GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

FINANCIAL STATEMENTS

Years Ended December 31, 2016 and 2015

MHM ®

Mayer
Hoffman
McCann P.C
An Independent CPA Firm

Goodwill
Industries of South Central California

4901 Stine Road
Bakersfield, CA 93313
Phone: (661) 837-0595
Fax: (661) 837-0801
TheGoodwill.org

April 27, 2017

Goodwill Industries of South Central California ("the Agency") offers readers of the financial statements contained in the following report an introduction to the Agency's financial statements which are listed in the Table of Contents to this report. These financial statements comprise four components for both of the report years: 1) the Statements of Financial Position, 2) the Statements of Activities, 3) the Statements of Functional Expenses, and 4) the Statements of Cash Flows. The report also contains Notes to Financial Statements.

The ***Statements of Financial Position*** presents information on all of the Agency's assets and liabilities, for the two most-recent years' end. The difference between each year's assets and liabilities is reported as ***Net Assets****.* Over time, increases or decreases in net assets may serve as a useful indicator of whether the Agency's financial position is improving or deteriorating. The assets of the Agency exceeded its liabilities at the close of the most-recent fiscal year by $992,494.

The ***Statements of Activities*** (and the ***Statements of Functional Expenses***) present information showing how the Agency's net assets changed during both report years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows.* Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., Interest Payable).

The ***Statement of Cash Flows*** shows where the Agency's money is coming from, and how it is being spent. Cash inflows and outflows are grouped according to the activity that gave rise to them: core business operations, investing and financing.

The Notes to Financial Statements can be found beginning on page eight of this report and provide additional information that is essential to a full understanding of the data presented in the financial statements. In years past, two of these notes referred to an Interest Rate Swap Agreement. The agency entered into this agreement in conjunction with a mortgage obtained on November 1, 2006, that terminated on November 1, 2016. The agency refinanced that mortgage in 2016 and the Interest Rate Swap Agreement terminated with the expiration of that original mortgage. ***Note 6*** (page 15) and ***Note 2*** (page 11) refer to this expired Interest Rate Swap Agreement; however, the agency did not renew the Agreement and there is no Interest Rate Swap Agreement as of December 31, 2016.

Sheryl Chalupa

Sheryl Chalupa
President / CEO

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

FINANCIAL STATEMENTS

Years Ended December 31, 2016 and 2015

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5060 California Ave., Suite 800 ■ Bakersfield, CA 93309
Main: 661.325.7500 ■ Fax: 661.325.7004 ■ www.mhmcpa.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

We have audited the accompanying financial statements of Goodwill Industries of South Central California (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 Goodwill Industries of South Central California as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Information

The introductory letter from Management has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Mayer Hoffman McCann P.C.

Bakersfield, California
April 27, 2017

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

STATEMENTS OF FINANCIAL POSITION

December 31, 2016 and 2015

A S S E T S

	2016	2015
CURRENT ASSETS		
Cash	$ 634,518	$ 850,239
Accounts receivable	154,348	293,350
Inventory held for sale	468,329	406,929
Prepaid expenses	58,885	255,908
Other assets	11,319	9,793
TOTAL CURRENT ASSETS	1,327,399	1,816,219
PROPERTY AND EQUIPMENT, net	5,233,140	5,620,940
DEPOSITS	171,513	62,700
TOTAL ASSETS	$ 6,732,052	$ 7,499,859

L I A B I L I T I E S A N D N E T A S S E T S

	2016	2015
CURRENT LIABILITIES		
Accounts payable	$ 446,721	$ 138,984
Accrued expenses	463,731	387,320
Accrued interest	16,037	32,097
Deferred rent	89,295	96,659
Current portion of notes payable	305,252	4,880,364
Current portion of interest rate swap liability	-	218,625
TOTAL CURRENT LIABILITIES	1,321,036	5,754,049
LONG-TERM LIABILITIES		
Notes payable, net	3,418,522	-
Line of credit	1,000,000	-
TOTAL LONG TERM LIABILITIES	4,418,522	-
TOTAL LIABILITIES	5,739,558	5,754,049
COMMITMENTS AND CONTINGENCIES (NOTE 8)		
UNRESTRICTED NET ASSETS	992,494	1,745,810
TOTAL NET ASSETS	992,494	1,745,810
TOTAL LIABILITIES AND NET ASSETS	$ 6,732,052	$ 7,499,859

