

(2) Increases (decreases) to the allowance for doubtful accounts on the condensed consolidated balance sheets are also recorded as increases (decreases) to administrative and other indirect operating expenses on the condensed consolidated statements of operations.

6. Assets Held for Sale

In September 2016, the Company entered into a letter of intent to sell property including land, a vacant building, related building improvements and fixtures, and warehouse space to a non-affiliated third party. Management expects to consummate the sale of this property during January 2017. The Company has not maintained any material operations within this property for several years.

The Company classified the $1.3 million net book value of this property as assets held for sale at October 29, 2016. The selling price is expected to approximate the net book value of the property.

7. Lines of Credit

Unsecured lines of credit are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Outstanding cash draws, recorded as lines of credit on the accompanying condensed consolidated balance sheets	$365	$312
Outstanding letters of credit to support operations	1,943	2,187
Total amounts used under lines of credit	2,308	2,499
Remaining amounts available under lines of credit	36,717	36,496
Total approved unsecured lines of credit	$39,025	$38,995

Contractual interest rates for lines of credit ranged from 3.50% to 15.60% at October 29, 2016. The Company's lenders have reaffirmed the lines of credit within the past twelve months.

8. Debt and Capital Lease Obligations

Debt and capital lease obligations are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Various bank loans and advances (interest rates ranging from 3.25% to 12.00% at October 29, 2016)	$215	$ 217
Capital lease obligations (interest rates ranging from 7.36% to 14.00% at October 29, 2016)	201	240
	416	457
Current portion of long-term debt and capital lease obligations	(232)	(240)
Long-term debt and capital lease obligations	$184	$ 217

The aggregate maturities of long-term debt and capital lease obligations as of October 29, 2016 are summarized in the following table.

Twelve Months Ended October 31, (in thousands)	Amount
2017	$ 232
2018	146
2019	22
2020	13
Thereafter	3
Total	$ 416

9. Income Taxes

The estimated effective tax rate was 40.1% and 77.7% for the three months ended October 29, 2016 and October 31, 2015, respectively.

The Company periodically evaluates the likelihood of realization of deferred tax assets, and provides for a valuation allowance when necessary. Based on available evidence, including recent cumulative operating losses, management determined during the three months ended October 31, 2015 that it was more likely than not that deferred tax assets related to net operating loss carryforwards from its Brazilian operations will not be realized. As a result, the Company recorded a valuation allowance of $0.9 million as a reduction of deferred tax assets on the condensed consolidated balance sheet at October 31, 2015 and an addition to income tax expense on the condensed consolidated statement of operations for the three months ended October 31, 2015.

10. Other Accrued Liabilities

Other accrued liabilities are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Allowance for project disallowances	$1,173	$1,819
Other	1,579	1,626
Total other accrued liabilities	$2,752	$3,445

Activity within the allowance for project disallowances is summarized in the following table.

	Three Months Ended October 29, 2016	October 31, 2015
	(in thousands)	
Balance at beginning of period	$ 1,819	$ 2,243
Reduction of settlement estimate recorded in prior periods	(646)	(424)

Balance at end of period	$ 1,173	$ 1,819

The allowance for project disallowances represents potential disallowances of amounts billed and collected resulting from contract close-outs and government audits. Allowances for project disallowances are recorded when the amounts are estimable, and may be revised during subsequent reporting periods when estimates of settlement amounts become more certain, or when actual settlements are finalized. Settlements of certain contracts completed during prior fiscal years were finalized during the three months ended October 29, 2016 and October 31, 2015, resulting in no cash received or paid during either period.

11. Stock Award Plan

EEI adopted the 1998 Stock Award Plan effective March 16, 1998. This plan, together with supplemental plans that were subsequently adopted by the Company's Board of Directors, is referred to as the "Stock Award Plan". The Stock Award Plan is not a qualified plan Section 401(a) of the Internal Revenue Code. Under the Stock Award Plan, Directors, officers and other key employees of EEI or any of its subsidiaries may be awarded Class A Common Stock as a bonus for services rendered to the Company or its subsidiaries, based upon the fair market value of the common stock at the time of the award. The Stock Award Plan authorizes the Company's Board of Directors to determine the vesting period and the circumstances under which the awards may be forfeited.

