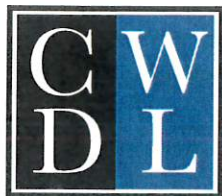


THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.

Financial Statements

For the year ended June 30, 2018
(With Comparative Totals for June 30, 2017)



COSSOLIAS | WILSON
DOMINGUEZ | LEAVITT
CERTIFIED PUBLIC ACCOUNTANTS

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
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JUNE 30, 2018
(With comparative totals for June 30, 2017)

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INDEPENDENT AUDITORS' REPORT

Board of Directors of
The Twelfth Step House of San Diego, Inc.
San Diego, California

We have audited the accompanying financial statements of The Twelfth Step House of San Diego, Inc., which comprise the statement of financial position as of June 30, 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 of 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 The Twelfth Step House of San Diego, Inc. as of June 30, 2018, 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.

CWDL, Certified Public Accountants

San Diego, California

October 8, 2018

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2018
(With comparative totals for June 30, 2017)

	2018	2017
ASSETS		
Cash and cash equivalents	\$ 29,935	\$ 224,077
Board restricted funds	485,826	507,193
Accounts receivable	103,080	39,039
Deposits/Prepaid expenses	1,701	2,635
Other assets	15,320	9,591
Property and equipment, net	913,729	648,599
Total Assets	\$ 1,549,591	\$ 1,431,134
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable	\$ 24,065	\$ 5,252
Accrued liabilities	35,382	8,902
Client fees paid in advance	1,250	1,250
Note payable	409,426	418,190
Line of credit	120,057	-
Total liabilities	590,180	433,594
Net Assets		
Unrestricted	473,585	490,347
Board restricted	485,826	507,193
Total net assets	959,411	997,540
Total Liabilities and Net Assets	\$ 1,549,591	\$ 1,431,134

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2018
(With comparative totals for June 30, 2017)

	<u>2018</u>	<u>2017</u>
SUPPORT AND REVENUES		
Contributions	\$ 181,519	\$ 37,218
Grant - County of San Diego	237,574	207,004
Other grants	21,819	-
Participant fees	410,338	327,728
Rental income	4,200	-
In-Kind donations	-	2,244
Interest and investment income	19,711	19,446
Other miscellaneous income	10,602	13,063
Total revenues and support	<u>885,763</u>	<u>606,703</u>
Expenses		
Program services	885,991	532,069
Fundraising	20,956	34,442
Management and general	16,945	107,217
Total expenses	<u>923,892</u>	<u>673,728</u>
CHANGE IN NET ASSETS	(38,129)	(67,025)
Net Assets - Beginning of year	<u>997,540</u>	<u>1,064,565</u>
Net Assets - End of year	<u>\$ 959,411</u>	<u>\$ 997,540</u>

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2018
(With comparative totals for June 30, 2017)

	2018			2017	
	Program Services	Fundraising	Management and General	Total	Total
EXPENSES					
Personnel expenses					
Salaries and wages	\$ 295,983	\$ -	\$ -	\$ 295,983	\$ 265,006
Employee benefits	12,181	-	-	12,181	24,151
Payroll taxes	27,861	-	-	27,861	26,115
Total personnel expenses	336,025	-	-	336,025	315,272
Non-personnel expenses					
Organizational development	-	-	15,649	15,649	14,901
Auto expense	15,768	-	-	15,768	6,183
Banquet expense	1,597	20,456	-	22,053	21,097
Rent expense	91,491	-	-	91,491	74,080
Equipment rental	861	-	-	861	504
Repairs and maintenance	51,109	-	-	51,109	27,618
Depreciation and amortization expense	11,968	-	-	11,968	1,002
Utilities expense	45,218	-	-	45,218	31,441
Supplies	9,381	-	-	9,381	11,992
Office expense	10,037	-	-	10,037	6,135
Printing and publishing	-	-	-	-	700
Membership fees	2,601	-	125	2,726	915
Laundry and linen	3,026	-	-	3,026	1,842
Recreation	1,910	400	-	2,310	3,652
Insurance	49,823	-	-	49,823	23,352
Taxes and license	14,506	-	300	14,806	11,439
Outside services	15,826	-	-	15,826	6,439
Computer and internet services	34,463	100	592	35,155	13,001
Bank and investment fees	8,881	-	-	8,881	6,925
Travel and lodging	4,295	-	-	4,295	1,136
Food expense	68,875	-	-	68,875	54,998
Equipment expense	-	-	-	-	1,124
Training/Education/Staff meetings	33,225	-	279	33,504	12,419
Miscellaneous expense	4,277	-	-	4,277	1,907
Drug testing	6,047	-	-	6,047	6,152
Interest expense	21,703	-	-	21,703	3,144
Tax expense	4,655	-	-	4,655	-
Unrealized loss on investments	14,024	-	-	14,024	-
Bad debt expense	24,399	-	-	24,399	14,358
Total non-personnel expenses	549,966	20,956	16,945	587,867	358,456
TOTAL EXPENSES	\$ 885,991	\$ 20,956	\$ 16,945	\$ 923,892	\$ 673,728