See Accompanying Notes to Financial Statements

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

STATEMENTS OF ACTIVITIES

Years Ended December 31, 2016 and 2015

	2016	2015
SUPPORT AND REVENUES		
Retail sales	$ 12,859,199	$ 12,679,666
Value of donated goods received	1,679,431	1,835,778
Salvage sales	1,238,603	1,265,985
Vocational services	238,935	221,617
Cash contributions received	12,974	20,446
Other revenues	-	46,870
TOTAL SUPPORT AND REVENUES	16,029,142	16,070,362
EXPENSES		
Program services		
Retail goods	13,048,844	12,190,554
Donated goods - salvage	1,488,063	1,438,261
TOTAL DONATED AND RETAIL GOODS	14,536,907	13,628,815
Vocational services	262,018	309,902
TOTAL PROGRAM SERVICES	14,798,925	13,938,717
Supporting services		
Management services	2,084,014	1,883,279
TOTAL EXPENSES	16,882,939	15,821,996
OTHER REVENUES AND EXPENSES		
Change in value of interest rate swap	218,625	237,878
Loss on disposal of property and equipment	(118,144)	(24,672)
TOTAL OTHER REVENUES AND EXPENSES	100,481	213,206
CHANGE IN NET ASSETS	(753,316)	461,572
NET ASSETS, BEGINNING OF YEAR	1,745,810	1,284,238
NET ASSETS, END OF YEAR	$ 992,494	$ 1,745,810

See Accompanying Notes to Financial Statements

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

STATEMENTS OF FUNCTIONAL EXPENSES

Year Ended December 31, 2016

	Program Services				Supporting Services	
	Retail Goods	Donated Goods Salvage	Vocational Services	Total Program Services	Management Services	Total Expenses
Salaries and related expenses:						
Salaries	$ 4,703,847	$ 781,146	$ 191,093	$ 5,676,086	$ 1,106,578	$ 6,782,664
Payroll taxes and worker's compensation	1,054,177	171,539	19,860	1,245,576	137,115	1,382,691
Employee benefits	475,638	79,280	18,613	573,531	75,038	648,569
Total salaries and related expenses	6,233,662	1,031,965	229,566	7,495,193	1,318,731	8,813,924
Other expenses:						
Cost of goods sold	2,057,835	-	-	2,057,835	-	2,057,835
Value of donated goods sold	1,679,431	-	-	1,679,431	-	1,679,431
Occupancy	1,268,251	59,393	95	1,327,739	930	1,328,669
Vehicles and travel	201,065	167,535	13,659	382,259	42,667	424,926
Utilities	354,749	35,248	-	389,997	4	390,001
Supplies	210,897	74,761	5,416	291,074	73,121	364,195
Interest expense	221,845	-	-	221,845	93,758	315,603
Professional fees and contract services	63,220	5,536	1,922	70,678	167,388	238,066
Advertising	153,321	-	-	153,321	4,904	158,225
Dues	1,350	-	-	1,350	152,428	153,778
Bank fees	137,747	289	-	138,036	13,459	151,495
Equipment rental and maintenance	61,965	35,203	1,686	98,854	13,345	112,199
Insurance	73,324	13,771	1,012	88,107	19,437	107,544
Telephone	56,656	6,325	2,902	65,883	18,602	84,485
Postage	3,269	56,080	-	59,349	16,379	75,728
Other	12,790	1,825	1,300	15,915	30,149	46,064
Training	9	-	4,299	4,308	20,003	24,311
Conferences, conventions, and meetings	606	132	161	899	10,203	11,102
Printing and publications	2,413	-	-	2,413	2,272	4,685
Special assistance	59	-	-	59	1,380	1,439
Total expenses before depreciation	12,794,464	1,488,063	262,018	14,544,545	1,999,160	16,543,705
Depreciation of property and equipment	254,380	-	-	254,380	84,854	339,234
TOTAL FUNCTIONAL EXPENSES	$ 13,048,844	$ 1,488,063	$ 262,018	$ 14,798,925	$ 2,084,014	$ 16,882,939