Under the supplemental plan in place as of July 31, 2016, which expired in October 2016, the Company issued 17,386 shares of Class A Common Stock under the Stock Award Plan, all of which were fully vested at July 31, 2016. In October 2016, the Company's Board of Directors adopted the current supplemental plan, the 2016 Stock Award Plan. This plan permits awards of up to 200,000 shares of Class A Common Stock for a period of up to five years until its termination in October 2021.

EEI recorded non-cash compensation expense of $0 and less than $0.1 million during the three months ended October 29, 2016 and October 31, 2015, respectively. As of July 31, 2016, all previous stock awards under the Stock Award Plan were fully vested.

12. Shareholders' Equity

Class A and Class B Common Stock

The relative rights, preferences and limitations of the Company's Class A and Class B Common Stock are summarized as follows: Holders of Class A shares are entitled to elect 25% of the Board of Directors so long as the number of outstanding Class A shares is at least 10% of the combined total number of outstanding Class A and Class B common shares. Holders of Class A common shares have one-tenth the voting power of Class B common shares with respect to most other matters.

In addition, Class A shares are eligible to receive dividends in excess of (and not less than) those paid to holders of Class B shares. Holders of Class B shares have the option to convert at any time, each share of Class B Common Stock into one share of Class A Common Stock. Upon sale or transfer, shares of Class B Common Stock will automatically convert into an equal number of shares of Class A Common Stock, except that sales or transfers of Class B Common Stock to an existing holder of Class B Common Stock or to an immediate family member will not cause such shares to automatically convert into Class A Common Stock.

Restrictive Shareholder Agreement

Messrs. Gerhard J. Neumaier (deceased), Frank B. Silvestro, Ronald L. Frank, and Gerald A. Strobel entered into a Stockholders' Agreement dated May 12, 1970, as amended January 24, 2011, which governs the sale of certain shares of Ecology and Environment, Inc. common stock (now classified as Class B Common Stock) owned by them, certain children of those individuals and any such shares subsequently transferred to their spouses and/or children outright or in trust for their benefit upon the demise of a signatory to the Agreement ("Permitted Transferees"). The Agreement provides that prior to accepting a bona fide offer to purchase some or all of their shares of Class B Common Stock governed by the Agreement, that the selling party must first allow the other signatories to the Agreement (not including any Permitted Transferee) the opportunity to acquire on a pro rata basis, with right of over-allotment, all of such shares covered by the offer on the same terms and conditions proposed by the offer.

Cash Dividends

The Company did not declare any cash or non-cash dividends during the three months ended October 29, 2016 or October 31, 2015. The Company paid dividends of $0.9 million and $1.0 million in August 2016 and 2015, respectively, that were declared and accrued in prior periods.

Stock Repurchase Program

In August 2010, the Company's Board of Directors approved a program for repurchase of 200,000 shares of Class A common stock (the "Stock Repurchase Program"). As of October 29, 2016, the Company repurchased 122,918 shares of Class A stock, and 77,082 shares had yet to be repurchased under the Stock Repurchase Program. The Company did not acquire any Class A shares under the Stock Repurchase Program during the three months ended October 29, 2016 or October 31, 2015.

Noncontrolling Interests

Noncontrolling interests are disclosed as a separate component of consolidated shareholders' equity on the accompanying consolidated balance sheets. Earnings and other comprehensive income (loss) are separately attributed to both the controlling and noncontrolling interests. EPS is calculated based on net income (loss) attributable to the Company's controlling interests.

