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

CONSOLIDATED FINANCIAL STATEMENTS

For The Year Ended December 31, 2015
(With Summarized Comparative Financial Information for the Year Ended December 31, 2014)

with

INDEPENDENT AUDITORS' REPORT THEREON

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

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KMJ Corbin & Company
Business Advisors Tax and Audit

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, 2015, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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.

p **714 380 6565** f **714 380 6566** 555 Anton Blvd Suite 1000 Costa Mesa CA 92626 **kmjpartnerscpa.com**
p **818 999 5885** f **818 704 4668** 20720 Ventura Blvd Suite 160 Woodland Hills CA 91364
p **760 431 5465** f **760 431 5466** 2768 Loker Avenue West Suite 101 Carlsbad CA 92010

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, 2015, 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, 2014 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated May 20, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2014 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

KMJ Corbin & Company LLP

KMJ Corbin & Company LLP

Costa Mesa, California
November 30, 2016

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

December 31, 2015
(With Comparative Financial Information as of December 31, 2014)

ASSETS	**December 31, 2015**	**December 31, 2014 (Summarized)**
Current assets:		
Cash and cash equivalents	$ 456,490	$ 580,920
Investments	44,830	43,900
Receivables	142,700	49,630
Prepaid expenses and other current assets	28,340	30,680
Total current assets	672,360	705,130
Property, furniture and equipment, net	1,746,700	856,530
Deposits and other assets	84,670	21,490
Total assets	$ 2,503,730	$ 1,583,150
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	$ 518,700	$ 183,880
Deferred revenue	34,200	14,540
Current portion of notes payable	-	18,500
Security deposits	1,550	1,550
Total current liabilities	554,450	218,470
Notes payable, net of current portion	1,039,120	245,470
Total liabilities	1,593,570	463,940
Commitments and contingencies		
Net assets:		
Unrestricted	910,160	944,210
Temporarily restricted	-	175,000
Total net assets	910,160	1,119,210
Total liabilities and net assets	$ 2,503,730	$ 1,583,150

CONSOLIDATED STATEMENTS OF ACTIVITIES

For The Year Ended December 31, 2015
(With Summarized Comparative Financial Information For The Year Ended December 31, 2014)

	2015			2014 Total (Summarized)
	Unrestricted	Temporarily Restricted	Total	
Revenues and support:				
Government, foundation and other private grants and contracts	$ 1,123,950	$ -	$ 1,123,950	$ 1,051,000
Contributions, including material and services of $84,680 in 2015 and $69,090 in 2014	454,540	-	454,540	290,680
Special events, net	407,100	-	407,100	433,560
Program income and other	47,040	-	47,040	29,770
Forgiveness of note payable	-	-	-	30,000
Change in fair value of investments	930	-	930	520
Net assets released from restriction	175,000	(175,000)	-	-
	2,208,560	(175,000)	2,033,560	1,835,530
Expenses:				
Program services	2,032,160	-	2,032,160	1,673,530
General and administrative	136,220	-	136,220	121,920
Fundraising	74,230	-	74,230	69,080
	2,242,610	-	2,242,610	1,864,530
Change in net assets	(34,050)	(175,000)	(209,050)	(29,000)
Net assets, beginning of year	944,210	175,000	1,119,210	1,148,210
Net assets, end of year	$ 910,160	$ -	$ 910,160	$ 1,119,210

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

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES

For The Year Ended December 31, 2015
(With Summarized Comparative Financial Information For The Year Ended December 31, 2014)

	2015				
	Program Services	General and Administrative	Fundraising	Total	2014 Total (Summarized)
Salaries and benefits	$ 1,101,850	$ 78,630	$ 73,670	$ 1,254,150	$ 1,091,840
Apartment rent	269,280	-	-	269,280	142,230
Client services	131,280	-	-	131,280	122,800
Land lease	69,120	2,880	-	72,000	72,000
Depreciation and amortization	94,350	1,930	-	96,280	78,970
Donated services	42,150	-	-	42,150	33,350
Workers’ compensation	56,980	460	560	58,000	64,670
Utilities	35,410	3,930	-	39,340	42,430
Repairs and maintenance	58,550	-	-	58,550	42,740
Donated materials	42,530	-	-	42,530	35,740
Professional fees	-	14,180	-	14,180	18,790
Interest	8,320	-	-	8,320	15,360
House supplies and equipment	18,630	-	-	18,630	14,350
Property taxes	16,560	340	-	16,900	15,040
Insurance	13,720	280	-	14,000	14,750
Office supplies and expense	5,030	20,130	-	26,160	12,330
Telephone	6,510	2,790	-	9,300	8,140
Transportation	37,040	-	-	37,040	17,780
Credit card processing fees	13,420	-	-	13,420	12,320
Miscellaneous expense	9,920	9,160	-	19,080	6,830
Postage	1,510	1,510	-	3,020	2,060
	$ 2,032,160	$ 136,220	$ 74,230	$ 2,242,610	$ 1,864,530