See Accompanying Notes to Financial Statements

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

STATEMENTS OF FUNCTIONAL EXPENSES

Year Ended December 31, 2015

	Program Services				Supporting Services	
	Retail Goods	Donated Goods Salvage	Vocational Services	Total Program Services	Management Services	Total Expenses
Salaries and related expenses:						
Salaries	$ 4,496,009	$ 663,035	$ 242,168	$ 5,401,212	$ 1,015,043	$ 6,416,255
Payroll taxes and worker's compensation	1,027,184	145,711	20,518	1,193,413	112,441	1,305,854
Employee benefits	401,407	67,332	14,887	483,626	52,766	536,392
Total salaries and related expenses	5,924,600	876,078	277,573	7,078,251	1,180,250	8,258,501
Other expenses:						
Value of donated goods sold	1,835,778	-	-	1,835,778	-	1,835,778
Cost of goods sold	1,423,375	-	-	1,423,375	-	1,423,375
Occupancy	1,232,066	67,570	-	1,299,636	18,365	1,318,001
Vehicles and travel	110,089	296,826	15,077	421,992	30,141	452,133
Utilities	355,024	31,618	-	386,642	142	386,784
Interest expense	251,677	-	-	251,677	100,975	352,652
Supplies	187,901	66,851	897	255,649	75,890	331,539
Advertising	165,109	-	122	165,231	10,107	175,338
Professional fees and contract services	74,119	8,018	453	82,590	86,842	169,432
Bank fees	140,679	553	-	141,232	15,662	156,894
Dues	1,086	-	-	1,086	140,925	142,011
Insurance	72,099	15,645	1,143	88,887	16,909	105,796
Equipment rental and maintenance	43,282	36,718	2,035	82,035	11,655	93,690
Telephone	65,373	6,090	2,863	74,326	19,094	93,420
Postage	1,487	29,219	-	30,706	9,803	40,509
Other	2,873	2,845	-	5,718	34,240	39,958
Training	1,969	230	9,540	11,739	26,859	38,598
Conferences, conventions, and meetings	1,030	-	199	1,229	16,048	17,277
Special assistance	406	-	-	406	4,507	4,913
Printing and publications	-	-	-	-	3,071	3,071
Total expenses before depreciation	11,890,022	1,438,261	309,902	13,638,185	1,801,485	15,439,670
Depreciation of property and equipment	300,532	-	-	300,532	81,794	382,326
TOTAL FUNCTIONAL EXPENSES	$ 12,190,554	$ 1,438,261	$ 309,902	$ 13,938,717	$ 1,883,279	$ 15,821,996

See Accompanying Notes to Financial Statements

GOODWILL INDUSTRIES OF SOUTH CENTRAL CALIFORNIA

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2016 and 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ (753,316)	$ 461,572
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation	339,234	382,326
Amortization of debt issuance cost	4,118	4,380
Loss on disposal of property and equipment	118,144	24,672
Change in fair value of interest rate swap	(218,625)	(237,878)
(Increase) decrease in operating assets:		
Accounts receivable	139,002	(157,425)
Inventory held for sale	(61,400)	(41,484)
Prepaid expenses	197,023	18,957
Other assets	(1,526)	3,630
Deposits	(108,813)	-
Increase (decrease) in operating liabilities:		
Accounts payable	307,737	(59,478)
Accrued expenses	76,411	19,709
Accrued interest	(16,060)	796
Deferred rent	(7,364)	537
NET CASH FLOWS FROM OPERATING ACTIVITIES	14,565	420,314
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(47,272)	(63,790)
Proceeds from sale of property and equipment	-	4,000
NET CASH FLOWS FROM INVESTING ACTIVITIES	(47,272)	(59,790)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on notes payable	(170,590)	(160,909)
Debt issuance cost incurred	(26,310)	-
Proceeds from issuance of notes payable	13,886	-
NET CASH FLOWS FROM FINANCING ACTIVITIES	(183,014)	(160,909)
NET CHANGE IN CASH	(215,721)	199,615
CASH, BEGINNING OF YEAR	850,239	650,624
CASH, END OF YEAR	$ 634,518	$ 850,239
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$ 327,545	$ 351,856
NONCASH FINANCING ACTIVITIES:		
Acquisition of property and equipment provided by issuance of notes payable	$ 22,306	$ -