The Company considers acquiring additional interests in majority owned subsidiaries when noncontrolling shareholders express their intent to sell their interests. Acquisitions of noncontrolling interests are settled and recorded at amounts that approximate fair value. Purchases of noncontrolling interests are recorded as reductions of shareholders' equity on the condensed consolidated statements of shareholders' equity. The Company did not acquire additional interest in any of its majority-owned subsidiaries during the three months ended October 29, 2016 or October 31, 2015.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are summarized in the following table.

	Balance at October 29, 2016	July 31, 2016
	(in thousands)	
Unrealized net foreign currency translation losses	$(2,168)	$ (2,176)
Unrealized net investment gains on available for sale investments	22	33
Total accumulated other comprehensive loss	$(2,146)	$ (2,143)

13. <u>Earnings Per Share</u>

Basic and diluted EPS is computed by dividing the net (loss) income attributable to Ecology and Environment, Inc. common shareholders by the weighted average number of common shares outstanding for the period. After consideration of all the rights and privileges of the Class A and Class B stockholders summarized in Note 11, in particular the right of the holders of the Class B common stock to elect no less than 75% of the Board of Directors making it highly unlikely that the Company will pay a dividend on Class A common stock in excess of Class B common stock, the Company allocates undistributed earnings between the classes on a one-to-one basis when computing earnings per share. As a result, basic and fully diluted earnings per Class A and Class B share are equal amounts.

The Company has determined that its unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities. These securities shall be included in the computation of earnings per share pursuant to the two-class method. The resulting impact was to include unvested restricted shares in the weighted average shares outstanding calculation.

The computation of earnings per share is included in the following table.

	Three Months Ended	
	October 29, 2016	October 31, 2015
	(in thousands, except share and per share amounts)	
Net income attributable to Ecology and Environment, Inc.	$ 888	$ 664
Dividends declared	---	---
Balance at end of period	$ 888	$ 664
Weighted-average common shares outstanding (basic and diluted)	4,292,733	4,288,404

Distributed earnings per share	$ ---	$ ---
Undistributed earnings per share	0.21	0.15
Total earnings per share	$ 0.21	$ 0.15

14. Segment Reporting

The Company reports segment information based on the geographic location of its customers (for revenues) and the location of its offices (for long-lived assets). Revenue and long-lived assets by business segment are summarized in the following tables.

	Three Months Ended	
	October 29, 2016	October 31, 2015
	(in thousands)	
Revenue, net by geographic location:		
EEI and its subsidiaries located in the United States	$ 20,346	$ 24,002
Subsidiaries located in South America (1)	5,259	6,060

(1) Significant South American revenues included revenues in Peru ($1.1 million and $3.0 million for the three months ended October 29, 2016 and October 31, 2015, respectively), Brazil ($2.2 million and $1.1 million for the three months ended October 29, 2016 and October 31, 2015, respectively) and Chile ($2.0 million and $1.8 million for the three months ended October 29, 2016 and October 31, 2015, respectively).

	Balance at	
	October 29, 2016	July 31, 2016
	(in thousands)	
Long-Lived Assets by geographic location:		
EEI and its subsidiaries located in the United States	$ 3,450	$ 4,916
Subsidiaries located in South America	1,215	1,178

15. Commitments and Contingencies

Legal Proceedings

From time to time, the Company is a named defendant in legal actions arising out of the normal course of business. The Company is not a party to any pending legal proceeding, the resolution of which the management believes will have a material adverse effect on the Company's results of operations, financial condition or cash flows, or to any other pending legal proceedings other than ordinary, routine litigation incidental to its business. The Company maintains liability insurance against risks arising out of the normal course of business.

On February 4, 2011, the Chico Mendes Institute of Biodiversity Conservation of Brazil (the "Institute") issued a Notice of Infraction to ecology and environment do brasil Ltda ("E&E Brasil"), a majority-owned subsidiary of EEI. The Notice of Infraction concerned the taking and collecting wild animal specimens without authorization by the competent authority and imposed a fine of 520,000 Reais against E&E Brazil. The Institute also filed Notices of Infraction against four employees of E&E Brasil alleging the same claims and imposed fines against those individuals that, in the aggregate, were equal to the fine imposed against E&E Brasil. No claim has been made against EEI.

