MERCY HOUSE LIVING CENTERS AND AFFILIATE

Combined Financial Statements
and
Independent Auditor's Report
For the Years Ended
June 30, 2017 and 2016
and
Single Audit Report
For the Year Ended June 30, 2017

Mercy House Living Centers and Affiliate

Table of Contents

Independent Auditor's Report

To the Audit Committee and Board of Directors of
Mercy House Living Centers
Santa Ana, California

Report on the Financial Statements

We have audited the accompanying combined financial statements of Mercy House Living Centers (a nonprofit organization) and affiliate, which comprise the combined statements of financial position as of June 30, 2017 and 2016, and the related combined statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended, and the related notes to the combined 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from 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 auditor's 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Mercy House Living Centers and affiliate as of June 30, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

www.HBLA.com
19600 Fairchild, Suite 320, Irvine, CA 92612 • (949) 833-2815 Office • (949) 833-2876 Fax

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2017, on our consideration of Mercy House Living Centers' and affiliate'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 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 Mercy House Living Centers' and affiliate's internal control over financial reporting and compliance.

HBLA Certified Public Accountants, Inc.

September 29, 2017

Mercy House Living Centers and Affiliate
Combined Statements of Financial Position
June 30, 2017 and 2016

Assets	2017	2016
Current Assets		
Cash and cash equivalents	$ 282,131	$ 194,115
Accounts receivable	40,000	180,000
Grants receivable	1,782,179	1,671,258
Contributions receivable	285,510	184,239
Prepaid expenses	50,223	21,503
Total current assets	2,440,043	2,251,115
Property and Equipment		
Land	2,415,741	2,415,741
Buildings and building improvements	8,037,198	8,014,141
Furniture and equipment	623,012	611,873
Computer equipment	125,033	110,964
Total property and equipment	11,200,984	11,152,719
Less accumulated depreciation	(3,930,547)	(3,511,405)
Property and equipment, net	7,270,437	7,641,314
Other Assets		
Contributions receivable	849,933	989,172
Deposits	5,735	7,985
Total other assets	855,668	997,157
Total assets	$ 10,566,148	$ 10,889,586

See accompanying notes to combined financial statements and independent auditor's report.

Mercy House Living Centers and Affiliate
Combined Statements of Financial Position (Continued)
June 30, 2017 and 2016

Liabilities and Net Assets	2017	2016
Current Liabilities		
Accounts payable	$ 254,277	$ 119,970
Accrued expenses	229,184	201,280
Resident deposits	35,867	35,327
Deferred revenue	41,034	36,171
Line of credit	200,000	400,000
Total current liabilities	760,362	792,748
Long-Term Liabilities		
Accrued interest	93,358	89,512
Notes payable	667,724	646,305
Total long-term liabilities	761,082	735,817
Total liabilities	1,521,444	1,528,565
Net Assets		
Unrestricted net assets	4,764,126	5,045,278
Temporarily restricted net assets	4,280,578	4,315,743
Total net assets	9,044,704	9,361,021
Total liabilities and net assets	$ 10,566,148	$ 10,889,586

See accompanying notes to combined financial statements and independent auditor’s report.

Mercy House Living Centers and Affiliate
Combined Statement of Activities and Changes in Net Assets
For the Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Total
Support and revenue			
Contributions	$ 1,702,860	$ 173,750	$ 1,876,610
Government grants and agreements	6,495,250	-	6,495,250
In-kind contributions	11,265	53,493	64,758
Program service fees	660,334	-	660,334
Special events, net of direct benefit expenses of $200,904	300,251	-	300,251
Investment gain	467	-	467
Net assets released from restrictions	262,408	(262,408)	-
Total support and revenue	9,432,835	(35,165)	9,397,670
Expenses			
Housing and living skills programs	8,744,658	-	8,744,658
Management and general	591,080	-	591,080
Fundraising and development	378,249	-	378,249
Total expenses	9,713,987	-	9,713,987
Decrease in net assets	(281,152)	(35,165)	(316,317)
Net assets, beginning of year	5,045,278	4,315,743	9,361,021
Net assets, end of year	$ 4,764,126	$ 4,280,578	$ 9,044,704

See accompanying notes to combined financial statements and independent auditor's report.

Mercy House Living Centers and Affiliate
Combined Statement of Activities and Changes in Net Assets
For the Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Total
Support and revenue			
Contributions	$ 1,446,863	$ 80,000	$ 1,526,863
Government grants and agreements	5,607,981	-	5,607,981
In-kind contributions	5,500	1,232,589	1,238,089
Program service fees	607,328	-	607,328
Special events, net of direct benefit expenses of $178,332	267,187	-	267,187
Investment gain	219	-	219
Net assets released from restrictions	353,038	(353,038)	-
Total support and revenue	8,288,116	959,551	9,247,667
Expenses			
Housing and living skills programs	7,865,322	-	7,865,322
Management and general	518,012	-	518,012
Fundraising and development	228,671	-	228,671
Total expenses	8,612,005	-	8,612,005
Increase (decrease) in net assets	(323,889)	959,551	635,662
Net assets, beginning of year	5,369,167	3,356,192	8,725,359
Net assets, end of year	$ 5,045,278	$ 4,315,743	$ 9,361,021

See accompanying notes to combined financial statements and independent auditor’s report.

