FRIENDSHIP SHELTER, INC.
(A California Non-Profit Corporation)

FINANCIAL STATEMENTS

For The Year Ended December 31, 2012
(With Comparative Financial Information for the Year ended December 31, 2011)

with

INDEPENDENT AUDITORS' REPORT THEREON

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Independent Auditors' Report

Board of Directors
Friendship Shelter, Inc.

We have audited the accompanying financial statements of Friendship Shelter, Inc. (the "Organization"), which comprise the statement of financial position as of December 31, 2012, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization's preparation and fair presentation of the 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 Organization'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 financial statements.

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Friendship Shelter, Inc. as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

The financial statements of the Organization for the year ended December 31, 2011, were audited by other auditors who expressed an unmodified opinion on those statements on May 8, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2011 is consistent, in all material respects, with the audited financial statements from which it has been derived.

KMJ Corbin & Company LLP

KMJ | Corbin & Company LLP

Costa Mesa, California
May 29, 2013

STATEMENTS OF FINANCIAL POSITION

December 31, 2012
(With Comparative Financial Information as of December 31, 2011)

ASSETS	December 31, 2012	December 31, 2011
Current assets:		
Cash and cash equivalents	$ 627,560	$ 704,010
Investments	14,140	12,860
Receivables	89,020	194,190
Prepaid expenses and other current assets	12,300	23,470
Total current assets	743,020	934,530
Property, furniture and equipment, net	894,480	810,390
Deposits	15,010	6,400
Total assets	$ 1,652,510	$ 1,751,320
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	$ 101,220	$ 98,660
Current portion of notes payable	16,880	15,780
Security deposits	3,900	2,600
Total current liabilities	122,000	117,040
Notes payable, net of current portion	318,110	340,480
Total liabilities	440,110	457,520
Net assets:		
Unrestricted	1,212,400	1,181,180
Temporarily restricted	-	112,620
Total net assets	1,212,400	1,293,800
Total liabilities and net assets	$ 1,652,510	$ 1,751,320

FRIENDSHIP SHELTER, INC.
(A California Non-Profit Corporation)

STATEMENTS OF ACTIVITIES

For The Year Ended December 31, 2012
(With Summarized Comparative Financial Information For The Year Ended December 31, 2011)

	2012			2011
	Unrestricted	Temporarily Restricted	Total	Total
Revenues and support:				
Government, foundation and other private grants and contracts	$ 678,600	$ -	$ 678,600	$ 642,300
County of Orange – Community Resources Rehabilitation	-	-	-	112,620
Contributions, including material and services of $61,910 in 2012 and $75,100 in 2011	321,240	-	321,240	348,600
Special events, net	389,660	-	389,660	312,000
Program income and other	57,490	-	57,490	63,890
Change in fair value of investments	1,280	-	1,280	(410)
Net assets released from restrictions	112,620	(112,620)	-	-
	1,560,890	(112,620)	1,448,270	1,479,000
Expenses:				
Program services	1,390,660	-	1,390,660	1,388,830
General and administrative	132,060	-	132,060	143,270
Fundraising	6,950	-	6,950	9,660
	1,529,670	-	1,529,670	1,541,760
Change in net assets	31,220	(112,620)	(81,400)	(62,760)
Net assets, beginning of year	1,181,180	112,620	1,293,800	1,356,560
Net assets, end of year	$ 1,212,400	$ -	$ 1,212,400	$ 1,293,800

STATEMENTS OF FUNCTIONAL EXPENSES

For The Year Ended December 31, 2012
(With Summarized Comparative Financial Information For The Year Ended December 31, 2011)