See Accompanying Notes to Financial Statements

(1) Nature of operations

Goodwill Industries of South Central California (the "Organization") was incorporated under the laws of the State of California on August 1, 1986, as a not-for-profit organization. The Organization is supported predominantly through sales of donated goods at 10 thrift stores. The service area of the Organization encompasses Kern, Kings, and Southern Tulare counties. The Organization provides work opportunities and skills development to people with barriers to employment. The Organization is affiliated with Goodwill Industries International (GII) and accredited by the Commission on Accreditation of Rehabilitation Facilities (CARF).

(2) Summary of significant accounting policies

This summary of significant accounting policies of Goodwill Industries of South Central California is presented to assist in understanding the Organization's financial statements. The financial statements and notes are representations of the Organization's management, who is responsible for their integrity and objectivity.

Basis of accounting - The financial statements of the Organization have been prepared on the accrual basis of accounting. Under this method of accounting, revenues are recognized when earned and expenses are recognized when incurred.

Basis of presentation - The accompanying financial statements are presented in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-205, *Not-for-Profit Entities - Presentation of Financial Statements*. Under FASB ASC 958-205, the Organization is required to report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Restricted and unrestricted revenue and support - The Organization follows FASB ASC 958-605, *Revenue Recognition*. In accordance with FASB ASC 958-605, contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support, depending on the existence and/or nature of any donor restrictions. Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions.

Use of 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. These estimates and assumptions 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

(2) Summary of significant accounting policies (continued)

Accounts receivable - The Organization considers accounts receivable to be fully collectible. Accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.

Concentrations of credit risk - Financial instruments, which potentially subject the Organization to credit risk, consist primarily of cash and accounts receivable. The Organization maintains cash with major financial institutions. The Organization has maintained balances in excess of federally insured limits periodically throughout the years ended December 31, 2016 and 2015.

As of December 31, 2016 and 2015, the Organization had three customers, each year, with uncollateralized accounts receivable balances in excess of 10% of total outstanding accounts receivable. The amounts of these account balances are 72% (30%, 25% and 17%) and 85% (32%, 30% and 23%) of total accounts receivable as of December 31, 2016 and 2015, respectively. Accounts receivable as of December 31, 2016 and 2015 represent 0.97% and 1.82% of revenue, respectively.

The Organization obtained approximately 29% and 22% of total purchases from one vendor during the years ended December 31, 2016 and 2015, respectively.

Inventory - GII publishes guidelines for accounting, reporting, and disclosures. The guidelines can be used by local Goodwill Industry agencies to assist in compliance with industry practices and comparability of financial performance from agency to agency. Effective for fiscal years beginning January 1, 1996, GII has recommended that local agencies estimate the value of donated goods received and of donated goods on hand at the end of the year.

In estimating these values, the Organization uses a portion of the direct and indirect costs of production, transportation, support, and management and general services in accordance with the guideline recommendations. The Organization uses the number of months that a typical item remains in inventory in estimating the value of inventories at year-end. The methodology used to value donated goods approximates fair value at the date of donation. Inventory also consists of goods purchased for resale.

Property, equipment, and depreciation – All acquisitions of property and equipment in excess of $5,000 and all expenditures for repairs, maintenance, renewals, and betterments that materially prolong the useful lives of assets are capitalized.

Donations of property and equipment are recorded as support at their estimated fair value. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to 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, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Organization reclassifies temporarily restricted

(2) Summary of significant accounting policies (continued)

net assets to unrestricted net assets at that time. As of December 31, 2016 and 2015, the Organization did not own any assets with temporary or permanent restrictions.