Mercy House Living Centers and Affiliate
Combined Statement of Functional Expenses
For the Year Ended June 30, 2017

	Housing	Living Skills	Management & General	Fundraising & Development	Total
Salaries and payroll taxes	$ 128,560	$ 2,374,384	$ 447,991	$ 232,955	$ 3,183,890
Workers compensation	7,783	126,168	9,897	2,951	146,799
Health insurance	2,534	220,670	38,880	17,853	279,937
Payroll service fees	19	23,782	3,998	1,078	28,877
Seminars and conferences	-	6,998	3,881	3,530	14,409
Travel	494	29,410	1,654	956	32,514
Office supplies	355	98,700	2,855	2,830	104,740
Postage	-	1,005	2,801	1,452	5,258
Dues and subscriptions	-	1,396	45	-	1,441
Development campaign	-	782	3,467	4,505	8,754
Telephone and fax	1,115	62,961	1,261	994	66,331
Security	999	160	-	8	1,167
Professional fees	-	89,518	27,055	84,083	200,656
Directors and officers insurance	-	8,851	1,388	693	10,932
General liability insurance	68,239	7,775	3,171	199	79,384
Printing	-	5,055	441	1,434	6,930
Newsletters	-	-	-	13,218	13,218
Interest	25,266	-	5,212	-	30,478
Rent	259,104	19,500	-	-	278,604
Taxes and licenses	(8,939)	-	1,194	-	(7,745)
Living assistance and client services and supplies	3,354,247	390,680	7,495	116	3,752,538
Emergency shelter	15,684	627,602	952	43	644,281
Staff development	-	9,598	4,378	735	14,711
Computer and IT	189	11,901	3,134	2,295	17,519
Utilities	137,581	2,414	-	-	139,995
Repairs	90,549	1,866	329	-	92,744
Social development	103	12,191	-	-	12,294
Other administration	1,504	21,967	12,354	5,594	41,419
Small furnishings and equipment	8,397	84,586	(938)	727	92,772
Depreciation	408,561	2,394	8,185	-	419,140
Total functional expenses	$4,502,344	$ 4,242,314	$ 591,080	$ 378,249	$ 9,713,987

See accompanying notes to combined financial statements and independent auditor's report.

Mercy House Living Centers and Affiliate
Combined Statement of Functional Expenses
For the Year Ended June 30, 2016

	Housing	Living Skills	Management & General	Fundraising & Development	Total
Salaries and payroll taxes	$ 114,384	$ 2,200,379	$ 373,908	$ 162,379	$ 2,851,050
Workers compensation	7,367	138,843	5,626	2,363	154,199
Health insurance	-	178,706	30,018	15,091	223,815
Payroll service fees	41	31,947	4,620	721	37,329
Seminars and conferences	-	3,035	3,825	9,125	15,985
Travel	1,485	18,290	1,705	1,442	22,922
Office supplies	745	96,897	7,886	2,283	107,811
Postage	-	1,074	2,794	1,544	5,412
Dues and subscriptions	-	416	-	-	416
Development campaign	3,750	1,305	3,846	1,856	10,757
Telephone and fax	1,626	60,060	3,556	575	65,817
Security	3,122	11	158	(1)	3,290
Professional fees	3,856	83,486	27,223	353	114,918
Directors and officers insurance	-	6,654	380	268	7,302
General liability insurance	38,052	6,076	1,665	-	45,793
Printing	43	5,032	1,401	6,516	12,992
Newsletters	-	-	43	17,512	17,555
Interest	25,100	1,667	5,594	-	32,361
Rent	250,562	250	-	-	250,812
Taxes and licenses	36,012	(10)	270	-	36,272
Living assistance and client services and supplies	2,556,772	244,212	12,041	-	2,813,025
Emergency shelter	630,456	315,222	-	-	945,678
Staff development	-	1,185	8,157	340	9,682
Computer and IT	65	17,395	6,453	2,047	25,960
Utilities	146,032	261	1,377	-	147,670
Repairs	133,560	1,601	1,209	6	136,376
Social development	352	11,921	-	-	12,273
Other administration	15,830	17,667	5,240	4,251	42,988
Small furnishings and equipment	24,442	4,069	108	-	28,619
Depreciation	420,851	3,166	8,909	-	432,926
Total functional expenses	$4,414,505	$ 3,450,817	$ 518,012	$ 228,671	$ 8,612,005

See accompanying notes to combined financial statements and independent auditor's report.

