

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

CONSOLIDATED FINANCIAL STATEMENTS

For The Year Ended December 31, 2016
(With Summarized Comparative Financial Information for the
Year Ended December 31, 2015)

with

INDEPENDENT AUDITORS' REPORT THEREON

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

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Independent Auditors' Report

Board of Directors
Friendship Shelter, Inc.

We have audited the accompanying consolidated financial statements of Friendship Shelter, Inc. (the "Organization"), which comprise the consolidated statement of financial position as of December 31, 2016, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Friendship Shelter, Inc. as of December 31, 2016, 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

We have previously audited the Organization's December 31, 2015 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated November 30, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2017 on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

KMJ Corbin & Company LLP

KMJ Corbin & Company LLP

Costa Mesa, California
September 20, 2017

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

December 31, 2016
(With Comparative Financial Information as of December 31, 2015)

ASSETS	December 31, 2016	December 31, 2015 (Summarized)
Current assets:		
Cash and cash equivalents	\$ 296,330	\$ 456,490
Investments	35,760	44,830
Receivables	371,950	142,700
Prepaid expenses and other current assets	<u>40,830</u>	<u>28,340</u>
Total current assets	744,870	672,360
Property, furniture and equipment, net	2,053,650	1,746,700
Deposits and other assets	<u>219,630</u>	<u>55,910</u>
Total assets	<u>\$ 3,018,150</u>	<u>\$ 2,474,970</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	\$ 263,630	\$ 518,700
Deferred revenue	-	34,200
Security deposits	<u>3,800</u>	<u>1,550</u>
Total current liabilities	267,430	554,450
Notes payable, net of debt discount	<u>1,756,540</u>	<u>1,010,360</u>
Total liabilities	<u>2,023,970</u>	<u>1,564,810</u>
Commitments and contingencies		
Net assets:		
Unrestricted	752,030	910,160
Temporarily restricted	<u>242,150</u>	<u>-</u>
Total net assets	<u>994,180</u>	<u>910,160</u>
Total liabilities and net assets	<u>\$ 3,018,150</u>	<u>\$ 2,474,970</u>

*See independent auditors' report and
accompanying notes to consolidated financial statements*

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

CONSOLIDATED STATEMENTS OF ACTIVITIES

For The Year Ended December 31, 2016
(With Summarized Comparative Financial Information For The Year Ended December 31, 2015)

	2016			2015 Total (Summarized)
	Unrestricted	Temporarily Restricted	Total	
Revenues and support:				
Government, foundation and other private grants and contracts	\$ 1,620,450	\$ 387,320	\$ 2,007,770	\$ 1,123,950
Contributions, including material and services of \$85,080 in 2016 and \$84,680 in 2015	570,350	-	570,350	454,540
Special events, net	378,590	-	378,590	407,100
Program income and other	244,830	-	244,830	47,040
Forgiveness of note payable	4,120	-	4,120	-
Change in fair value of investments	1,140	-	1,140	930
Net assets released from restriction	<u>145,170</u>	<u>(145,170)</u>	<u>-</u>	<u>-</u>
	<u>2,964,650</u>	<u>242,150</u>	<u>3,206,800</u>	<u>2,033,560</u>
Expenses:				
Program services	2,771,650	-	2,771,650	2,032,160
General and administrative	269,140	-	269,140	136,220
Fundraising	<u>81,990</u>	<u>-</u>	<u>81,990</u>	<u>74,230</u>
	<u>3,122,780</u>	<u>-</u>	<u>3,122,780</u>	<u>2,242,610</u>
Change in net assets	(158,130)	242,150	84,020	(209,050)
Net assets, beginning of year	<u>910,160</u>	<u>-</u>	<u>910,160</u>	<u>1,119,210</u>
Net assets, end of year	<u>\$ 752,030</u>	<u>\$ 242,150</u>	<u>\$ 994,180</u>	<u>\$ 910,160</u>

See independent auditors' report and accompanying notes to consolidated financial statements

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

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES

For The Year Ended December 31, 2016
(With Summarized Comparative Financial Information For The Year Ended December 31, 2015)