E&E Brasil has filed court claims appealing the administrative decisions of the Institute for E & E Brasil's employees that: (a) deny the jurisdiction of the Institute; (b) state that the Notice of Infraction is constitutionally vague; and (c) affirmatively state that E&E Brasil had obtained the necessary permits for the surveys and collections of specimens under applicable Brazilian regulations and that the protected conservation area is not clearly marked to show its boundaries. The claim of violations against one of the four employees was dismissed. The remaining three employees have fines assessed against them that are being appealed through the federal courts. Violations against E&E Brasil are pending agency determination. At July 31, 2016, the Company maintained a reserve of approximately $0.3 million in other accrued liabilities related to these claims.

Contract Termination Provisions

Certain contracts contain termination provisions under which the customer may, without penalty, terminate the contracts upon written notice to the Company. In the event of termination, the Company would be paid only termination costs in accordance with the particular contract. Generally, termination costs include unpaid costs incurred to date, earned fees and any additional costs directly allocable to the termination. The Company did not experience early termination of any material contracts during the three months ended October 29, 2016 or during the fiscal year ended July 31, 2016.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

References in this Quarterly Report on Form 10-Q (the "Form 10-Q") to "EEI" refer to Ecology and Environment, Inc., a New York corporation. References to "the Company," "we," "us," "our," or similar terms refer to EEI together with its consolidated subsidiaries.

Executive Overview

Earnings per share increased to $0.21 for the quarter ended October 29, 2016 from $0.15 reported for the same quarter of the prior year. Consolidated net income attributable to EEI of $0.9 million for the three months ended October 29, 2016 reflected a 34% increase from the same quarter of the prior fiscal year. Selected financial information by business segment is summarized in the following table.

	Three Months Ended October 29, 2016	October 31, 2015
	(in thousands)	
EEI and its subsidiaries located in the United States:		
Revenue, net less subcontract costs (1)	$ 17,448	$ 19,633
Direct operating expenses (2)	7,405	8,321
Indirect operating expenses (3)	8,224	8,707
Income (loss) before income tax provision	1,658	2,428
Net income (loss) attributable to EEI	1,202	1,195
Subsidiaries located in South America:		
Revenue, net less subcontract costs (1)	$ 3,856	$ 4,834
Direct operating expenses (2)	2,005	2,363
Indirect operating expenses (3)	2,019	2,161
Income (loss) before income tax provision	(235)	244
Net income (loss) attributable to EEI	(310)	(499)
Other foreign subsidiaries:		
Revenue, net less subcontract costs (1)	$ ---	$ ---
Direct operating expenses (2)	---	---
Indirect operating expenses (3)	4	52
Income (loss) before income tax provision	(4)	(52)
Net income (loss) attributable to EEI	(4)	(32)

(1) Revenue, net less subcontract costs, which is a key operations metric for our company, represents the net of revenue, net, and subcontract costs from the condensed consolidated statements of operations. References to "revenues" in the following commentary refer to revenue, net less subcontract costs.

(2) Direct operating expenses consist of cost of professional services and other direct operating expenses from the condensed consolidated statements of operations.

(3) Indirect operating expenses consist of administrative and indirect operating expenses and marketing and related costs from the condensed consolidated statements of operations.

Consolidated income before income tax provision was $1.4 million for the first quarter of 2017, which represented a $1.2 million (46%) decrease from income of $2.6 million reported for the same period in the prior fiscal year. Pre-tax earnings from our U.S. operations decreased $0.8 million (32%), due mainly to an 11% decrease in revenues.

Pre-tax earnings from our combined South American operations decreased $0.5 million (196%), as improved earnings from our Brazilian operations were more than offset by lower earnings from our subsidiaries in Peru and Chile.