Property and equipment are recorded at cost. Depreciation of property and equipment is provided on the straight-line method over the estimated useful lives of the assets as follows:

Assets	Useful Lives
Buildings and improvements	5 - 31 years
Equipment	3 - 15 years

The cost of leasehold improvements is amortized using the straight-line method over the lesser period between the lease contract life or the useful life of the related leasehold improvement.

In accordance with FASB ASC Topic 360, *Property, Plant, and Equipment*, property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, the impairment charge to be recognized is measured by the excess of the carrying amount over the fair value of the asset. Assets to be disposed of are reported at the lower of carrying amount or fair value, less cost to sell. There was no impairment recorded during the years ended December 31, 2016 and 2015.

Fair value – FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

Level 2 - Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in inactive markets; inputs other than quoted market prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

(2) Summary of significant accounting policies (continued)

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Interest rate swap - The Organization is exposed to interest rate risk through its borrowing activities. The interest rate swap expired in November 2016 and was not renewed at that time. As of December 31, 2015, one of the Organization's long-term borrowings is a variable rate instrument. The Organization previously entered into interest rate swap contracts under which the Organization agreed to pay an amount equal to a specified fixed rate of interest times a notional principal amount, and receives in return an amount equal to a specified variable rate of interest times the same notional principal amount.

The Organization accounts for its interest rate swap agreements in accordance with FASB ASC Topic 958-815, *Not-for Profit Entities - Derivatives and Hedging*. FASB ASC 958-815 requires that all derivative instruments be recorded at fair value and changes in fair value be recorded each period as a change in net assets.

The Organization maintains an interest-rate risk management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest-rate volatility. The Organization's specific goals are (1) to manage interest-rate sensitivity by modifying the repricing or maturity characteristics of certain debt instruments and (2) to lower (where possible) the cost of its borrowed funds. Interest-rate fluctuations create an unrealized appreciation or depreciation in the market value of the Organization's debt when compared with its cost. The effect of this unrealized appreciation or depreciation in market value, however, will generally be offset by income or loss on derivative instruments that are linked to the debt.

By using derivative financial instruments to hedge exposure to a change in interest rates, the Organization exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Organization, which creates repayment risk for the Organization. When the fair value of a derivative contract is negative, the Organization owes the counterparty and therefore, it does not possess repayment risk. The Organization minimizes the credit (or repayment) risk in derivative instruments by (1) entering into transactions with high quality counterparties, and (2) limiting the amount of exposure to the counterparty. The Organization does not anticipate nonperformance by the counterparties.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate contracts is managed by the establishment and monitoring of parameters that limit the types and degree of market risk that may be undertaken.

(2) Summary of significant accounting policies (continued)

Retail and salvage revenues - Retail and salvage sales revenues are recognized when the merchandise is sold, typically at the point of sale in thrift stores or salvage facilities.

Advertising and promotion - Advertising and promotion costs are expensed when incurred and amounted to $158,225 and $175,338 for the years ended December 31, 2016 and 2015, respectively.

Functional allocation of expenses - The costs of providing the various programs and other activities are summarized on a functional basis in the statement of activities. It is policy of the Organization to allocate the indirect expenses of administrative overhead and occupancy to certain programs based on combining equally their relative values of revenues and expenses. Accordingly, certain costs are allocated among the programs and supporting services benefited. Interest expense is directly allocated among the programs and among the functional expense items benefited by the asset underlying the debt for which the interest was incurred.

Tax exempt status - The Organization is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC), and from California franchise and/or income taxes under Section 23701(d) of the Revenue and Taxation Code. FASB ASC Topic 740, *Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, disclosure, and transition. Management believes that no such uncertain tax positions exist for the Organization at December 31, 2016 and 2015.

With few exceptions, the Organization is no longer subject to U.S. Federal and State income tax examinations for tax years 2013 and 2012, respectively.

Recently adopted accounting pronouncement - In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. Therefore, effective January 1, 2015, the Organization has presented these costs as a direct deduction to the related note payable and the amortization of debt issuance costs as interest expense in accordance with the new guidance.

The adoption had no effect on previously reported net assets or change in net assets.