CONSOLIDATED STATEMENTS OF CASH FLOWS

For The Year Ended December 31, 2015
(With Summarized Comparative Financial Information For The Year Ended December 31, 2014)

	2015	2014 (Summarized)
Cash flows from operating activities:		
Change in net assets	$ (209,050)	$ (29,000)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	96,280	78,970
Change in fair value of investments	(930)	(520)
Forgiveness of note payable	-	(30,000)
Amortization of debt discount	740	-
Change in operating assets and liabilities:		
Receivables	(93,070)	26,370
Prepaid expenses and other current assets	2,340	(24,850)
Deposits and other assets	(14,420)	(4,910)
Accounts payable and accrued expenses	63,470	51,110
Deferred revenue	19,660	14,540
Security deposits	-	350
Net cash (used in) provided by operating activities	(134,980)	82,060
Cash flows used in investing activities:		
Purchases of property, furniture and equipment	(715,100)	(93,920)
Cash flows used in financing activities:		
Proceeds from notes payable	739,160	-
Principal payments on notes payable	(13,510)	(18,340)
Net cash provided by (used in) financing activities	725,650	(18,340)
Net change in cash and cash equivalents	(124,430)	(30,200)
Cash and cash equivalents at beginning of year	580,920	611,120
Cash and cash equivalents at end of year	$ 456,490	$ 580,920
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest, net of amounts capitalized	$ 8,320	$ 15,360

Continued…

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

For The Year Ended December 31, 2015
(With Summarized Comparative Financial Information For The Year Ended December 31, 2014)

	2015	2014 (Summarized)
Supplemental disclosures of non-cash investing and financing activities:		
Construction in progress recorded in accounts payable and accrued expenses	$ 271,350	$ -
Loan fees and deposits netted against loan proceeds	$ 49,500	$ -
Note payable repaid from proceeds of new loan	$ 250,460	$ -

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, 2015 and 2014, the Organization did not have permanently restricted net assets or contributions. At December 31, 2014, the Organization had one private foundation grant of $175,000 that was to be used for general operations through the end of 2015 that was reflected as a temporarily restricted contribution as of December 31, 2014; no such contributions existed at December 31, 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 statement 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.

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, 2015 and 2014, 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 MHSA promissory note (see Note 5), the Organization incurred debt issuance costs of $29,500 in 2015 which were recorded in deposits and other assets in the accompanying consolidated statement of financial position and will be amortized over the term of the promissory note. During 2015, $740 was amortized and included as miscellaneous expense in the accompanying consolidated statement of functional expenses.

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, 2015 and 2014.

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.

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, 2015 and 2014, 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, 2015 and 2014, 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 2011.

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, 2015 and 2014, three and two of the Organization's grantors accounted for approximately 71% and 85%, respectively, of receivables. For the years ended December 31, 2015 and 2014, two and two of the Organization's grantors accounted for approximately 39% and 32%, 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

Certain amounts were reclassified as of December 31, 2014 in order to conform to the current period presentation with no impact on 2014 change in net assets.

Subsequent Events

The Organization has evaluated and determined that no events have occurred subsequent to the consolidated statement of financial position date and through November 30, 2016, the date of issuance of these consolidated financial statements, which would require inclusion or disclosure in its consolidated financial statements.

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, 2014	$ 74,180
Deposits	4,960
Payments/expenses	(35,760)
Change in fair value of investments	520
Balance, December 31, 2014	43,900
Deposits	4,960
Payments/expenses	(4,960)
Change in fair value of investments	930
Balance, December 31, 2015	$ 44,830

NOTE 4 – PROPERTY, FURNITURE AND EQUIPMENT

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

	2015	2014
Land	$ 347,690	$ 347,690
Buildings	1,091,790	1,091,790
Construction in progress	978,820	46,936
Equipment, furnishings and improvements	549,700	495,144
	2,968,000	1,981,560
Less accumulated depreciation and amortization	(1,221,300)	(1,125,030)
	$ 1,746,700	$ 856,530

NOTE 5 – NOTES PAYABLE

Notes payable at December 31 consisted of the following:

	2015	2014
Note payable to bank, secured by real property	$ -	$ 263,970
Note payable to California Housing Finance Agency	1,039,120	-
	1,039,120	263,970
Less current portion	-	(18,500)
	$ 1,039,120	$ 245,470

The Organization had a note payable to a bank that was secured by a housing facility in San Clemente, California (the "City"). The terms of the note required monthly payments of principal and interest. The interest rate was 5.765% and the monthly payment was $2,780. The note was paid off in connection with the California Housing Finance Agency ("CHFA") financing (see below).

