CALIFORNIA FRIENDS HOMES

dba ROWNTREE GARDENS

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2018

WITH

INDEPENDENT AUDITOR'S REPORT

kdp
Certified Public Accountants, LLP
audit | tax | advisory | wealth management | cfo

CALIFORNIA FRIENDS HOMES
dba ROWNTREE GARDENS

Year Ended December 31, 2018

Table of Contents

kdp
Certified Public Accountants, LLP
841 O'Hare Parkway, Ste. 200
Medford, OR 97504
P: 541.773.6633
F: 541.773.1965
KDPLLP.COM

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
California Friends Homes
dba Rowntree Gardens

We have audited the accompanying financial statements of California Friends Homes, dba Rowntree Gardens (a non-profit organization), which comprise the statement of financial position as of December 31, 2018, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 financial statements referred to above present fairly, in all material respects, the financial position of California Friends Homes, dba Rowntree Gardens as of December 31, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

The accompanying financial statements have been prepared assuming that the Corporation will continue as a going concern. As discussed in Note 17 to the financial statements, the Corporation has suffered recurring losses from operations, and has experienced other financial challenges. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note 17. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Additionally, as discussed in Note 2 to the financial statements, the Corporation adopted a new accounting standard ASU 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities. Our opinion is not modified with respect to this matter.

Mark E. Damon CPA, Partner
KDP Certified Public Accountants, LLP
Medford, Oregon
May 24, 2019

CALIFORNIA FRIENDS HOMES
STATEMENT OF FINANCIAL POSITION
December 31, 2018

Assets:		
Current assets:		
Cash and cash equivalents	$	1,429,716
Assets held on behalf of residents		22,852
Accounts receivable, net		990,970
Other assets		312,069
Total current assets		2,755,607
Property and equipment, net		8,431,651
Other assets:		
Capital investments		1,077,081
Total other assets		1,077,081
Total assets	$	12,264,339
Liabilities and Net Assets:		
Current liabilities:		
Accounts payable and accrued expenses	$	729,021
Accrued payroll		305,746
Compensated absences		488,445
Assets held on behalf of residents		22,852
Settlement payable		210,000
Current portion long-term debt		72,129
Deferred revenue		375,653
Line of credit		571,571
Total current liabilities		2,775,417
Long-term debt, net of current portion		2,075,000
Deferred revenue from entrance fees		3,465,420
Total liabilities		8,315,837
Net assets:		
Without donor restrictions		3,923,012
With donor restrictions		25,490
Total net assets		3,948,502
Total liabilities and net assets	$	12,264,339

CALIFORNIA FRIENDS HOMES
STATEMENT OF ACTIVITIES
Year Ended December 31, 2018

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues:			
Resident service fees	$ 9,917,739	$ -	$ 9,917,739
Health center revenue	6,935,206	-	6,935,206
Entrance fees earned	692,610	-	692,610
Contributions	-	43,345	43,345
Interest income	200	-	200
Other revenue	374,981	-	374,981
	17,920,736	43,345	17,964,081
Net assets released from restriction	32,781	(32,781)	-
Total revenue, gains and support	17,953,517	10,564	17,964,081
Expenses:			
Program services:			
Dietary services	3,600,953	-	3,600,953
Facility services and utilities	2,606,346	-	2,606,346
Health and social services	10,289,402	-	10,289,402
General and administrative:			
Administrative and marketing	3,998,066	-	3,998,066
Total expenses	20,494,767	-	20,494,767
Operating income (loss)	(2,541,250)	10,564	(2,530,686)
Other Income/(Loss):			
Unrealized change in value of capital investments	263,592	-	263,592
Related party contribution	1,308,730	-	1,308,730
Total other income/(loss)	1,572,322	-	1,572,322
Change in net assets (loss)	(968,928)	10,564	(958,364)
Net assets, beginning of year	4,891,940	14,926	4,906,866
Net assets, end of year	$ 3,923,012	$ 25,490	$ 3,948,502

See notes to financial statements

CALIFORNIA FRIENDS HOMES
STATEMENT OF FUNCTIONAL EXPENSES
Year Ended December 31, 2018 (continued)