	2012				
	Program Services	General and Administrative	Fundraising	Total	2011 Total
Salaries and benefits	$ 879,420	$ 91,820	$ -	$ 971,240	$ 925,570
Client services	128,820	-	-	128,820	172,070
Land lease	68,320	2,850	-	71,170	70,000
Depreciation and amortization	72,520	1,480	-	74,000	66,700
Donated services	26,640	-	-	26,640	46,220
Workers' compensation	42,450	4,720	-	47,170	39,470
Utilities	30,180	3,350	-	33,530	34,550
Repairs and maintenance	16,660	-	-	16,660	33,150
Donated materials	35,270	-	-	35,270	28,880
Professional fees	-	11,700	6,950	18,650	18,470
Interest	18,050	-	-	18,050	19,890
House supplies and equipment	11,970	-	-	11,970	13,590
Property taxes	12,750	260	-	13,010	13,100
Insurance	14,920	310	-	15,230	11,770
Office supplies and expense	2,500	10,020	-	12,520	11,390
Telephone	7,790	2,600	-	10,390	10,880
Transportation	9,730	-	-	9,730	9,150
Credit card charges	9,540	-	-	9,540	7,600
Miscellaneous expense	2,320	2,140	-	4,460	7,220
Postage	810	810	-	1,620	2,090
	$1,390,660	$ 132,060	$ 6,950	$ 1,529,670	$ 1,541,760

STATEMENTS OF CASH FLOWS

For The Year Ended December 31, 2012
(With Summarized Comparative Financial Information For The Year Ended December 31, 2011)

	2012	2011
Cash flows from operating activities:		
Change in net assets	$ (81,400)	$ (62,760)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	74,000	66,700
Change in fair value of investments	(1,280)	410
Change in operating assets and liabilities:		
Receivables	105,170	29,270
Prepaid expenses and other current assets	11,170	(17,640)
Deposits	(8,610)	-
Accounts payable and accrued expenses	2,560	16,570
Security deposits	1,300	(400)
Net cash provided by operating activities	102,910	32,150
Cash flows used in investing activities:		
Purchases of property, furniture and equipment	(158,090)	-
Cash flows used in financing activities:		
Principal payments on notes payable	(21,270)	(19,430)
Net change in cash and cash equivalents	(76,450)	12,720
Cash and cash equivalents at beginning of year	704,010	691,290
Cash and cash equivalents at end of year	$ 627,560	$ 704,010

NOTE 1 – BUSINESS HISTORY

Friendship Shelter, Inc. (the "Organization") was incorporated on January 20, 1987 as a not-for-profit public benefit corporation. The Organization is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code and from California state income taxes under Section 23701(d) of the California Revenue and Taxation Code.

The Organization is based in Laguna Beach, California and provides shelter and services for the temporarily homeless and/or mentally or psychologically distressed individuals. A Board of Directors comprised of volunteer members governs the shelter.

The Organization is primarily funded by contributions from the public, grant awards and special events.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted, depending on the presence of donor restrictions. At December 31, 2012, the Organization did not have temporarily restricted or permanently restricted net assets or contributions. At December 31, 2011, temporarily restricted net assets consisted of a grant received for the purpose of constructing building improvements, which were completed during 2012. As a result, the temporarily restricted net assets balance was released to unrestricted net assets during 2012.

Cash and Cash Equivalents

Temporary, short-term and highly liquid investments that mature in less than three months from the date they are acquired are classified as cash and cash equivalents. The Organization maintains cash balances at financial institutions that are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $250,000. In addition to the basic insurance coverage, the FDIC provided temporary unlimited coverage for noninterest bearing transaction accounts through December 31, 2012. As of December 31, 2012, the Organization had no amounts in excess of the FDIC insurance limits. Beginning January 1, 2013, noninterest bearing transaction accounts are subject to the $250,000 limit on FDIC insurance per covered institution. Management believes that it has invested in high credit, quality institutions for which the Organization has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk related to these accounts.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Investments

Investments consist of a long-term investment pool which is carried at fair value.

Donated investments are recorded at fair value at the date of donation and thereafter carried at fair value. Net appreciation (depreciation) in the fair value of investments, which consists of the realized and unrealized gains or losses on those investments, is shown in the statement of activities.

Accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market, or in the absence of a principal market, the most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Accounting guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs in priority that may be used to measure fair value:

Level 1—Quoted prices in active markets for identical assets or liabilities;

Level 2—Observable inputs other than quoted prices included within Level 1, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates and yield curves, credit risks, and default rates) or other inputs that are principally derived from or corroborated by observable market data by correlation or by other means; and

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

See Note 3 for fair value disclosures.