(2) Summary of significant accounting policies (continued)

Recently issued accounting pronouncements - In August 2016, the FASB issued ASU 2016-14, Presentation of Financial Statements of Not for-Profit Entities. The main provisions of this update, amend the requirements for financial statements and notes in Topic 958, *Not-for-Profit Entities*. The ASU requires Not-for-Profit entities (NFP) to present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. A NFP will report amounts for net assets with donor restrictions and net assets without donor restrictions, as well as the currently required amount for total net assets. Additionally, a NFP will be required to present on the face of the statement of activities the amount of the change in each of the two classes of net assets, net assets with donor restrictions and net assets without donor restrictions, rather than that of the currently required three classes. The amendments in this update are effective for financial statements issued for fiscal years beginning after December 15, 2017. Early application of the amendments in this update is permitted. The Organization has yet to assess the full impact of this guidance.

In February 2016, the FASB issued ASU 2016-02, Leases. The amendments in this update require lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date, a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and, a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The amendments in this update will be effective for the annual period beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. The Organization has yet to assess the full impact of this guidance.

(3) Property and equipment

Property and equipment as of December 31, 2016 and 2015, consists of the following:

	2016	2015
Buildings and improvements	$ 5,879,993	$ 5,879,993
Land	1,685,282	1,685,282
Equipment	1,577,797	1,542,654
Leasehold improvements	701,463	1,001,284
Total Cost	9,844,535	10,109,213
Accumulated depreciation	(4,628,379)	(4,488,273)
	5,216,156	5,620,940
Construction in progress	16,984	-
Property and equipment, net	$ 5,233,140	$ 5,620,940

Depreciation expense for the years ended December 31, 2016 and 2015 was $339,234 and $382,326, respectively.

(4) Notes payable

Notes payable as of December 31, 2016 and 2015 consist of the following:

	2016	2015
Note Payable - Wells Fargo Bank, payable in monthly installments ranging from $12,770 to $25,110, including interest at 4.40%, secured by real property, accounts receivable, inventory and equipment, due in November 2026.	$ 3,729,890	$ -
Note Payable - Jim Burke Ford, payable in monthly installments of $356, including interest at 1.90%, secured by equipment, due in October 2021.	19,726	-
Note Payable - Wells Fargo Bank, payable in monthly installments ranging from $11,656 to $12,496, including interest at a variable rate (effective rate of 6.98% with swap agreement), secured by real property, balance was refinanced in November 2016.	-	4,548,363
Note Payable - Wells Fargo Bank, payable in monthly installments ranging from $777 to $833 including interest at a variable rate (effective rate of 6.98% with swap agreement), secured by real property, balance was refinanced in November 2016.	-	335,651
Total notes payable	3,749,616	4,884,014
Less current portion	(305,252)	(4,880,364)
Less unamortized debt issuance costs	(25,842)	(3,650)
Non current portion	$ 3,418,522	$ -

(4) Notes payable (continued)

Future scheduled maturities of notes payable are as follows:

Years Ending December 31,		
2017	$	305,252
2018		157,903
2019		165,871
2020		174,261
2021		182,859
Thereafter		2,763,470
		3,749,616

On November 1, 2016, the Organization refinanced its note payable with Wells Fargo Bank through the issuance of a 10 year term note for $3,755,000 and the issuance of a $1,000,000 line of credit. The note payable to Wells Fargo Bank is subject to certain financial and non-financial covenants, including requirements relating to liquidity.

(5) Line of credit

On November 1, 2016, the Organization opened a line of credit with Wells Fargo Bank, which expires on November 1, 2026. The maximum line of credit under the agreement is $1,000,000 and the outstanding balance is $1,000,000 as of December 31, 2016. The line of credit is secured by real property, accounts receivable, inventory, and equipment. Interest is payable monthly at LIBOR plus 2.25%. The interest rate was 3.02% as of December 31, 2016. The line of credit with Wells Fargo Bank is subject to certain financial and non-financial covenants, including requirements relating to liquidity.