	Program Services		
Expense:	**Dietary Services**	**Facility Services and Utilities**	**Health and Social Services**
Employee expenses	$ 1,961,725	$ 1,197,776	$ 7,420,633
Payroll taxes	127,422	72,028	470,317
Legal fees	-	-	-
Accounting / audit fees	-	-	-
Advertising & promotion	-	-	-
Office expense	-	9,929	1,841
Information technology	-	-	-
Occupancy expense	-	795,285	103,577
Travel expense	1,505	-	6,433
Interest expense	-	-	-
Depreciation	191,537	138,563	547,938
Insurance expense	-	-	-
Activities expense	-	-	81,941
Bad debt expense	-	-	15,600
Bank service charges	-	-	-
Contract services	29,536	232,468	150,134
Education & training	1,110	524	7,346
Licensing & memberships	1,368	2,830	39,560
Repairs & maintenance	7,678	155,487	-
Therapy expense	-	-	853,868
Uniforms expense	4,262	1,456	-
Dietary expense & supplies	1,259,960	-	-
Small equipment and tools	14,850	-	13,079
Medical expense & supplies	-	-	577,135
Total	$ 3,600,953	$ 2,606,346	$ 10,289,402

CALIFORNIA FRIENDS HOMES
STATEMENT OF FUNCTIONAL EXPENSES
Year Ended December 31, 2018 (continued)

Total Program Services	Administration and Marketing	2018 Total
$ 10,580,134	$ 1,793,885	$ 12,374,019
669,767	110,208	779,975
-	46,383	46,383
-	51,527	51,527
-	376,423	376,423
11,770	125,588	137,358
-	66,318	66,318
898,862	-	898,862
7,938	31,941	39,879
-	145,402	145,402
878,038	162,291	1,040,329
-	164,053	164,053
81,941	32,954	114,895
15,600	79,780	95,380
-	33,933	33,933
412,138	662,182	1,074,320
8,980	59,210	68,190
43,758	53,168	96,926
163,165	-	163,165
853,868	-	853,868
5,718	-	5,718
1,259,960	-	1,259,960
27,929	2,820	30,749
577,135	-	577,135
$ 16,496,701	$ 3,998,066	$ 20,494,767

CALIFORNIA FRIENDS HOMES
STATEMENT OF CASH FLOWS
Year Ended December 31, 2018

Cash Flows from Operating Activities:		
Cash received from customers	$	17,256,329
Entrance fees received from new residents, net of refunds paid		1,126,550
Other operating cash receipts		375,181
Cash paid to employees and suppliers		(19,287,389)
Interest paid		(145,402)
Contributions received		1,352,075
Net cash provided (used) by operating activities		677,344
Cash Flows from Investing Activities:		
Purchases of property and equipment		(565,340)
Payments received, note receivable		686,979
Net cash provided (used) by investing activities		121,639
Cash Flows from Financing Activities:		
Principal payments toward long-term debt		(67,175)
Net cash provided (used) by financing activities		(67,175)
Net increase (decrease) in cash and cash equivalents		731,808
Cash and cash equivalents, January 1, 2018		697,908
Cash and cash equivalents, December 31, 2018	$	1,429,716
Adjustments to Reconcile to Net Cash Provided (Used) by Operating Activities (Indirect Method):		
Increase (decrease) in net assets	$	(958,364)
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation		1,040,329
Entrance fees received from new residents		1,232,000
Entrance fee refund on early termination		(105,450)
Entrance fees earned		(692,610)
Unrealized change in value of capital investment		(263,592)
Net changes in:		
Accounts receivable, net		27,731
Supplies and prepaid expenses		(40,398)
Accounts payable and accrued expenses		345,287
Accrued payroll		(39,470)
Deferred revenue		375,653
Compensated absences		(33,772)
Settlement payable		(210,000)
Net cash provided (used) by operating activities	$	677,344

See notes to financial statements

CALIFORNIA FRIENDS HOMES
NOTES TO FINANCIAL STATEMENTS
December 31, 2018

NOTE 1 – ORGANIZATION

California Friends Homes, dba Rowntree Gardens (formerly dba Quaker Gardens) Senior Living (the Corporation) was founded in 1962 as a California non-profit public benefit corporation for charitable purposes. The corporation was established to provide residential facilities, health and welfare programs, and various services and sponsor programs for the elderly and operates a continuing care retirement community in Stanton, California. The community consists of 65 (70 beds) independent units and 96 (105 beds) assisted living units, 58 skilled nursing facility units and 25 (50 beds) memory care units.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The financial statements of the Corporation have been prepared on the accrual basis of accounting and are presented in accordance with accounting for financial statements of not-for-profit Corporations, which requires classification of an Corporation's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. The assets, liabilities, revenues, expenses, and net assets of the Corporation are reported in the following categories:

> **Net assets without donor restrictions:** Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the Corporation. These net assets may be used at the discretion of management and the board of directors.
>
> **Net assets with donor restrictions**: Net assets subject to stipulations imposed by donors, and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Corporation. or by the passage of time. Other donor restrictions are perpetual in nature, where by the donor has stipulated the funds be maintained in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the statements of activities.