Receivables

Receivables are primarily due from private and public granting agencies under grants and contracts. The Organization determines an allowance for uncollectible receivables based on historical experience. At December 31, 2012 and 2011, there was no allowance for uncollectible receivables.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Property, Furniture and Equipment

Property, furniture and equipment are stated at cost. Contributed property and equipment are recorded at estimated fair value at the time of contribution. Significant additions or improvements that extend asset lives are capitalized; normal maintenance and repair costs are expensed as incurred. Depreciation and amortization on the building and improvements is computed over 29.5 years using the straight-line method with regard to the facility in Laguna Beach and over 27.5 years with regard to the facilities in San Clemente. Depreciation on the furniture and equipment is provided over estimated useful lives of three or four years using the straight-line method.

Long-Lived Assets

The Organization evaluates long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of the asset group may not be recoverable. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 360-55, *Impairment or Disposal of Long-Lived Assets*, the evaluations address the estimated recoverability of the assets' carrying value. When the carrying value of an asset exceeds estimated recoverability, an impairment is recorded to reduce the carrying value to fair value. No impairments were required to be recorded during the years ended December 31, 2012 and 2011.

Contributed Services and Materials

Contributed services are recorded at the estimated fair value at the time the services were performed. Only those contributed services that are a significant and an integral part of the efforts of the Organization and would have to be performed by professional salaried personnel if the services had not been contributed are included in the financial statements.

In addition, many individuals volunteer their time and perform a variety of tasks that assist the Organization at the resident facilities that are not recorded. The Organization receives more than 5,000 of these volunteer hours each year.

Contributed materials are recorded at their estimated fair value at the date of receipt.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Contributions, Grants and Contracts

Contributions and grants are recognized when the donor makes an unconditional promise to give to the Organization. All donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. Certain grants are considered exchange contracts, with revenue recognized as the related costs are incurred.

Use of Estimates

The preparation of financial statements in conformity with 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates embodied in these financial statements include the collectibility of receivables, the recoverability of long-lived assets and the allocation of expenses to program services, general and administrative expenses and fundraising expenses. Actual results could differ from those estimates.

Income Taxes

The Organization is a public charity that has obtained an exemption from Federal income taxes and California state income taxes. Accordingly, no provision has been made for Federal or California state income taxes in the accompanying financial statements. The Organization is subject, however, to Federal and California state income taxes on net unrelated business income as stipulated in Internal Revenue Code Section 511 and Regulation Section 1.511. During the years ended December 31, 2012 and 2011, the Organization had no unrelated business income.

The Organization annually evaluates tax positions as part of the preparation of its exempt tax return. This process includes an analysis of whether tax positions the Organization takes with regard to a particular item of income or deduction would meet the definition of an uncertain tax position under current accounting guidance. The Organization believes its tax positions are appropriate based on current facts and circumstances. The Organization's policy is to recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. At December 31, 2012 and 2011, the Organization did not have any unrecognized tax benefits. The Organization is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for years before 2008.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Allocated Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among program services, general and administrative expenses and fundraising expenses based upon estimated usage.

Risks and Uncertainties

Certain of the Organization's services are governed by contracts with governmental and private agencies. All such contracts to which the Organization currently is a party are for fixed terms and expire at the end of those terms. One of the Organization's grantors accounted for approximately 15% of total revenues and support.

There can be no assurances that the Organization will be able to obtain future contracts as deemed necessary by management. The loss of some of the current contracts or the inability to obtain future contracts could cause the Organization's to curtail or discontinue certain programs. Failure of the Organization to comply with applicable contract and regulatory requirements can result in, among other things, loss of funding, warning letters, fines, injunctions, and civil penalties which could have an adverse effect on the Organization's financial position and activities.

Subsequent Events

The Organization has evaluated and determined that no events have occurred subsequent to the statement of financial position date and through May 29, 2013, the date of issuance of these financial statements, which would require inclusion or disclosure in its financial statements.