Mercy House Living Centers and Affiliate
Combined Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Decrease in unrestricted net assets	$ (281,152)	$ (323,889)
(Decrease) increase in temporarily restricted net assets	(35,165)	959,551
Total (decrease) increase in net assets	(316,317)	635,662
Adjustments to reconcile (decrease) increase in net assets to net cash provided (used) by operating activities:		
Depreciation expense	419,140	432,926
In-kind contribution - interest-free loan	-	(27,309)
In-kind contribution - free rent	(53,495)	(1,205,280)
Rent accretion	146,881	139,239
(Increase) decrease in assets:		
Accounts receivable	140,000	-
Grants receivable	(110,921)	(382,462)
Contributions receivable	(55,418)	100,845
Prepaid expenses	(28,720)	(15,387)
Deposits	2,250	(800)
Increase in liabilities:		
Accounts payable	134,307	84,509
Accrued expenses	27,904	38,033
Resident deposits	540	4,382
Deferred revenue	4,863	13,898
Accrued interest	3,846	3,846
Total adjustments	631,177	(813,560)
Net cash provided (used) by operating activities	314,860	(177,898)
Cash flows from investing activities		
Purchases of property and equipment	(48,263)	(51,111)
Cash flows from financing activities		
Borrowings on line of credit	350,000	400,000
Payments on line of credit	(550,000)	(247,100)
Interest accretion	21,419	21,254
Net cash (used) provided by financing activities	(178,581)	174,154
Net increase (decrease) in cash and cash equivalents	88,016	(54,855)
Cash and cash equivalents, beginning of year	194,115	248,970
Cash and cash equivalents, end of year	$ 282,131	$ 194,115

See accompanying notes to combined financial statements and independent auditor's report.

Mercy House Living Centers and Affiliate
Combined Statements of Cash Flows (Continued)
For the Years Ended June 30, 2017 and 2016

Supplemental Disclosure of Cash Flow Information

	2017	2016
Cash paid during the year for interest	$ 5,212	$ 7,261

Supplemental Disclosure of Noncash Investing and Financing Activities

During the year ended June 30, 2016, Mercy House Living Centers financed rehabilitation of real estate with a non-interest bearing loan, reported at present value, using a 4% imputed market rate of interest, of approximately $12,000 (see Note 5).

See accompanying notes to combined financial statements and independent auditor's report.

1. Organization

Nature of Activities

Mercy House Living Centers (MHLC) was incorporated as a nonprofit public benefit corporation under the laws of the State of California on June 29, 1988. MHLC provides housing and comprehensive supportive services for a variety of homeless populations that include families, adult men and women, mothers and their children, persons living with HIV and/or AIDS, individuals overcoming substance addictions, and some who are physically and mentally disabled. MHLC is based in Santa Ana, California.

Mercy House CHDO, Inc. (CHDO) was incorporated as a nonprofit public benefit corporation under the laws of the State of California on December 15, 2005. CHDO was created to assist and support MHLC's existing transitional housing activities.

During the year ended June 30, 2015, CHDO partnered with Wakeland Corporation to form a limited partnership (Camp Anza, L.P.) in order to develop Camp Anza, a supportive housing project for veterans in Riverside, California (Note 8). CHDO held a 0.0049% interest in Camp Anza, L.P. and reported its investment on the cost basis. Camp Anza, L.P. indemnified CHDO from third-party suits brought against CHDO, as a general partner, pursuant to certain conditions as described in the partnership agreement. On April 1, 2017, CHDO voluntarily withdrew from the partnership as managing general partner and transferred and assigned its right, title, and interest in the managing general partner interest to Wakeland Opportunities for Affordable Housing.

During the year ended June 30, 2016, CHDO partnered with CDP Newport LLC and Community Development Partners to form a limited partnership (Newport Veterans Housing LP) in order to purchase and rehabilitate certain real property in Newport Beach, California for the purpose of providing affordable rental housing for low-income tenants. CHDO holds a 0.0041% interest in Newport Veterans Housing LP and reports its investment on the cost basis. Newport Veterans Housing LP indemnifies CHDO from third-party suits brought against CHDO, as a general partner, pursuant to certain conditions as described in the partnership agreement.

During the year ended June 30, 2017, CHDO partnered with Aqua CDP LLC, Affordable Housing Alliance II, Inc., and Community Development Partners to form a limited partnership (Aqua Housing LP) in order to purchase and rehabilitate certain real property in Santa Ana, California for the purpose of providing affordable rental housing for low-income tenants. CHDO holds a 0.0041% interest in Aqua Housing LP and reports its investment on the cost basis. Aqua Housing LP indemnifies CHDO from third-party suits brought against CHDO, as a general partner, pursuant to certain conditions as described in the partnership agreement.

The accompanying combined financial statements include the accounts of MHLC and CHDO (together, Mercy House), which are under common control.

Programs

Homeless Prevention Program: Mercy House provides rental assistance with supportive services to Orange County families and individuals at risk of becoming homeless due to a financial crisis.

Mercy House Access Centers: The Ontario and San Bernardino Access Centers provide emergency services and resources that address the immediate needs of the homeless and at-risk populations in San Bernardino and Ontario.

Emergency (Cold Weather) Shelter Program: Mercy House provides emergency lodging, meals, showers, and supportive services for up to 400 individuals nightly during the cold weather months at the Santa Ana and Fullerton National Guard armories.

1. Organization (Continued)

Redirection Program: Mercy House designed this program specifically for armory families with children. It offers immediate alternative placement with case management services aimed at moving families directly into permanent or transitional housing.

Transitional Shelters: Mercy House has programs in Ontario and throughout Orange County to assist various homeless populations with finding permanent housing options.

Permanent Housing: Mercy House owns and operates several housing units in Orange County and the City of Ontario for low-income individuals and families. Clients receive various supportive services.