Refer to “Results of Operations” below for further commentary regarding the Company’s revenues and expenses for the quarter ended October 29, 2016.

Liquidity and Capital Resources

Cash and cash equivalents increased $0.9 million during the first quarter of 2017. Excluding payment of $0.9 million of dividends to shareholders, which were approved on a discretionary basis by the Company’s Board of Directors, cash generated from operations exceeded cash required to fund investing and financing activities by $1.7 million during the quarter.

We maintain $39.0 million of unsecured lines of credit available for working capital and letters of credit as of October 29, 2016 at contractual interest rates ranging from 3.50% to 15.60%. Total amounts used under lines of credit were $2.3 million at October 29, 2016. Our lenders have reaffirmed the lines of credit within the past twelve months.

We believe that available cash balances, anticipated cash flows and our available lines of credit will be sufficient to cover working capital and operating requirements of our U.S. operations during the next twelve months and the foreseeable future.

Historically, our foreign subsidiaries have generated adequate cash flow to fund their operations. In recent months, our Brazilian subsidiary has been adversely affected by an economic downturn and weakening of the Brazilian Real in relation to the U.S. dollar. The total scope and duration of the downturn and the ultimate impact that it will have on our Brazilian operations are uncertain. In the event that our Brazilian subsidiary is unable to generate adequate cash flow to fund its operations, additional funding from EEI, other subsidiaries or lending institutions will be considered.

We intend to reinvest net cash generated from undistributed foreign earnings into operations and business expansion opportunities outside the U.S. Excess cash accumulated by any foreign subsidiary, beyond that necessary to fund operations or business expansion, may be repatriated to the U.S. at the discretion of the Boards of Directors of the respective entities. We would be required to accrue and pay taxes on any amounts repatriated to the U.S. from foreign subsidiaries.

Contract Receivable Concentration Risk

Significant concentrations of contract receivables and the allowance for doubtful accounts and contract adjustments are summarized in the following table.

Region	Balance at October 29, 2016		Balance at July 31, 2016	
	Contract Receivables	Allowance for Doubtful Accounts and Contract Adjustments	Contract Receivables	Allowance for Doubtful Accounts and Contract Adjustments
	(in thousands)			
United States, Canada and South America	$33,420	$ 1,124	$ 35,266	$ 1,034
Middle East and Africa	4,922	4,895	4,921	4,895
Asia	61	---	61	---
Totals	$38,403	$ 6,019	$ 40,248	$ 5,929

Combined contract receivables related to projects in the Middle East, Africa and Asia represented 13% and 12% of total contract receivables at October 29, 2016 and July 31, 2016, respectively, while the combined allowance for doubtful accounts and contract adjustments related to these projects represented 81% and 83% of the total allowance for doubtful accounts and contract adjustments at those same period end dates. These allowance percentages highlight the Company's experience of heightened operating risks (i.e., political, regulatory and cultural risks) within these foreign regions in comparison with similar risks in the United States, Canada and South America, which result in increased collection risks and the risk of the Company expending resources that it may not recover for several months, or at all.

Assets Held for Sale

In September 2016, the Company entered into a letter of intent to sell property including land, a vacant building, related building improvements and fixtures, and warehouse space to a non-affiliated third party. Management expects to consummate the sale of this property during January 2017. The Company has not maintained any material operations within this property for several years.

The Company has classified the $1.3 million net book value of this property as assets held for sale at October 29, 2016. The selling price is expected to approximate the net book value of the property.

Results of Operations

Revenue, net

Our revenues are derived primarily from the professional and technical services performed by its employees or, in certain cases, by subcontractors engaged to perform on under contracts entered into with our clients. The revenues recognized, therefore, are derived from our ability to charge clients for those services under the contracts. Revenue, the cost of professional services, other direct operating expenses and subcontract costs of our South American subsidiaries exclude tax assessments by governmental authorities, which are collected by us from its customers and then remitted to governmental authorities.