(6) Interest rate swap agreement

In 2006, the Organization entered into a master agreement with Wells Fargo Bank for an interest rate swap transaction to reduce the impact of changes in interest rates on its variable long-term debt of $5,600,000 dated September 1, 2006. The loan was also structured as such that the original line of credit with Wells Fargo Bank would convert to a term loan at November 1, 2007. The line of credit was limited to a maximum of $400,000 and the Organization took down the full amount as of October 30, 2007. This amount remains as a separate note, but the swap agreement was amended to include both notes. This agreement effectively changed the interest rate exposure on the variable rate loan to a fixed rate of 6.98%. The interest rate swap matured on November 1, 2016 and was not renewed. The Organization is exposed to credit loss in the event of nonperformance by Wells Fargo Bank. However, the Organization does not anticipate nonperformance by the counterparty. The fair value of the swap agreement is recorded on the accompanying statement of financial position as a liability and totaled $0 and $218,625 as of December 31, 2016 and 2015, respectively. For the years ended December 31, 2016 and 2015, $218,625 and $237,878, respectively, was recorded as part of other revenues and expenses in the statement of activities related to the change in the swap agreement's fair value.

(6) Interest rate swap agreement (continued)

	2016	2015
Change in net assets before effect of swap agreement	$ (971,941)	$ 223,694
Change in fair value of interest rate swap	218,625	237,878
Change in net assets	$ (753,316)	$ 461,572

(7) Fair value measurements

The following table summarizes the valuation of liabilities subject to measurement at fair value using FASB ASC 820 categories as of December 31, 2016 and 2015:

	Fair Value	Level 1	Level 2	Level 3
December 31, 2016				
Interest rate swap liability	$ -	$ -	$ -	$ -
	$ -	$ -	$ -	$ -
December 31, 2015				
Interest rate swap liability	$ (218,625)	$ -	$ (218,625)	$ -
	$ (218,625)	$ -	$ (218,625)	$ -

The fair value of the interest rate swap is estimated by a third party using a model that builds a yield curve from market data for actively traded securities at various times and maturities and takes into account current interest rates and the current credit worthiness of the respective counterparties. Such securities are classified within Level 2 of the valuation hierarchy.

(8) Commitments and contingencies

Facility operating leases – Commencing on March 10, 2005, the Organization entered into an 84-month lease agreement beginning in May 2005 for a retail store on Olive Drive in Bakersfield. On June 29, 2009, the lease was amended to adjust the base rent and extend the term of the lease until April 30, 2015. The Organization is required to pay property taxes, insurance, and common area expenses associated with the leased property. On January 28, 2015, the lease was extended for an additional 60 month term commencing on May 1, 2015 and ending April 30, 2020 with monthly payments ranging from $10,000 to $14,689, and is currently $13,443 per month.

(8) Commitments and contingencies (continued)

On May 20, 2009, the Organization exercised its option under the original lease agreement for its retail store on Rosedale Highway in Bakersfield to extend the term of its lease to 60 months. This extension expired October 14, 2014. On October 14, 2014, the lease was renewed for an additional 36 months and will expire on October 14, 2017. The lease requires minimum monthly rental payments of $5,200 exclusive of utilities, personal property tax, liability insurance, and certain repairs and maintenance.

Commencing on November 4, 1998, the Organization entered into a 60-month lease agreement for the retail store on Oswell Street in Bakersfield. Subsequent amendments to the agreement had changed the monthly rent payments and extended the original term until August 31, 2013. On March, 28, 2013 the lease was extended for an additional 60 month term commencing on September 1, 2013 and ending August 31, 2018 with monthly payments ranging from $11,057 and $13,163, and is currently $12,636 per month, exclusive of personal property tax.

On February 14, 2005, the Organization exercised its option under the original lease agreement for its retail store and storage space on China Lake Boulevard in Ridgecrest to extend the term of the lease for 60 months, beginning in September 2005. On September 3, 2009, the lease was amended to adjust the base rent and extend the term of the lease until August 31, 2015. The minimum monthly rental amount was $5,710 exclusive of utilities, personal property tax, liability insurance, certain repairs and maintenance, and common area expenses. The lease provided for an increase to $6,566 per month beginning September 1, 2010. The lease was not renewed as of August 31, 2015, the retail store was closed at that time.