2. Summary of Significant Accounting Policies

Principles of Combination

All significant inter-organization transactions have been eliminated in the accompanying combined financial statements.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. Actual results could differ from those estimates.

Net Asset Classifications

Mercy House reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Net assets of the two restricted classes are created only by donor-imposed restrictions on their use. All other net assets, including Board-designated amounts, are legally unrestricted, and are reported as part of the unrestricted class.

Unrestricted net assets consist of funds that are fully available for Mercy House to utilize in any of its programs or supporting services at the discretion of the Board of Directors.

Temporarily restricted net assets consist of funds that are restricted by donors for a specific time period or purpose.

Permanently restricted net assets consist of funds that contain donor-imposed restrictions requiring the principal be invested in perpetuity and that only the income be used. Income earned on these funds may be unrestricted or temporarily restricted, depending upon the donor-imposed restrictions. There were no permanently restricted net assets at June 30, 2017 and 2016.

Support and Revenue

Grants were received from various governmental agencies and private foundations. The majority of grant funds were used for program related purposes, acquisition of property, and improvements to facilities owned by Mercy House.

A portion of government grants received are passed through to subrecipients. During the years ending June 30, 2017 and 2016, subrecipient pass-through expenses totaled approximately $976,000 and $452,000, respectively, which are included in living assistance and client services and supplies in the combined statements of functional expenses.

2. Summary of Significant Accounting Policies (Continued)

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as additions to temporarily restricted or permanently restricted net assets. When a temporary restriction has been satisfied, the related temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as “net assets released from restrictions.”

When donor restrictions on contributions are satisfied in the same period as the receipt of the contribution, Mercy House reports both revenue and the related expense in the unrestricted net asset category.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits, market rate savings, and short-term, highly liquid investments readily convertible into cash within 90 days of purchase.

Grants Receivable

Grants receivable are recorded when an obligation from a granting agency is committed in writing and when qualifying expenditures are made in connection with grants that provide for reimbursement of such expenditures. Management believes that all grants receivable as of June 30, 2017 and 2016 were fully collectible; therefore, no allowance for doubtful accounts was recorded.

Promises to Give

Unconditional promises to give are reported at fair value at the date the promise is received. Conditional promises to give are recognized when the conditions on which they depend are substantially met or if the likelihood that such conditions would not be met is considered to be remote.

Property and Equipment

Fixed assets are stated at cost or, if donated, at the approximate fair value on the date of donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to be used for a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, Mercy House reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. Mercy House reclassifies temporarily restricted net assets to unrestricted net assets at that time. Property and equipment are depreciated using the straight-line method over their estimated useful lives (40 years for buildings and 5 to 10 years for furniture and equipment). Expenditures that extend the useful life of the asset or enhance its productivity are capitalized.

Impairment of Long-Lived Assets

Mercy House’s long-lived assets include land, buildings, and equipment. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the expected future cash flow from the use of the asset and its eventual disposition is less than the carrying amount of the asset, an impairment loss is recognized and measured using the fair value of the related asset. As of June 30, 2017 and 2016, Mercy House did not identify any material impairment of its long-lived assets.

Reclassifications

Certain amounts in the prior year comparative information have been reclassified to conform to the current year financial statement presentation. These reclassifications have no effect on previously reported net assets.

2. Summary of Significant Accounting Policies (Continued)

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the combined statements of activities and changes in net assets and combined statements of functional expenses. Functional expenses have been allocated among the programs and supporting services based, in part, on direct costing (such as time spent, supplies used, etc.) and in part on an analysis of personnel time and facilities utilized for the related activities.

Income Taxes

Mercy House is exempt from Federal and California income tax under Internal Revenue Code Section 501(c)(3) and similar provisions of the State of California Revenue and Taxation Code. Mercy House's federal income tax and informational returns for the fiscal years ended June 30, 2014, and subsequent, remain open for examination by the Internal Revenue Service. The returns for California, Mercy House's only state jurisdiction, remain open for examination by the California Franchise Tax Board for the fiscal years ended June 30, 2013, and subsequent. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the combined financial statements.

In-Kind Donations

Donated non-cash assets are recorded at their estimated fair values at the date of receipt if there is an objective basis available to measure their value. The estimated fair values of donated assets reflected in the combined financial statements as in-kind contributions are as follows for the years ended June 30:

	2017	2016
Interest free loans (Note 5)	$ -	$ 27,309
Facility rent (Note 7)	53,495	1,205,280
Goods and services	11,263	5,500
Total	$ 64,758	$ 1,238,089

The value of contributed services would be recognized if the services received create or enhance nonfinancial assets or require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Services valued at $5,500 for financial advisory services from a member of the Board of Directors were recorded as in-kind donations during the year ended June 30, 2016. A substantial number of volunteers have made significant contributions of their time to help develop Mercy House's programs and activities. Except as described above, no amounts have been reported in the combined financial statements for these donated services because the services do not meet the above noted reporting requirements.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. This ASU will simplify the face of the financial statements by eliminating the distinction between resources with permanent restrictions and those with temporary restrictions, while at the same time enhancing the footnote disclosures to provide financial statement readers with more useful information about an entity's resources and changes in those resources. This ASU will be effective for fiscal years beginning after December 15, 2017. Management is evaluating the impact of adopting this new ASU on the combined financial statements.