Performance Indicator - "Unrestricted operating income/(loss)" as reflected in the accompanying statements of activities is the performance indicator. Unrestricted operating income/(loss) includes all changes in net assets without donor restrictions, excluding unrealized change in value of capital investments, restricted contributions, related party contributions, assets released from donor restrictions related to long-lived assets, extraordinary items, and investment returns restricted by donors or law.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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 reported amounts of revenues, expenses, gains and losses during the reporting period. Actual results could differ from those estimates.

Functional Expenses - The costs of providing program and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among different services and supporting services benefited. Such allocations are determined by management on an equitable basis.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Functional Expenses (continued) -

The expenses that are allocated include the following:

Expense	Allocation Method
Other Salaries & Wages	Split
Pension Plan	Split
Other Employee Benefits	Split
Payroll Taxes	Split
Legal Fees	All general/admin
Accounting / Audit Fees	All general/admin
Advertising & Promotion	Split
Office Expense	Split
Information Technology	All general/admin
Occupancy Expense	All program
Travel Expense	Split
Interest Expense	All general/admin
Depreciation	Split
Insurance Expense	Split
Activities expense	All program
Bad Debt Expense	All program
Bank Service Charges	All general/admin
Board Expense	Split
Contract Services	Split
Education / Training	Split
Licensing, Memberships	Split
Repairs & Maintenance	Split
Therapy Expense	All program
Uniforms Expense	All program
Dietary Exp/Supplies	All program
Small Equipment and Tools	Split
Medical Exp/Supplies	All program
Incentives	All program

*Split = 84.4% Program, 15.60% General/Admin

Cash and Cash Equivalents - Cash and cash equivalents include cash and other commercial paper with maturities of three months or less at the date of acquisition.

Assets held on behalf of residents - Assets held on behalf of residents include cash deposits held in the Corporation's name. These monies are distributed to residents when necessary or in the case of death.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accounts Receivable - Accounts receivable primarily represent amounts due from residents for living accommodations, services, and amounts due from third parties. An allowance for doubtful accounts is established based on past collection history and specific identification of uncollectable amounts. The Corporation's policy is to charge off uncollectible receivables when management determines the receivable will not be collected.

Supplies Inventory - The accounting method used to record inventory is the FIFO (First In First Out) method. Inventory is valued at the lower of cost or market value at December 31, 2018.

Property and Equipment - Purchased property and equipment are recorded at cost. Donated property and equipment are recorded at fair value as of the date of contribution. Maintenance, repairs, and minor replacements are charged to expense when incurred. Replacements and betterments with a cost of $1,000 or more are capitalized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39 years. When assets are retired or otherwise disposed of, the cost of the asset and its related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in the Statement of Activities for the period.

The Corporation, using its best estimates based on reasonable and supportable assumptions and projections, reviews for impairment of long-lived assets when indicators of impairment are identified. No impairment losses were present for the year ended December 31, 2018.

Refundable Fees - The Corporation requires each applicant for independent living and assisted living to pay a $1,175 application fee; and each applicant for memory care and skilled nursing care pay a $495 application fee. This fee will be refunded if no move-in occurs. Should the resident move out within the first three months, the fee is subject to a pro-rated refund.

Deferred Revenue from Entrance Fees - Fees paid by a resident upon entering into a continuing care contract are recorded as deferred revenue and are amortized to income over the estimated remaining actuarial life expectancy of the resident. The Corporation has two different non-refundable continuing care contracts, a Lifecare (Type A) contract and a Modified (Type B) contract. California law requires a 90 day cancellation period during which the resident is entitled to a refund of the amounts subject to a fee to process the cancelation. After the cancelation period, residents are entitled to refunds of their entrance fee reduced by 1.67% for each month of residency should they withdraw within the first 60 months. There is no refund of the entrance fee in the event of death. No refunds were pending at December 31, 2018.