	2016			2015 Total (Summarized)	
	Program Services	General and Administrative	Fundraising		Total
Salaries and benefits	\$ 1,311,490	\$ 147,100	\$ 81,370	\$ 1,539,960	\$ 1,254,150
Apartment rent	639,810	-	-	639,810	269,280
Client services	116,250	-	-	116,250	131,280
Land lease	69,120	2,880	-	72,000	72,000
Depreciation and amortization	124,870	2,540	-	127,410	96,280
Donated services	36,670	-	-	36,670	42,150
Workers' compensation	72,280	890	620	73,790	58,000
Utilities	68,650	7,630	-	76,280	39,340
Repairs and maintenance	88,060	-	-	88,060	58,550
Donated materials	48,410	-	-	48,410	42,530
Professional fees	-	58,270	-	58,270	14,180
Interest	38,030	-	-	38,030	8,320
House supplies and equipment	21,020	-	-	21,020	18,630
Property taxes	15,970	320	-	16,290	16,900
Insurance	27,230	550	-	27,780	14,000
Office supplies and expense	6,960	27,850	-	34,810	25,160
Telephone	10,840	4,650	-	15,490	9,300
Transportation	49,000	-	-	49,000	37,040
Credit card processing fees	9,320	-	-	9,320	13,420
Miscellaneous expense	15,790	14,580	-	30,370	19,080
Postage	1,880	1,880	-	3,760	3,020
	<u>\$ 2,771,650</u>	<u>\$ 269,140</u>	<u>\$ 81,990</u>	<u>\$ 3,122,780</u>	<u>\$ 2,242,610</u>

*See independent auditors' report and
accompanying notes to consolidated financial statements*

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

For The Year Ended December 31, 2016
(With Summarized Comparative Financial Information For The Year Ended December 31, 2015)

	2016	2015
		(Summarized)
Cash flows from operating activities:		
Change in net assets	\$ 84,020	\$ (209,050)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	127,410	96,280
Change in fair value of investments	(1,140)	(930)
Forgiveness of note payable	(4,120)	-
Amortization of debt discount	1,480	740
Changes in operating assets and liabilities:		
Receivables	(229,250)	(93,070)
Prepaid expenses and other current assets	(12,490)	2,340
Deposits and other assets	(1,150)	(14,420)
Accounts payable and accrued expenses	(251,120)	63,470
Deferred revenue	(34,200)	19,660
Security deposits	2,250	-
Net cash used in operating activities	<u>(318,310)</u>	<u>(134,980)</u>
Cash flows used in investing activities:		
Purchases of property, furniture and equipment	<u>(428,100)</u>	<u>(715,100)</u>
Cash flows from financing activities:		
Proceeds from notes payable	586,250	739,160
Principal payments on notes payable	<u>-</u>	<u>(13,510)</u>
Net cash provided by financing activities	<u>586,250</u>	<u>725,650</u>
Net change in cash and cash equivalents	(160,160)	(124,430)
Cash and cash equivalents at beginning of year	<u>456,490</u>	<u>580,920</u>
Cash and cash equivalents at end of year	<u>\$ 296,330</u>	<u>\$ 456,490</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest, net of amounts capitalized	<u>\$ -</u>	<u>\$ 8,320</u>

Continued ...

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

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

For The Year Ended December 31, 2016
(With Summarized Comparative Financial Information For The Year Ended December 31, 2015)

	<u>2016</u>	<u>2015</u> (Summarized)
Supplemental disclosures of non-cash investing and financing activities:		
Construction in progress/capitalized interest recorded in accounts payable and accrued expenses	\$ <u>6,260</u>	\$ <u>271,350</u>
Loan fees and deposits netted against loan proceeds	\$ <u>162,570</u>	\$ <u>49,500</u>
Note payable repaid from proceeds of new loan	\$ <u>-</u>	\$ <u>250,460</u>
Unemployment insurance deposit included in investments offset against unemployment liability	\$ <u>10,210</u>	\$ <u>-</u>

See independent auditors' report and accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 1 – BUSINESS HISTORY

Friendship Shelter, Inc. (“FSI”) was incorporated on January 20, 1987 as a not-for-profit public benefit corporation. FSI 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.

In 2014, the Organization formed a wholly owned subsidiary, Henderson House, LLC (“HH”), to hold the assets of the Organization’s Henderson House property and related borrowings to improve the Henderson House (see Note 5). FSI and HH are collectively referred to herein as the “Organization.”

The Organization is based in Laguna Beach, California and provides shelter services for homeless individuals as well as housing and supportive services for disabled individuals who were previously homeless. A board of directors comprised of volunteer members governs the Organization.