2. Summary of Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU will require entities to recognize lease assets and lease liabilities on the face of the financial statements and to disclose key information about leasing arrangements to enable readers of the financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. This ASU will be effective for fiscal years beginning after December 15, 2019. Management is evaluating the impact of adopting this new ASU on the combined financial statements.

3. Contributions Receivable

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the projected fair value (future value) of the underlying assets at the date that those assets are expected to be received. The discounts on those amounts are computed using the rates at which Mercy House can borrow money applicable to the years in which the promises are received. In cases in which the future fair value of the underlying asset is difficult to determine, the fair value of an unconditional promise to give is based on the fair value of the underlying asset at the date of initial recognition, with no discount computed.

Contributions receivable consists of the following as of June 30:

	2017	2016
Long-term lease (Notes 6 and 7)	$ 1,035,023	$ 1,128,411
United Way - rapid rehousing	43,750	-
Bethany House and Regina House operations	45,000	45,000
Living with Heart Gala pledges	11,670	-
Total contributions receivable	$ 1,135,443	$ 1,173,411

Amounts expected to be collected during the years ended June 30 are:

2018	$ 285,510
2019	126,765
2020	120,528
2021	120,528
2022	120,528
Thereafter	361,584
	$ 1,135,443

4. Line of Credit

Mercy House has a revolving line of credit with California United Bank, with maximum borrowings of $800,000. The credit facility bears interest at prime plus 1.0% (5.25% at June 30, 2017), is collateralized by a deed of trust, and matures on November 15, 2018.

5. Long-Term Debt

Long-term debt consisted of the following as of June 30, 2017 and 2016:

	2017	2016
Note payable of $128,200 with government agency due March 2023, with interest at 3% due on outstanding balance. The note is secured by a trust deed on land and a building. Terms of the arrangement call for an annual installment payment including interest, in an amount equal to the "net income" of the property. "Net income" is defined as rental income in excess of the following expenditures: debt service on senior liens, taxes, maintenance and operating expenses, and a reasonable reserve for replacement costs. The property is used to house single mothers and children. Mercy House does not charge rental income to house its single mothers and children and, therefore, does not have "net income" as defined in the terms of the note payable arrangement, so no principal or interest payments have been made on the balance. Cumulative accrued interest on the note payable was $93,358 and $89,512 as of June 30, 2017 and 2016, respectively.	$ 128,200	$ 128,200
Four notes payable, dated April 2006, to a government agency originally aggregating $205,376. The notes are non-interest bearing, secured by deeds of trust, and due and payable at the end of the 55 year terms, at which point the terms may be renegotiated. The notes are reported at their net present value, using a 6.5% imputed market rate of interest (the 30-year fixed mortgage rate in April 2006) over 55 years. The differences between the face value and the net present value of the notes were recorded as temporarily restricted in-kind contributions and are being released from restriction over 55 years in conjunction with the interest accretion (see Note 6).	12,644	11,851
Draw-down note payable, dated February 28, 2014, to a government agency with maximum borrowings of $1,523,858. Cumulative draw downs on the note were $1,488,083 as of June 30, 2017 and 2016. The note is non-interest bearing, secured by a deed of trust, and due and payable at the end of the 30 year term. The note is reported at its net present value, using a 4.0% imputed market rate of interest (the 30-year fixed mortgage rate in February 2014) over 30 years. The difference between the face value and the net present value of the note was recorded as a temporarily restricted in-kind contribution and is being released from restriction over 30 years in conjunction with the interest accretion (Note 6).	526,880	506,254
Total long-term notes payable	$ 667,724	$ 646,305

5. Long-Term Debt (Continued)

Annual principal payments required on the notes are as follows for the years ending June 30:

2018	$	-
2019		-
2020		-
2021		-
2022		-
Thereafter		667,724
Total	$	667,724

The reconciliations of the net present value of the non-interest bearing notes to the temporarily restricted net assets (Note 6) are as follows as of June 30:

2017		
Face Value	Net Present Value	Temporarily Restricted
$ 205,376	$ 12,644	$ 192,732
$ 1,488,083	$ 526,880	961,203
		$ 1,153,935

2016		
Face Value	Net Present Value	Temporarily Restricted
$ 205,376	$ 11,851	$ 193,525
$ 1,488,083	$ 506,254	981,829
		$ 1,175,354

6. Temporarily Restricted Net Assets

Two notes payable, originally dated December 2011 and amended several times through 2013, to a government agency aggregating $1,001,105. The notes are non-interest bearing, secured by deeds of trust and, if there are no uncured events of default under the Regulatory Agreements or the deeds of trust, will be forgiven at the end of the 30 year terms. The face values of the notes are reported as temporarily restricted net assets, as management considers the likelihood of default and repayment to be remote.

Two notes payable, originally dated February 2013 and amended in April 2013, to a government agency aggregating $930,873. The notes are non-interest bearing, secured by deeds of trust and, if there are no uncured events of default under the Regulatory Agreements or the deeds of trust, will be forgiven at the end of the 30 year terms. The face values of the notes are reported as temporarily restricted net assets, as management considers the likelihood of default and repayment to be remote.