Obligation to Provide Future Services - Every five years the Corporation calculates the present value of the net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of deferred revenue from entrance fees. If the present value of the net cost of future services and the use of facilities exceeds the deferred revenue from entrance fees, a liability is recorded (obligation to provide future services and use of facilities) with the corresponding charge to income. At December 31, 2018, no future service liability is deemed to exist.

General Liability Policy - The Corporation has secured claims-made policies for general liability insurance with self-insured retentions of $1,000,000 per claim and $3,000,000 aggregate per policy period. The Corporation has also secured excess general and professional liability insurance with limits of $5,000,000 aggregate per policy period. Policy period begins January 1, 2018 and ends January 1, 2018. The Corporation has not accrued a liability associated with, or claims incurred but not yet reported as amounts could not be estimated and are considered by management to be immaterial. These liabilities would be included in accounts payable and accrued expenses in the accompanying statement of financial position.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributions - Contributions received are recorded as net assets without donor restrictions or net assets with donor restrictions, depending on the existence and/or nature of any donor-imposed restrictions. Contributions that are restricted by the donor are reported as an increase in net assets without donor restrictions if the restriction expires in the reporting period in which the contribution is recognized. All other donor restricted contributions are reported as an increase in net assets with donor restrictions, depending on the nature of restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statements of activities as net assets released from restrictions.

Contributed property and equipment are recorded at fair value at the date of donation. Contributions with donor-imposed stipulations regarding how long the contributed assets must be used are recorded as net assets with donor restrictions; otherwise, the contributions are recorded as net assets without donor restrictions.

Revenue Recognition - Service fees and health center revenues are recognized in the month in which services are provided and collectability is reasonably assured. In addition, health center revenue is presented net of third party rate adjustments. Other revenue is recognized as the related services are provided and include guest services income, catering income, and other miscellaneous income.

Charity Care - As part of its charitable mission, the Corporation provides care without charge or at amounts less than its established rates to residents who meet certain criteria under its charity care policy. Total charges for charity care services amounted to $103,577 for the year ended December 31, 2018.

Tax-Exempt Status - The Corporation has been recognized by the Internal Revenue Service as a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes on related activities. No tax provision has been made in the accompanying statements of activities.

The Corporation recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Corporation recognizes interest and penalties related to income tax matters in operating expenses. At December 31, 2018, there were no such uncertain tax positions.

Advertising - The Corporation expenses advertising costs as incurred. The Corporation incurred advertising costs for the year ended December 31, 2018 of $376,423.

Concentrations of Credit Risk - The Corporation maintains cash balances in several financial institutions located in California. These balances may subject the Corporation to concentrations of risk as, from time to time, cash balances may exceed amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2018 cash balances exceeded amounts insured by the FDIC. Management monitors the financial condition of these institutions on an ongoing basis and does not believe significant credit risk exists at this time.

Concentration of credit risk results from the Corporation granting credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables at December 31, 2018 from residents and third-party payors, is listed at Note 4.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

New Accounting Pronouncement - On August 18, 2016, FASB issued ASU 2016-14, Not-for-Profit Entities (Topic 958) – *Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Corporation has adjusted the presentation of these statements accordingly.

Note 3 – AVAILABILITY AND LIQUIDITY

The following represents the Corporation's financial assets at December 31, 2018:

Financial assets at year end:	
Cash and cash equivalents	$ 1,429,716
Receivables	990,970
Total financial assets	2,420,686
Less amounts not available to be used within one year:	
Net assets with donor restrictions	25,490
Financial assets available to meet general expenditures over the next twelve months	$ 2,395,196

The corporation's goal is generally to maintain cash and cash equivalents available to meet 75 days of general operating expenses (excludes depreciation). Utilizing the 2018 statement of activities, 75 days of general operating expenses approximates $4,014,750. As part of its liquidity plan, the Corporation is currently working toward rebalancing operations to flex with occupancy. Rebalancing operations is intended to reduce general operating expenses and increase financial assets available to meet general expenditures. At December 31, 2018, the Corporation had 26 days of cash and cash equivalents to meet general operating expenses.