Reclassifications

Certain amounts in the 2011 financial statements have been reclassified to conform with the 2012 presentation with no net effect on the change in net assets.

NOTE 3 – FAIR VALUE MEASUREMENTS

The Organization currently holds its investments in a long-term investment pool. In this investment, funds are invested to provide safety through diversification in a portfolio of common stocks, bonds, mutual funds, alternative investments and cash equivalents. The fair value of the Organization's investments in its long-term investment pool is based partially upon unobservable inputs that are significant to the fair value of the investments, as estimated by the investment manager. These investments have been classified within Level 3 of the valuation hierarchy.

The following is a reconciliation of investments in which significant unobservable inputs (Level 3) were used in determining fair value:

Balance, December 31, 2010	$ 13,270
Change in fair value of investments	(410)
Balance, December 31, 2011	12,860
Change in fair value of investments	1,280
Balance, December 31, 2012	$ 14,140

NOTE 4 – PROPERTY, FURNITURE AND EQUIPMENT

Property, furniture and equipment, net at December 31 consisted of the following:

	2012	2011
Land	$ 347,690	$ 347,690
Buildings	1,091,790	1,091,790
Equipment, furnishings and improvements	424,570	266,480
	1,864,050	1,705,960
Less accumulated depreciation and amortization	(969,570)	(895,570)
	$ 894,480	$ 810,390

NOTE 5 – NOTES PAYABLE

Notes payable at December 31 consisted of the following:

	2012	2011
Note payable to bank, secured by real property	$ 304,990	$ 326,260
Note payable to City of San Clemente	30,000	30,000
	334,990	356,260
Less current portion	(16,880)	(15,780)
	$ 318,110	$ 340,480

The Organization has a note payable to a bank that is secured by a housing facility in San Clemente, California (the "City"). The terms of the note require monthly payments of principal and interest. The interest rate is 5.765%, the monthly payment is $2,780 and the note matures on February 1, 2017.

The Organization has a non-interest bearing note payable to the City. The note is secured by a housing facility in the City. This note does not require payments and the City agreed to forgive this note if the property was not sold before May 2012. As of December 31, 2012, the property was not sold; however, the process to have the note forgiven by the City is still in progress. Management will recognize income related to the forgiveness of this note on the date the note is formally forgiven by the City.

Future minimum annual principal payments on the note payable to bank are as follows:

Years Ending December 31,	
2013	$ 16,880
2014	17,200
2015	18,220
2016	19,300
2017	233,390
	$ 304,990

NOTE 6 – SPECIAL EVENTS

Special events include revenue and expenses from events sponsored and managed by the Organization. Income and expenses from special events for the years ended December 31 are as follows:

	2012	2011
Revenues	$ 508,750	$ 430,670
Expenses	(119,090)	(118,670)
	$ 389,660	$ 312,000

NOTE 7 – RELATED PARTY TRANSACTIONS

Various board members make contributions to the Organization through donations, fundraising events and volunteer time. For the years ended December 31, 2012 and 2011, cash contributions recorded from board members totaled approximately $118,000 and $143,000, respectively, which are recorded in both contributions and special events, net in the accompanying statements of activities.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

Lease Commitment

The Organization leases land in Laguna Beach, California, on which a shelter facility is located under a lease that expires in 2061. The lease requires monthly payments of $6,000. The lease provides that the real property be appraised every five years. The annual rent is then adjusted to 8% of the appraised value. The last appraisal was performed in June 2012. The minimum lease commitment based on the current lease amount is approximately $72,000 annually.

Guarantees and Indemnities

The Organization has made certain indemnities, under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain actions or transactions. The Organization indemnifies its directors, officers, employees and agents, as permitted under the laws of the State of California. In connection with its land lease, the Organization has indemnified its lessor for certain claims arising from the use of the land. The duration of the indemnities varies, and is generally tied to the life of the respective agreement. These indemnities do not provide for any limitation of the maximum potential future payments the Organization could be obligated to make. Historically, the Organization has not been obligated nor incurred any payments for these obligations and, therefore, no liabilities have been recorded for these indemnities in the accompanying statements of financial position.