Substantially all of our revenue is derived from environmental consulting work. The consulting revenue is principally derived from the sale of labor hours. The consulting work is performed under a mix of fixed price, cost-type, and time and material contracts. Contracts are required from all customers. Revenue is recognized as follows:

Contract Type	Work Type	Revenue Recognition Policy
Time and materials	Consulting	As incurred at contract rates.
Fixed price	Consulting	Percentage of completion, approximating the ratio of either total costs or Level of Effort (LOE) hours incurred to date to total estimated costs or LOE hours.
Cost-plus	Consulting	Costs as incurred plus fees. Fees are recognized as revenue using percentage of completion determined by the percentage of LOE hours incurred to total LOE hours in the respective contracts.

Revenue, net associated with these contract types are summarized in the following table.

	Three Months Ended October 29, 2016	October 31, 2015
	(in thousands)	
Time and materials	$ 14,490	$ 15,613
Fixed price	7,161	11,318
Cost-plus	3,954	3,131
Total revenue by contract type	$ 25,605	$ 30,062

Revenue, net and revenue, net less subcontract costs, by business segment, are summarized in the following table.

		Three Months Ended October 29, 2016	October 31, 2015
		(in thousands)	
Revenue, net, by business segment:			
EEI and its subsidiaries located in the U.S.		$ 20,346	$ 24,002
Subsidiaries located in South America:			
Walsh Peru, S.A. Ingenieros y Cientificos Consultores (“Walsh Peru”)		1,061	2,981
Gestion Ambiental Consultores S.A. (“GAC”)		1,961	1,845
Ecology & Environment do Brasil, Ltda (“E&E Brasil”)		2,167	1,098
Other		70	136
		5,259	6,060
Total revenue, net		$ 25,605	$ 30,062
Revenue, net less subcontract costs, by business segment:			
EEI and its subsidiaries located in the U.S.	$ 17,448	$ 19,633	

Subsidiaries located in South America:		
Walsh Peru	642	2,122
GAC	1,526	1,657
E&E Brasil	1,627	947
Other	61	108
	3,856	4,834
Total revenues	$21,304	$24,467

Revenue, net less subcontract costs is a key operations metric for our company. References to “revenues” in the following commentary refer to revenue, net less subcontract costs from the table above.

EEI and Subsidiaries Located in the U.S.

Revenues from EEI and its U.S. subsidiaries decreased $2.2 million (11%) during the current quarter, as compared with the same quarter of the prior year, primarily due to a lower average selling rate per hour of service charged to our clients. General competitive pricing pressure continues to have a negative impact on revenues for many of EEI's market sectors. The volume of hours charged to clients also decreased slightly, particularly in the energy and mining market sectors.

During the quarter ended October 31, 2015, we recorded $0.5 million of revenues from our Kentucky-based subsidiary that was sold near the end of the first quarter of fiscal year 2016, which also contributed to lower revenues from U.S. subsidiaries during the current quarter.

Subsidiaries Located in South America

Revenues from our Peruvian operations decreased $1.5 million (70%) during the current quarter, due to lower energy sector project activity. Global economic trends in oil, gas and commodity prices continued to have a severe negative impact on revenues from energy and mining sectors in Peru.

Revenues from our Brazilian operations increased $0.7 million (72%) during the current quarter, mainly due to increased project activity in the energy transmission market sector. An economic downturn that has adversely affected our Brazilian operations for several previous reporting quarters appears to have stabilized. EEI management continues to work closely with management in Brazil to implement a business development strategy that is responsive to current economic conditions while also reducing operating costs and improving operating efficiency.

Direct Operating Expenses

The cost of professional services and other direct operating expenses represents labor and other direct costs of providing services to our clients under our project agreements. We refer to these expenses as "direct operating expenses." These costs, and fluctuations in these costs, generally correlate directly with related project work volumes and revenues. Direct operating expenses, by business segment, are summarized in the following table.