NOTE 4 – ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 2018 consisted of the following:

Resident monthly fees	$	240,854
Health care		890,492
Subtotal accounts receivable		1,131,346
Less allowance for doubtful accounts		(140,376)
Total accounts receivable	$	990,970

Health care accounts receivable, gross by payor mix, consisted of the following at December 31, 2018:

Self pay	22%
Medicare	45%
HMO	33%

CALIFORNIA FRIENDS HOMES
NOTES TO FINANCIAL STATEMENTS
December 31, 2018

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2018 consisted of the following:

Land	$ 1,039,386
Land improvements	1,313,857
Building	16,989,838
Furniture and equipment	4,753,594
Automobiles	216,700
Total	24,313,375
Less accumulated depreciation	(15,881,724)
	$ 8,431,651

NOTE 6 – CAPITAL INVESTMENTS

The Corporation has made two investments in which they are active participants: Captive Insurance Company and a Risk Retention Group.

Captive Insurance Company: The Corporation is a shareholder with one other unaffiliated retirement communities in Alternative RE Holdings Limited; Cell 16L, a Bermuda holding company. The Corporation has a 50% ownership in the captive insurance company. There is a separate indemnification agreement where profits and losses are allocated based upon the percentage of participation and profitability of each facility. Arch Insurance Group maintains a re-insurance contract with Cell 16L of Alternative RE to be reimbursed for individual worker's compensation losses for the first $350,000 per claim. There is a separate re-insurance policy purchased by Cell 16L of Alternative RE for individual losses in excess of $350,000 and an aggregate loss limit that includes the two facilities. The group aggregate loss limit changes annually based upon the total payroll for the two facilities. The policy provides coverage as required by the statutory limits of the State of California.

The Captive Insurance Company allocates premiums and losses on an entity-specific basis and therefore, the Corporation accounts for its investment based on its specifically identified premiums paid, hard costs incurred, paid losses, outstanding loss reserves and incurred but not reported reserves, plus the investment income, less dividend distributions multiplied by the percentage of cash in the captive as of the reporting date. Claim experience is identified to each participating entity within the captive insurance company and subsequent premiums will be modified based on the entity's experience. At December 31, 2018 the Corporation's estimated investment in Alternative RE Holdings Limited; was $640,522.

Beginning December 1, 2015, the Corporation elected to be fully insured through an outside source for all new future claims. The Captive will continue to pay all claims applicable to the coverage period.

Risk Retention Group: The Corporation invested in a traditional risk retention group which converted to a reciprocal mutual insurance exchange. It was formed under the Federal Liability Risk Retention Act to insure various affiliated members (subscribers) of a group of faith-based retirement Corporations. The investment amount is recorded at cost plus a reciprocal adjustment, for a total of $436,559 at December 31, 2018. The fair value of the investment is not estimated as there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value. The Corporation documents authorize the return of the charter capital account of a discontinued or withdrawing subscriber within seven years without interest as long as it doesn't cause substantial harm to the group's asset position.

NOTE 7 – OPERATING LEASES

The Corporation has operating leases associated with office equipment. Lease expenses associated with the operating leases was $16,567 for the year ended December 31, 2018. The future minimum lease payments for these leases are as follows:

Year Ending December 31,		
2019	$	16,567
2020		4,142
	$	20,709

NOTE 8 – LINE OF CREDIT

The Corporation has a commercial credit line commitment Farmers & Merchants Bank. The credit line is in the amount of $700,000 with interest at 6.5%. On October 29, 2018, Farmers & Merchants changed the terms of the agreement, extending the maturity date of the principal to October 1, 2019. The amount outstanding at December 31, 2018 was $571,571. The amount charged to interest expense was $37,668 for the year ended December 31, 2018.

NOTE 9 – LONG-TERM DEBT

On January 30, 2014, the Corporation entered into a $2,500,000 Business Loan Agreement and Promissory Note with Farmers & Merchants Bank of Long Beach (the Bank). The Corporation entered into the Business Loan Agreement for the purpose of assisting with the cost of deferred maintenance and upgrades. Monthly payments of principal and interest of $14,360 are due commencing March 1, 2014 (actual payments commenced on May 30, 2014 as the first draw on the note did not occur until April 2014). The initial fixed rate payment was calculated using a term of 300 months. Interest will be fixed at 4.75% for the first 60 months and will then reset to 2.75% over the weekly 10-year nominal constant maturity U.S. Treasury. The loan matures with a final balloon payment on February 1, 2024. The loan is secured by a Deed of Trust on the real property owned by the Corporation.