6. Temporarily Restricted Net Assets (Continued)

Temporarily restricted funds were as follows as of June 30:

	2017	2016
In-kind rent (Note 7)	$ 1,035,023	$ 1,128,411
Loan forgiveness	1,931,978	1,931,978
Interest-free loans (Note 5)	1,153,935	1,175,354
United Way	43,750	-
Program operations	115,892	80,000
Total temporarily restricted net assets	$ 4,280,578	$ 4,315,743

7. Operating Leases

Mercy House leases real estate (Assisi House) from the City of Ontario under a 10 year lease agreement, originally dated July 1, 2005, and renewed for an additional 10 year period effective July 1, 2015. No rent is required from Mercy House. Management was unable to estimate the future fair value of the free rent as of the date of the renewal agreement, therefore, the fair value of the unconditional promise to give was based on the fair value of the free rent as of the date of initial recognition (see Note 3). The fair value of the 10 year term is included in contributions receivable and temporarily restricted net assets as of June 30, 2017 and 2016 and is being amortized over the life of the lease. The fair value of the rent was estimated at approximately $121,000 for each of the years ended June 30, 2017 and 2016, and is included in expenses and net assets released from restrictions in the statements of activities. Mercy House leases this property in conjunction with the Continuum of Care program, as described in Note 12.

Mercy House leases real estate (the Ontario Access Center) from the City of Ontario under a 5 year lease agreement, dated October 15, 2013. No rent is required from Mercy House. Management was unable to estimate the future fair value of the free rent as of the date of the agreement, therefore, the fair value of the unconditional promise to give was based on the fair value of the free rent as of the date of initial recognition. The fair value of the 5 year term is included in contributions receivable and temporarily restricted net assets and is being amortized over the life of the lease. The fair value of the rent is estimated at approximately $19,000 per year and is included in expenses and net assets released from restrictions in the statements of activities for each of the years ended June 30, 2017 and 2016. Mercy House leases this property in conjunction with the Continuum of Care program, as described in Note 12.

Mercy House leases the Kraemer Place year-round shelter (Note 13) from the County of Orange under a 20 year lease agreement, with an option to extend the lease for two ten year periods. No rent is required from Mercy House. Mercy House considers the 20 year lease term to be conditional upon renewal of the service contract for operating the shelter. As such, Mercy House records, as an unconditional promise to give, the fair value of the free rent through June 30, 2018, the termination date of the service contract. The fair value of the rent is estimated at approximately $46,000 per year.

The aggregate fair values of the free rent for the long-term leases of Assisi House, the Ontario Access Center, and Kraemer Place for the years ended June 30, 2017 and 2016 were approximately $147,000 and $139,000, respectively, and are included in rent expense in the combined statements of functional expenses. (See Note 3 for contributions receivable and Note 6 for temporarily restricted net assets related to in-kind rent).

7. Operating Leases (Continued)

Mercy House leases office space under an operating lease agreement originally dated in October 2011 and amended and extended in June 2015 to May 31, 2018. The monthly rental charge was approximately $4,700 as of June 30, 2017. For the years ended June 30, 2017 and 2016, total rent expense was approximately $56,000 and $54,000, respectively, under this lease.

Mercy House leases five copiers under operating lease agreements that terminate between September 2019 and May 2022 with monthly lease rates ranging from $167 to $1,093. For the years ended June 30, 2017 and 2016, total rent expense was approximately $25,000 and $20,000, respectively, under these leases.

Future minimum rental obligations under the leases are as follows for the years ending June 30:

	Facility	Equipment	Total
2018	$ 52,085	$ 23,264	$ 75,349
2019	-	23,264	23,264
2020	-	20,267	20,267
2021	-	17,294	17,294
2022	-	12,766	12,766
	$ 52,085	$ 96,855	$ 148,940

8. Related Party Transactions

During the years ended June 30, 2017 and 2016, Mercy House received approximately $168,000 and $154,000, respectively, in contributions from its Board of Directors.

During the year ended June 30, 2015, CHDO received $180,000 in funding through Camp Anza, L.P. (Note 1) for developer fees and accrued an additional $180,000 in accounts receivable to be received when the project is ready to operate. CHDO provided supportive services to the project during the year ended June 30, 2016 through Mercy House staff. As of June 30, 2017, $40,000 of the accounts receivable balance remains outstanding.

9. Concentrations and Contingencies

The County of Orange and the United States Department of Housing and Urban Development together accounted for approximately 61% of Mercy House's contributions and grants for the year ended June 30, 2017. The County of Orange and the City of Ontario together accounted for approximately 69% of Mercy House's grants and contributions receivable as of June 30, 2017. The County of Orange, the City of Ontario, and the United States Department of Housing and Urban Development together accounted for approximately 64% of Mercy House's contributions and grants for the year ended June 30, 2016. The City of Ontario, the Children and Families Commission of Orange County, and the County of Orange together accounted for approximately 70% of Mercy House's grants and contributions receivable as of June 30, 2016.

Governmental agencies that gave grants for the purchase and rehabilitation of the land and buildings on which Mercy House operates its shelters have liens against the various properties that they could enforce should Mercy House cease to operate the properties as homeless shelters or sell or otherwise dispose of the properties. Management has no intention to cease operating the properties as homeless shelters or to sell or otherwise dispose of the properties.