	Three Months Ended	
	October 29, 2016	October 31, 2015
	(in thousands)	
EEI and its subsidiaries located in the U.S.	$ 7,405	$ 8,321
Subsidiaries located in South America:		
Walsh Peru	221	981
GAC	690	654
E&E Brasil	1,045	673
Other	49	55
	2,005	2,363
Total	$ 9,410	$ 10,684

Total direct operating expenses decreased $1.3 million (12%) during the current quarter, as compared with the same quarter last year. Within each of the business segments noted in the table above, increases and decreases in direct expenses resulted directly from corresponding increases or decreases in project revenues.

Indirect Operating Expenses

Administrative and indirect operating expenses and marketing and related costs represent administrative and other operating costs not directly associated with the generation of revenue. We refer to these costs as "indirect operating expenses." Indirect operating expenses by business segment are summarized in the following table.

	Three Months Ended	
	October 29, 2016	October 31, 2015
	(in thousands)	
EEI and its subsidiaries located in the U.S.	$ 8,224	$ 8,707
Subsidiaries located in South America:		
Walsh Peru	800	947
GAC	668	532
E&E Brasil	541	634
Other	10	48
	2,019	2,161
Other foreign subsidiaries	4	52
Total	$ 10,247	$ 10,920

EEI and Subsidiaries Located in the U.S.

EEI and its subsidiaries may, at the discretion of their respective Board of Directors, award incentive compensation to Directors, senior management and other employees in the form of cash bonuses. Cash bonus expense may vary significantly from year to year depending on company financial performance. EEI and its U.S. subsidiaries recorded $0.2 million and $0.5 million of incentive compensation expense in indirect operating expenses during the quarters ended October 29, 2016 and October 31, 2015, respectively, as a result of bonus expense accruals.

In October 2015, EEI sold its majority interest in a Kentucky-based subsidiary. Indirect operating expenses were $0.3 million lower during the current quarter as a result of sale of this subsidiary during the prior year.

Excluding the impact of bonuses and sale of a subsidiary noted above, total indirect operating expenses from U.S. operations was relatively unchanged during current quarter, as compared with the same quarter last year.

Subsidiaries Located in South America

Indirect operating expenses generally decreased within our South American business segment. During fiscal year 2016, management within our foreign subsidiaries continued with its critical review of indirect staffing levels and key administrative processes, resulting in improved operating efficiency and cost reductions. These operations also realized a full year benefit of efficiencies and cost reductions initiated in the prior fiscal year.

Income Taxes

The estimated effective tax rate decreased to a provision of 40.1% for the three months ended October 29, 2016 from a provision of 77.7% for the three months ended October 31, 2015, mainly due to significantly lower foreign income tax expense during the current quarter.

The Company periodically evaluates the likelihood of realization of deferred tax assets, and provides for a valuation allowance when necessary. Based on available evidence, including recent cumulative operating losses, management determined during the three months ended October 31, 2015 that it was more likely than not that deferred tax assets related to net operating loss carryforwards from its Brazilian operations will not be realized. As a result, the Company recorded a valuation allowance of $0.9 million as a reduction of deferred tax assets on the condensed consolidated balance sheet at October 31, 2015 and an addition to income tax expense on the condensed consolidated statement of operations for the three months ended October 31, 2015. Excluding this adjustment, the effective tax rate for the three months ended October 31, 2015 would have approximated 45.0%.

Critical Accounting Policies and Use of Estimates

The Company's condensed consolidated financial statements presented in Item 1 of this Form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts and contract adjustments, income taxes, impairment of long-lived assets and contingencies. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Refer to the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2016 for a description of our critical accounting policies.

Inflation

Inflation did not have a material impact on our business during the three months ended October 29, 2016 and October 31, 2015 because a significant amount of our contracts are either cost based or contain commercial rates for services that are adjusted annually.