The loan agreement contains a subjective acceleration clause, which gives the Bank the right to accelerate repayment upon the Bank's determination of a material adverse change in the Corporation's financial position. Management has evaluated the likelihood of the Bank exercising the clause to be remote. As a result, the amounts owed are classified based upon the stated payment schedule.

Interest associated with long-term debt charged to expense for the year ended December 31, 2018 totaled $105,146.

NOTE 9 – LONG-TERM DEBT (continued)

Maturities of long-term debt are shown as follows:

Year Ending December 31,		
2019	$	72,129
2020		75,631
2021		79,302
2022		83,152
2023		87,189
Thereafter		1,749,726
	$	2,147,129

NOTE 10 – RELATED PARTY TRANSACTIONS

Friends Church Southwest Yearly Meeting (FCSYM) is the sole corporate member of California Friends Inc. (CFI), CFI is the sole corporate member of the Corporation. CFI is also the sole corporate member of California Friends Foundation, Inc. (CFF).

For the year ended December 31, 2018, the Corporation received $1,308,730 in unrestricted cash donations from CFF.

On February 28, 2013, the Boards of Directors of California Friends Inc. and the Corporation elected to retain the services of a current Board Member of the Corporation. The current Board Member is serving as the contract Chief Executive Officer for the Corporation. For the year ended December 31, 2018, the Corporation paid $186,624 to this Board Member for management and oversight services.

NOTE 11 – THIRD-PARTY RATE ADJUSTMENTS AND REVENUE

Approximately 45% of health center revenue for the year ended December 31, 2018, was derived under federal third-party reimbursement programs. These revenues are based, in part, on cost reimbursement principles and are subject to audit and retroactive adjustment by the respective third-party fiscal intermediary. In the opinion of management, retroactive adjustments, if any, would not be material to the financial position, the changes in net assets, or cash flows of the Corporation.

NOTE 12 – RETIREMENT PLAN

On June 1, 2011 the Corporation adopted a new 403(b) matching retirement plan that covers employees who have reached the age of 21 and have completed 12 months of eligibility service. Employees who normally work fewer than 30 hours per week are not covered under the plan for purposes of receiving employer contributions. Contributions to the plan are based on a match of the employee’s own contribution, which is discretionary, up to a maximum of 2.5% of employee’s eligible compensation.

Total contributions charged to expense for the plan was $103,795 for the year ended December 31, 2018.

NOTE 13 – TEMPORARILY RESTRICTED NET ASSETS

Net assets with specific purpose donor restrictions were available for the following purposes at December 31, 2018:

Chapel maintenance	$	4,559
Faith fund		4,375
General Chapel		16,556
Net assets with donor restrictions	$	25,490

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 820 *Fair Value Measurements and Disclosures* defines fair value as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC Topic 820 describes three levels of inputs 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 Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or net asset value per share (or its equivalent) with the ability to redeem the investment in the near term.

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.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying statement of financial position at December 31, 2018, as well as the general classification of such instruments pursuant to the valuation hierarchy.

The Corporation has an interest in a Captive Insurance Company. The Corporation accounts for its investment based upon on its specifically identified premiums paid, hard costs incurred, paid losses, outstanding loss reserves and incurred but not reported reserves, plus the investment income, less dividend distributions multiplied by the percentage of cash in the captive as of the reporting date.

The carrying values of cash, accounts receivable, accounts payable and accrued liabilities, and refundable fees approximate fair value due to the short maturity of such instruments.

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table presents the fair value hierarchy for those assets measured at fair value on a recurring basis at December 31, 2018:

	Level 1	Level 2	Level 3	Total
Assets:				
Capital investment in Captive Insurance	$ -	$ -	$ 640,522	$ 640,522
Total assets	$ -	$ -	$ 640,522	$ 640,522

The following table reconciles the beginning and ending balances of recurring fair value measurements recognized in the accompanying financial statements using significant unobservable (Level 3) inputs:

	Level 3 Funds
Balance, January 1, 2018	$ 376,930
Included in changes in unrestricted net assets	263,592
Balance, December 31, 2018	$ 640,522

NOTE 15 – SETTLEMENT PAYABLE

During the year ended December 31, 2018, the Corporation entered into a Stipulation of Settlement in connection with a complaint filed in Orange County Superior Court. In connection with the Stipulation of Settlement, the Corporation agreed to pay certain class representatives $420,000. At December 31, 2018, the balance of this settlement payable was $210,000. The Corporation paid the remainder of the settlement balance ($210,000) on April 1, 2019 (subsequent to December 31,2018).