9. Concentrations and Contingencies (Continued)

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, deposits of up to $250,000 at FDIC-insured institutions are covered by FDIC insurance. At times, deposits may be in excess of the FDIC insurance limit; however, management does not believe Mercy House is exposed to any significant related credit risk.

10. Retirement Plan

Mercy House has a Simple IRA program for its employees. The program calls for Mercy House to make matching contributions up to 3% of an employee's salary. Employer matching contributions totaled approximately $25,000 and $20,000 for the years ended June 30, 2017 and 2016, respectively.

11. Special Event Activities

Mercy House conducted the following special events for fundraising purposes during the years ended June 30:

	2017		
	Proceeds	Direct Expenses	Net
Living With Heart Gala	$ 376,973	$ 156,632	$ 220,341
Golf Tournament	88,885	22,419	66,466
Bethany House Fashion Show	28,651	11,383	17,268
Miscellaneous Events	6,646	10,470	(3,824)
Total	$ 501,155	$ 200,904	$ 300,251

	2016		
	Proceeds	Direct Expenses	Net
Living With Heart Gala	$ 310,034	$ 138,956	$ 171,078
Golf Tournament	72,241	24,021	48,220
Bethany House Fashion Show	49,337	12,305	37,032
Miscellaneous Events	13,907	3,050	10,857
Total	$ 445,519	$ 178,332	$ 267,187

12. Continuum of Care Program

Mercy House is part of the Homeless Services Continuum of Care Program (the CoC), which provides a comprehensive homeless strategy to assist homeless individuals and families to become self-sufficient. The CoC includes a homeless outreach service center at the Ontario Access Center (Note 7), which provides emergency case management, basic hygiene kits, clothing vouchers, bus coupons, and other such homeless outreach services; transitional housing units and supportive services at Assisi House (Note 7); and affordable permanent housing units and optional supportive services. The CoC award from the City of Ontario is $368,000, which is comprised of government grants renewed annually and rental income received from the permanent housing units.

12. Continuum of Care Program (Continued)

The permanent housing units are in four Ontario locations. One property, owned by MHLC, was financed with the draw-down note payable (Note 5). MHLC granted the Ontario Housing Authority the option to purchase this property from MHLC in the event that the sum of the grant funding and rental income from the CoC program is less than $368,000. The purchase price would equal the then outstanding balance on the draw-down note payable. One property is subject to a 10 year lease agreement between MHLC and the Ontario Housing Authority effective July 1, 2015. Two properties are subject to 99 year lease agreements between CHDO and the City of Ontario effective July 1, 2015. In accordance with the three lease agreements, annual rent is calculated as the greater of $1 or the aggregate annual CoC-related government grants and rental income received in excess of $368,000. In-kind rent was not accrued as a promise-to-give, as the free rents are conditional upon the renewal of and the proceeds earned under the CoC award.

The aggregate CoC-related government grants and rental income received in excess of the CoC award were approximately $7,000 and $22,000, which are included in accounts payable in the combined statements of financial position as of June 30, 2017 and 2016, respectively.

13. Bridges at Kraemer Place

During September 2016, the Orange County Board of Supervisors selected MHLC to operate Bridges at Kraemer Place (Kraemer Place), the county’s first permanent, year-around shelter and multiservice center, located in Anaheim. Kraemer Place is expected to provide shelter to 200 people, with supportive services available to help the homeless in areas such as employment and mental health care. Pursuant to the contract, dated December 29, 2016, the County approved an allocation of $2,775,000 in program funding through June 30, 2018. The shelter opened in May 2017. (See Note 7).

14. Subsequent Events

Management has evaluated subsequent events through September 29, 2017, the date the combined financial statements were available to be issued.

Mercy House Living Centers and Affiliate
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2017

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Total Expenditures to Subrecipients
United States Department of Housing and Urban Development				
Continuum of Care Program*	14.267			
U.S. Department of Housing and Urban Development		CA1351L9D021501	$ 324,654	$ -
U.S. Department of Housing and Urban Development		CA1352L9D021400	103,213	42,112
U.S. Department of Housing and Urban Development		CA1352L9D021501	1,764,340	623,870
U.S. Department of Housing and Urban Development		CA1514L9D021500	685,370	522,395
U.S. Department of Housing and Urban Development		CA0578L9D021508	120,573	-
U.S. Department of Housing and Urban Development		CA1238L9D021401	41,201	-
U.S. Department of Housing and Urban Development		CA1238L9D021502	61,730	-
U.S. Department of Housing and Urban Development		CA1001L9D021502	47,496	-
U.S. Department of Housing and Urban Development		CA1120L9D021402	81,464	-
U.S. Department of Housing and Urban Development		CA1120L9D021503	260,207	-
Subtotal	14.267		3,490,248	1,188,377
Emergency Solutions Grant Program	14.231			
City of Anaheim		E-16-MC-06-0501	19,850	-
City of Ontario		E-16-MC-06-0537	118,117	-
City of Garden Grove		1158071.1	17,500	-
City of Santa Ana		E-16-MC-06-0508	82,034	-
County of Orange		E-16-UC-06-0504	200,795	-
State of California		14-ESG-10290	29,616	-
State of California		16-22-0039-ESG	8,373	-
Subtotal	14.231		476,285	-
Community Development Block Grant	14.218			
City of Costa Mesa		16-17 Contract	18,650	-
City of Fullerton		B-16-MC-06-0504	15,000	-
City of Ontario		B-16-MC-06-0537	52,249	-
City of Tustin		FY 16/17-03	5,000	-
County of Orange		B-16-UC-06-0504	184,236	-
County of Orange - Neighborhood Stabilization Program:				
Loan balance		DO012-13011048	933,585	-
Loan balance		DO012-10018622	504,750	-
Loan balance		DO012-14018685	493,259	-
Subtotal	14.218		2,206,729	-

See accompanying notes to schedule of expenditures of federal awards and independent auditor’s report.