The Organization is primarily funded by a diverse mix of public funds, foundation grants, fundraising events and gifts from individual donors.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of FSI and HH. Intercompany balances and transactions have been eliminated in consolidation.

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, 2016 and 2015, the Organization did not have permanently restricted net assets or contributions. During the year ended December 31, 2016, the Organization received two private foundation grants totaling \$387,320 that will be used for general operations through September 2017. At December 31, 2016, the balance of the foundation grants of \$242,150 is reflected as temporarily restricted net assets; no such contributions existed at December 31, 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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 per owner. 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.

Investments

Investments consist of an investment pool which is carried at fair value and a general unallocated fund from an insurance company.

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 consolidated statements of activities.

Fair Value Measurements

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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, 2016 and 2015, there was no allowance for uncollectible receivables.

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. Expenditures for property, furniture and equipment that are not in use by the end of the fiscal year are accumulated and capitalized as construction in progress. Once items in construction in progress have been placed in service they are capitalized to the appropriate asset categories and depreciated. The Organization capitalizes interest costs as part of the historical cost of acquiring assets it constructs using debt.

Depreciation and amortization on buildings 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.

Debt Issuance Costs

In connection with executing the California Housing Finance Agency MHSAs promissory note (see Note 5), the Organization incurred debt issuance costs of \$29,500 during 2015, which were recorded as an offset to the corresponding MHSAs note payable in the accompanying consolidated statements of financial position and are being amortized over the term of the promissory note. During 2016 and 2015, \$1,480 and \$740, respectively, was amortized and included as miscellaneous expense in the accompanying consolidated statements of functional expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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, 2016 and 2015.

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 consolidated 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.

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. Amounts billed under exchange contracts prior to the related costs being incurred are recorded as deferred revenue.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Use of Estimates

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

Income Taxes

FSI 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 consolidated financial statements. FSI 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, 2016 and 2015, FSI had no unrelated business income.

HH is a limited liability company that is taxed under sections of the Federal and California tax law which provide that, in lieu of federal corporation income taxes and the normal state corporation income taxes, the member separately accounts for HH's items of income, deductions, losses and credits. Therefore, these consolidated financial statements do not include any provision for HH's Federal corporation income taxes. A minimum state income tax has been provided for California.

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, 2016 and 2015, 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 2012.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

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. As of December 31, 2016 and 2015, three and three of the Organization's grantors accounted for approximately 59% and 71%, respectively, of receivables. For the years ended December 31, 2016 and 2015, one and two of the Organization's grantors accounted for approximately 32% and 39%, respectively, 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 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 consolidated financial position and activities.

Reclassifications

In 2016, the Organization adopted Accounting Standards Update ("ASU") 2015-03, *Interest - Imputation of Interest*, on a retrospective basis relating to the presentation of debt issuance costs as an offset to the corresponding debt balance. As a result, 2015 net debt issuance costs of \$28,760 have been reclassified from deposits and other assets to notes payable, net of debt discount in the accompanying statement of financial position to conform to the current year presentation with no effect on the beginning net assets balance.

Subsequent Events

The Organization has evaluated and determined that no events have occurred subsequent to the consolidated statement of financial position date and through September 20, 2017, the date of issuance of these consolidated financial statements, which would require inclusion or disclosure in its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 3 – FAIR VALUE MEASUREMENTS

The Organization currently holds its investments in a long-term investment pool and a general unallocated fund from a trust company.

In the long-term investment pool, 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 using generally accepted valuation methodologies.

Investments in the general unallocated fund from a trust company represent an account that the Organization maintains with Unemployment Services Trust related to its unemployment self-funding arrangement. The account funds are pooled with other client accounts and invested in accordance with the third party's investment policies. The Organization has no ability to direct this investment in any specific manner and has no visibility to the individual components of its account.