On October 11, 2004, the Organization entered into a 60-month lease agreement for a retail store in Taft, beginning in November 2004. On July 10, 2009, the lease was renewed for an additional 60 months, commencing December 1, 2009, and continuing through November 30, 2014. On December 1, 2014, the lease was renewed for an additional 60 months at a fixed monthly rental amount of $4,200 per month exclusive of utilities, personal property tax, liability insurance, certain repairs and maintenance, and common area expenses.

Commencing on September 1, 2011, the Organization entered into a 60-month lease agreement for a retail store in Porterville. The monthly rent amount ranged from $6,190 to $6,897 per month, exclusive of utilities, personal property tax, liability insurance, certain repairs and maintenance, and common area expenses. On February 22, 2016, the Porterville lease was renewed for an additional 60 month term commencing on August 1, 2016 and ending July 31, 2021 with monthly rent payments ranging from $7,369 to $8,077, and is currently $7,369 per month.

(8) Commitments and contingencies (continued)

Commencing on November 1, 2011, the Organization entered into a 38-month lease agreement with two 36-month options to extend for a retail store in Tulare. On July 29, 2014 the lease was extended for an additional 24 months commencing on November 1, 2014 and ending October 31, 2016 with monthly rent payments of $5,580, exclusive of utilities, personal property tax, liability insurance, certain repairs and maintenance, and common area expenses. The lease was not renewed as of October 31, 2016, the retail store was closed at that time.

Commencing on May 1, 2013, the Organization entered into an 87-month lease agreement for a second retail store on Rosedale Highway (west of the other Rosedale location). The monthly rent amount ranges from $7,166 to $9,306, and is currently $8,516, exclusive of utilities, personal property taxes, liability insurance, certain repairs and maintenance, and common area expenses.

On January 1, 2013, the Organization entered into a 60-month lease agreement for a retail store in Hanford. The monthly rent amount is $4,000 throughout the lease term. Utilities, real and personal property taxes, liability insurance and certain repairs and maintenance expenses are to be paid directly by the Organization. There are no common area expenses. During August 2016, the Organization closed the retail store and ceased operations at the location. The rent payments will continue through December 31, 2017, the date the lease expires. Lease termination costs of $60,000 were accrued as of December 31, 2016 and are included as occupancy expense for the year ending December 31, 2016.

Commencing on July 1, 2014, the Organization entered into a 60-month lease agreement for a retail store in Lemoore. The monthly rent amount ranges from $5,281 to $6,178 per month, and is currently $5,492, exclusive of utilities, personal property tax, liability insurance, certain repairs and maintenance, and common area expenses.

Future minimum lease commitments under noncancellable facility leases as of December 31, 2016, are as follows:

Years Ending December 31,		
2017	$	729,459
2018		596,614
2019		547,930
2020		220,758
2021		56,539
	$	2,151,300

For the years ended December 31, 2016 and 2014, rental expense was $772,221 and $811,889, respectively.

(8) Commitments and contingencies (continued)

Vehicle operating leases - The Organization entered into a master agreement and several subordinate operating leases for vehicles with various payments and terms. The minimum lease commitments subsequent to December 31, 2016 are as follows:

Years Ending December 31,		
2017	$	191,613
2018		104,640
2019		57,762
2020		19,561
	$	373,576

For the years ended December 31, 2016 and 2015, vehicle lease expense was $239,867 and $263,119, respectively.

Litigation - The Organization is involved in various legal proceedings in the normal course of business. Management does not believe that the final disposition of any of these cases will have a material impact on the financial position or results of operations of the Organization.

(9) Subsequent events

The Organization has evaluated subsequent events through April 27, 2017, the date that the financial statements were available to be issued.

In January 2017, the Organization executed a 123-month lease agreement with monthly rent payments ranging from $17,846 to $19,578 for a retail store on Ashe Road in Bakersfield. The lease commences upon the delivery of the premise, which is currently undergoing certain improvements by the landlord. If the property is not delivered to the Organization on or before July 1, 2017, the Organization has the option to terminate the lease without recourse. As of the report date, the Organization has yet to receive possession of the premise.