Mercy House Living Centers and Affiliate
Schedule of Expenditures of Federal Awards (Continued)
For the Year Ended June 30, 2017

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Total Expenditures to Subrecipients
HOME Investment Partnerships Program	14.239			
City of Ontario		ONTCA-0000038378	$ 54,678	$ -
City of Ontario II		45774.00420/29735060.4	143,298	-
City of Huntington Beach		16/5435/143675/DO	143,446	-
City of Santa Ana:				
Loan balance		1000026890	71,328	-
Loan balance		1000026893	31,360	-
City of Ontario - Loan balance		MHLC	1,488,083	-
Subtotal	14.239		1,932,193	-
United States Department of Homeland Security				
Emergency Food and Shelter National Board Program	97.024			
County of Orange		78600026	69,732	-
County of San Bernardino		Phase 33	8,516	-
Subtotal	97.024		78,248	-
Total Expenditures of Federal Awards			$ 8,183,703	$ 1,188,377

*MAJOR PROGRAM

See accompanying notes to schedule of expenditures of federal awards and independent auditor's report.

Mercy House Living Centers and Affiliate
Notes to Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2017

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (SEFA) includes the federal award activity of Mercy House Living Centers for the year ended June 30, 2017 and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the SEFA presents only a selected portion of the operations of Mercy House Living Centers, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Mercy House Living Centers.

2. Indirect Cost Rate

Mercy House Living Centers has elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

3. Loan Balances with Continuing Compliance Requirements

Mercy House received various governmental loans for the acquisition and rehabilitation of real estate. The outstanding loan balances with continuing compliance requirements were $3,522,365 as of June 30, 2017 and 2016. There were no loans disbursed during the year ended June 30, 2017.

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Audit Committee and Board of Directors of
Mercy House Living Centers
Santa Ana, California

We have audited, in accordance with the 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, the combined financial statements of Mercy House Living Centers (a California nonprofit organization) and affiliate (together, Mercy House), which comprise the combined statement of financial position as of June 30, 2017, and the related combined statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the related notes to the combined financial statements, and have issued our report thereon dated September 29, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered Mercy House's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of Mercy House's internal control. Accordingly, we do not express an opinion on the effectiveness of Mercy House's internal control.

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 entity'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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mercy House's combined financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

www.HBLA.com
19600 Fairchild, Suite 320, Irvine, CA 92612 • (949) 833-2815 Office • (949) 833-2876 Fax

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

HBLA Certified Public Accountants, Inc.

September 29, 2017

Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance

To the Audit Committee and Board of Directors of
Mercy House Living Centers
Santa Ana, California

Report on Compliance for Each Major Federal Program

We have audited Mercy House Living Centers' (a California nonprofit organizations) and affiliate's (together, Mercy House) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Mercy House's major federal programs for the year ended June 30, 2017. Mercy House's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Mercy House's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Mercy House's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Mercy House's compliance.

Opinion on Each Major Federal Program

In our opinion, Mercy House complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

Report on Internal Control over Compliance

Management of Mercy House is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Mercy House's internal control over compliance with the types of requirements that

www.HBLA.com
19600 Fairchild, Suite 320, Irvine, CA 92612 • (949) 833-2815 Office • (949) 833-2876 Fax

could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Mercy House's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

HBLA Certified Public Accountants, Inc.

September 29, 2017

Mercy House Living Centers and Affiliate
Summary Schedule of Prior Audit Findings
For the Year Ended June 30, 2017

There were no prior year audit findings or questioned costs relative to federal awards.

Mercy House Living Centers and Affiliate
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2017

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
Material weakness identified?	___ yes _x_ no
Significant deficiency identified that is not considered to be a material weakness?	___ yes _x_ no
Noncompliance material to financial statements noted?	___ yes _x_ no

Federal Awards

Internal control over major programs:	
Material weakness identified?	___ yes _x_ no
Significant deficiency identified that is not considered to be a material weakness?	___ yes _x_ no
Type of auditor's report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR section 200.515(d)(2)?	___ yes _x_ no

Identification of major programs:

CFDA Number	Name of Federal Program
14.267	Continuum of Care Program

Dollar threshold used to distinguish between type A and type B programs: $750,000

Auditee qualified as low-risk auditee? ___ yes _x_ no

Section II – Findings – Financial Statement Audit

There were no findings relative to the financial statement audit.

Section III – Federal Award Findings and Questioned Costs

There were no major federal award program findings required to be reported under 2 CFR section 200.516(a).