Both of 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, January 1, 2015	\$ 43,900
Deposits	4,960
Payments/expenses	(4,960)
Change in fair value of investments	<u>930</u>
Balance, December 31, 2015	44,830
Deposits	2,020
Payments/expenses	(12,230)
Change in fair value of investments	<u>1,140</u>
Balance, December 31, 2016	<u>\$ 35,760</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 4 – PROPERTY, FURNITURE AND EQUIPMENT

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

	<u>2016</u>	<u>2015</u>
Land	\$ 347,690	\$ 347,690
Buildings	2,150,920	1,091,790
Construction in progress	-	978,820
Equipment, furnishings and improvements	<u>903,750</u>	<u>549,700</u>
	3,402,360	2,968,000
Less accumulated depreciation and amortization	<u>(1,348,710)</u>	<u>(1,221,300)</u>
	<u>\$ 2,053,650</u>	<u>\$ 1,746,700</u>

NOTE 5 – NOTES PAYABLE

Notes payable at December 31 consisted of the following:

	<u>2016</u>	<u>2015</u>
Note payable to California Housing Finance Agency	\$ 1,771,440	\$ 1,039,120
Note payable to the City of San Clemente	12,380	-
Less: unamortized debt issuance costs	<u>(27,280)</u>	<u>(28,760)</u>
	1,756,540	1,010,360
Less current portion	<u>-</u>	<u>-</u>
	<u>\$ 1,756,540</u>	<u>\$ 1,010,360</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

NOTE 5 – NOTES PAYABLE, continued

The Organization has a note payable to the California Housing Finance Agency (“CHFA”) that is secured by a deed of trust. The terms of the note require annual payments of principal and interest from 100% of the development’s residual receipts. The Organization had no residual receipts during the years ended December 31, 2016 and 2015. The interest rate is 3% and the note matures on June 1, 2035. The maximum loan amount is \$1,771,440, based on actual approved construction expenditures. As of March 2016, the loan balance reached the maximum amount allowed.

In addition, the CHFA note contains certain covenants. The Organization was in compliance with all but one covenant as of December 31, 2016, for which it subsequently obtained a waiver.

The CHFA note’s regulatory agreement requires establishing and maintaining various reserve accounts, including an operating expense reserve, a replacement reserve, and a capitalized operating subsidy reserve. At December 31, 2016, the Organization maintained a \$28,620 operating expense reserve, a \$20,000 replacement reserve, and a \$113,950 capitalized operating subsidy reserve in deposits and other assets. No other reserves were required as of December 31, 2016.

The Organization capitalized accrued interest of \$6,260 and \$11,380 during the years ended December 31, 2016 and 2015, respectively, related to financed building improvements, which is being amortized over the remaining life of the building.

The Organization has a forgivable note payable to the City of San Clemente that is secured by a deed of trust. The terms of the forgivable note require the Organization to make improvements on the multi-family rental housing building and the note will be forgiven after four years if the Organization does not sell or transfer the building. The Organization recorded forgiveness on the forgivable note of \$4,120 and \$0 in the accompanying statements of activities for the years ended December 31, 2016 and 2015, respectively.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

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:

	<u>2016</u>	<u>2015</u>
Revenues	\$ 542,050	\$ 587,680
Expenses	<u>(163,460)</u>	<u>(180,580)</u>
	<u>\$ 378,590</u>	<u>\$ 407,100</u>

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, 2016 and 2015, cash contributions recorded from board members totaled approximately \$166,110 and \$149,000, respectively, which are recorded in both contributions and special events, net, in the accompanying consolidated statements of activities.

The Organization's Board Vice President owns the entity used by the Organization for the architectural fees related to the Henderson House project. During 2016, the Organization incurred and paid fees related to such architectural services of \$9,300 which are included in property, furniture and equipment, net in the accompanying consolidated statement of financial position. During 2015, the Organization incurred and paid fees related to such architectural services of \$3,060 which are included in construction in progress in the accompanying consolidated statement of financial position. Additionally, the Organization's Board President owns an entity used by the Organization to purchase computers. As of and for the years ended December 31, 2016 and 2015, the Organization incurred costs of \$30,050 and \$23,310, respectively, related to such computer purchases, of which \$29,100 and \$23,280, respectively, is included in property, furniture and equipment in the accompanying consolidated statements of financial position and \$950 and \$30, respectively, is included in general and administrative expenses in the accompanying consolidated statements of activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Years Ended December 31, 2016 and 2015

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 \$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. In connection with the CHFA note, the Organization has indemnified the lender for all claims arising from the occupancy or construction of Henderson House and other matters. 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 consolidated statements of financial position.

Unemployment Insurance

The Organization has elected to self-fund its California unemployment claims. Using a third-party actuarial expert, the Organization has a reserve of \$19,170 and \$28,450 as of December 31, 2016 and 2015, respectively, related to its estimated future liability for these claims based on past claims experience, actual claims filed and estimated future claims.