Off-Balance Sheet Arrangements

We had outstanding letters of credit drawn under our lines of credit to support operations of $1.9 million and $2.2 million at October 29, 2016 and July 31, 2016, respectively. Other than these letters of credit, we did not have any off-balance sheet arrangements as of October 29, 2016 and July 31, 2016.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

As disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2016, management concluded that the Company’s internal control over financial reporting was not effective as of July 31, 2016 due to the fact that there was a material weakness in the Company’s internal control over financial reporting. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company’s annual or interim financial statements would not be prevented or detected on a timely basis.

Specifically, management identified control deficiencies related to: (i) contingent losses that were incorrectly accrued as liabilities by certain foreign subsidiaries during fiscal years prior to 2016; and (ii) deferred income tax assets and liabilities that were incorrectly recorded by certain foreign subsidiaries during fiscal year prior to 2016. Accounting staff of these foreign subsidiaries were not adequately trained regarding U.S. GAAP accounting and reporting requirements related to contingent losses and income taxes. In addition, management located at the Company’s corporate headquarters in the U.S. did not provide adequate review and oversight over accounting for these items by foreign subsidiaries. Although the combined deficiencies did not result in a material misstatement of the Company’s financial statements for any of the periods presented in this Form 10-K, management concluded that there was a reasonable possibility that, if any material misstatement had occurred, it would not have been prevented or detected on a timely basis.

Management has actively engaged in developing a remediation plan to address the material weakness noted above. Specifically, the following controls have been established or will be established during the fiscal year ended July 31, 2017:

- Enhanced training of foreign accounting staff regarding U.S. GAAP accounting and reporting requirements as they relate to their operations;
- Enhanced training of foreign accounting staff regarding accounting and reporting risks inherent in their operations and development of internal controls developed to mitigate those risks; and
-

Enhanced review and oversight controls established for corporate finance management located in the U.S. over the accounting and financial reporting activities of subsidiaries.

Management has developed a detailed plan and timetable for the implementation of the foregoing remediation efforts. Under the direction of the Audit Committee, management will monitor the implementation plan and continue to review and make necessary changes to the plan to improve the overall design of the Company’s internal control environment.

As of the end of the period covered by this report, our management, with the participation of our chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 promulgated under the Exchange Act. Based upon this evaluation, our chief executive officer and our chief financial officer concluded that, excluding the control deficiencies that resulted in the material weakness described above, our disclosure controls and procedures were: (1) designed to ensure that material information relating to our Company is accumulated and made known to our management, including our chief executive officer and chief financial officer, in a timely manner, particularly during the period in which this report was being prepared; and (2) effective, in that they provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Management believes, however, that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

Internal Controls

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the three months ended October 29, 2016 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is a named defendant in legal actions arising out of the normal course of business. The Company is not a party to any pending legal proceeding, the resolution of which the management believes will have a material adverse effect on the Company’s results of operations, financial condition or cash flows, or to any other pending legal proceedings other than ordinary, routine litigation incidental to its business. The Company maintains liability insurance against risks arising out of the normal course of business. The Company’s legal proceedings are disclosed in Note 15 of the condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q.

Item 2. Changes in Securities and Use of Proceeds

(e) Purchased Equity Securities. In August 2010, the Company’s Board of Directors approved a 200,000 share repurchase program. The following table summarizes the Company’s purchases of its common stock during the three months ended October 29, 2016 under this share repurchase program:

Fiscal Year 2017 Reporting Month	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Share Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
August 2016	---	---	---	77,082
September 2016	---	---	---	77,082
October 2016	---	---	---	77,082

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Registrant filed a Current Report on Form 8-K on November 15, 2016 to announce that the tenure of Frank B. Silvestro as Chairman of the Board of Directors will be extended to the date of the Company's Annual Meeting of Shareholders to be held on April 20, 2017.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Ecology and Environment, Inc.

Date: December 13, 2016 By: /s/ H. John Mye III
H. John Mye III
Chief Financial Officer and Treasurer
Principal Financial and Accounting Officer