NOTE 16 – COMMITMENTS AND CONTINGENCIES

Litigation – The Corporation is party to various claims and legal actions in the normal course of business. In the opinion of management, the Corporation has substantial meritorious defenses to pending or threatened litigation and, based upon current facts and circumstances, the resolution of these matters is not expected to have a material adverse effect on the financial position of the Corporation.

Asbestos Abatement – The Corporation is aware of the existence of asbestos in certain areas of its buildings. The Corporation has not recorded a liability for any asbestos abatement costs because the cost cannot be reasonably estimated at this time. At such time in the future that plans are made to make changes to structures with asbestos and the related asbestos removal cost estimates are completed, the Corporation will record an estimate of the costs of the required asbestos abatement.

Lifecare Agreement – The Corporation has agreed to enter into a Lifecare Agreement with a former member of executive management and his spouse. As part of this agreement, the entrance fee and all monthly fees (at all levels of care) will be waived. On January 16, 2012, the Lifecare Agreement was executed. The former executive has yet to move into the facility. The Corporation has not recorded a liability associated with this agreement as it is uncertain if the former member of management will occupy the facility.

Note 17 – GOING CONCERN

Principal conditions that raise doubt about the Corporation's ability to continue as a going concern –

During the year ending December 31, 2018, the following conditions raised concern about the entity's ability to continue as a going concern: 1) the Corporation has suffered recurring losses from operations, 2) at certain points during the year ending December 31, 2018, the Corporation dropped below the required level of operating liquidity required by the California Health and Safety Code section 1792, and 3) due to the operating liquidity concerns, the Corporation was required by the California Department of Social Services (DSS) to provide a financial plan pursuant to Health and Safety Code section 1793.13.

Management has evaluated the significance of the conditions that raise doubt about the Corporation's ability to continue as a going concern and developed the following plans –

During the fourth quarter of 2018, management started to formally develop a plan to "right size" the operational aspects of its business. As part of the plan, management hired a third party sales consultant to provide recommendations and assistance with its sales process. Management provided its formal financial plan to the Department of Social Services in February of 2019. The financial plan focused on the following action items -

1. Organizational Structure – the Corporation developed an organizational chart that provided a transparent organizational structure that delegated responsibilities accordingly.
2. As part of the Corporation's analysis, it identified significant opportunity in relation to its staff to resident ratios. The Corporation determined this key performance metric was out of alignment with industry standards and as a result, a formal plan was developed to transition toward industry standards.
3. The Corporation hired a third party sales consultant to perform an in-depth marketing and sales assessment. The Corporation received the recommendations from the report in January of 2019 (Strengths, Opportunities, Aspirations, and Results).
4. The Corporation developed a monthly monitoring dashboard with a summary of key performance indicators and cash flows.
5. Utilizing historic and anticipated (budgeted) results for 2019, the Corporation developed certain forecasts which denoted base-case, mid-case, and best case scenarios.

Utilizing the historical information, it became clear that while occupancy declined over the past year the Corporations full time employee count increased. Utilizing historical data it was noted that the facility has historically operated on a 1 to 1 ratio staffing to resident ratio and during 2018 that ratio increased to 1.20 to 1. As a result, aligning staffing to residents has become a significant focus of management's plans to mitigate its liquidity concerns.

Management started to implement the most significant aspects of its right sizing plan in February of 2019. As a result, operating performance continues to stress the liquidity of the Corporations (continued operating losses). Management projects significant improvement to its financial results beginning April of 2019 as a result of staffing alignment associated with its plan developed for DSS.

As a result of management formal implementation of a staffing plan and sales strategy plan, management believes it will be able to alleviate the conditions that raise doubt about the Corporations ability to continue as a going concern.

The ability of the Company to continue as a going concern and meet its obligations as they become due is dependent on management ability to successfully implement its plans. The financial statements do not include any adjustments that might be necessary if the Corporation is unable to continue as a going concern.

NOTE 18 – SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the statement of financial position date but before financial statements are available to be issued. The Corporation recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. The Corporation's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position but arose after the statement of financial position date and before financial statements were available to be issued.

The Corporation evaluated all events or transactions that occurred after December 31, 2018 up through May 24, 2019, the date the financial statements were available to be issued.