NOTE 5 – NOTES PAYABLE, continued

The Organization has a note payable to the 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 year ended December 31, 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 financial covenants that are not applicable until the year construction is completed. The development was completed in 2016; therefore, these covenants will be applicable during the year ending December 31, 2016.

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, 2015, The Organization maintained a $20,000 replacement reserve deposit in deposits and other assets. No other reserves were required as of December 31, 2015.

The Organization capitalized interest of $11,380 during the year ended December 31, 2015 related to financed building improvements, which will be amortized over the remaining life of the building.

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:

	2015	2014
Revenues	$ 587,680	$ 586,560
Expenses	(180,580)	(153,000)
	$ 407,100	$ 433,560

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, 2015 and 2014, cash contributions recorded from board members totaled approximately $149,000 and $121,000, 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 2015, the Organization incurred and paid fees related to such architectural services of $3,060 and are included in construction in progress in the accompanying consolidated statement of financial position. During 2014, the Organization incurred fees related to such architect services of $33,400 and are included in construction in progress and accounts payable and accrued expenses in the accompanying consolidated statement of financial position at December 31, 2014, which was paid in 2015. 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, 2015 and 2014, the Organization incurred costs of $23,310 and $8,270, respectively, related to such computer purchases, of which $23,280 and $7,030, respectively, is included in property, furniture and equipment in the accompanying consolidated statements of financial position and $30 and $1,240, respectively, is included in general and administrative expenses in the accompanying consolidated 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.

NOTE 8 – COMMITMENTS AND CONTINGENCIES, continued

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 $28,450 and $27,520 as of December 31, 2015 and 2014, respectively, related to its estimated future liability for these claims based on past claims experience, actual claims filed and estimated future claims.

KMJ | Corbin & Company
Business Advisors Tax and Audit

November 30, 2016

To the Board of Directors
Friendship Shelter, Inc.

In planning and performing our audit of the consolidated financial statements of Friendship Shelter, Inc. (the "Organization") as of and for the year ended December 31, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered the Organization's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a deficiency in internal control that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency in the Organization's internal control to be a significant deficiency:

Observation

> The Organization did not conduct a thorough analysis and reconciliation of its consolidated statement of financial position accounts at December 31, 2015, particularly in the accounts affected by the new Henderson House construction activities and related construction loan. These new activities are supported by many lengthy and cumbersome agreements that are at times difficult to understand and interpret for accounting and financial reporting purposes. As a result, the Organization had several corrected misstatements identified during the audit.

p **714 380 6565** f **714 380 6566** 555 Anton Blvd Suite 1000 Costa Mesa CA 92626 **kmjpartnerscpa.com**
p **818 999 5885** f **818 704 4668** 20720 Ventura Blvd Suite 160 Woodland Hills CA 91364
p **760 431 5465** f **760 431 5466** 2768 Loker Avenue West Suite 101 Carlsbad CA 92010

Recommendation

We recommend that management improves its process of analyzing all consolidated statement of financial position accounts on at least a quarterly basis, and completing the year-end analysis process by using a comprehensive closing checklist to ensure that all of these accounts are properly analyzed, reconciled and recorded according to GAAP. This will minimize any GAAP-related audit adjustments and help insure that management has timely, accurate financial information throughout the year to assist them in their decision making.

Management Response

2015 was a year of unexpectedly rapid growth for Friendship Shelter. In early 2016, Friendship Shelter management recognized significant program growth and complex real estate development activity had created increased demand on its financial management function. In mid-2016, Friendship Shelter added professional accounting staff and increased other finance staff hours. To further improve the timeliness and quality of both interim and year-end financial statements, the Organization is in the process of implementing comprehensive closing checklists and other process improvements designed specifically for the Organization. These financial safeguards should ensure that financial statement preparation is done in an accurate and timely manner and that going forward, all accounts are properly analyzed, reconciled and recorded according to GAAP.

This communication is intended solely for the information and use of management, the Board of Directors and others within the Organization, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KMJ Corbin & Company LLP

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