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2018
(With comparative totals for June 30, 2017)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Change in Net Assets	\$ (38,129)	\$ (67,025)
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities:		
Depreciation	11,968	1,002
Increase (decrease) in cash resulting from changes in:		
Accounts receivable	(64,041)	(12,227)
Other assets	(4,795)	(5,662)
Board restricted funds	21,367	645
Accounts payable	18,813	(1,025)
Accrued liabilities	26,480	5,952
Deferred revenues	-	-
Net cash provided by (used in) by operating activities	<u>(28,337)</u>	<u>(78,340)</u>
Cash flows from investing activities		
Purchase of property and equipment	(277,098)	(600,000)
Net cash used in investing activities	<u>(277,098)</u>	<u>(600,000)</u>
Cash flows from financing activities		
Issuance of note payable	-	418,190
Net borrowing (repayment) on line of credit	120,057	-
Payments on note payable	(8,764)	-
Net cash provided by financing activities	<u>111,293</u>	<u>418,190</u>
Net increase (decrease) in cash	<u>(194,142)</u>	<u>(260,150)</u>
Cash - Beginning	<u>224,077</u>	<u>484,227</u>
Cash - Ending	<u>\$ 29,935</u>	<u>\$ 224,077</u>
Supplemental Information		
Cash paid during the year for interest	<u>\$ 21,703</u>	<u>\$ 3,144</u>

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 1 – ORGANIZATION

The Twelfth Step House of San Diego, Inc. (the Company - also known as Heartland House) is a not-for-profit organization incorporated in 1960 under the General Non – profit Corporation law of the State of California. The Company’s mission is to establish, operate and maintain in San Diego County a rehabilitation center for the care, treatment and rehabilitation of men suffering from alcoholism or drug abuse. The Company operates a residential recovery home which is licensed by the State of California Department of Alcohol and Drug Programs.

The Company is funded through government grants, user fees and contributions and provides a living environment conducive to continued sobriety, conducts an educational program that serves the newly recovering alcoholic or drug abuser, provides a means for establishing a long-term support system that generates attitudes that support self-sufficiency and enhance self-worth.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statements and Fund Accounting

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP). The organization’s accounting records are maintained on the accrual basis of accounting.

The corporation complies with the Statement of Financial Accounting Standards (SFAS) No. 117, “Financial Statements of Not-for-profit organizations. Under SFAS No. 117, information regarding its financial position and activities is reported according to its three classes of net assets: unrestricted, temporarily restricted and permanently restricted. The corporation also presents a statement of cash flows. For the year ending June 30, 2018, there are no restricted funds.

Support, Contributions, and Grant Revenue

All Support, Contributions, and Grant(s) revenue are considered to be available for unrestricted use unless specifically restricted by the donor. For Contributions, the corporation complies with SFAS No. 116 “Accounting for Contributions Received and Contributions Made.” Under SFAS No.116 contributions are defined as an unconditional transfer of cash or other asset(s) to an entity, or a settlement or cancellation of its liabilities in a voluntary non-reciprocal transfer. Other assets include use of facilities (or utilities), services and unconditional promises to give these items in the future. Generally, contributions received are recognized as revenues in the period received at fair market value. In situations where contributions are restricted or conditional upon the corporation incurring certain qualifying expenses such contributions become unrestricted or unconditional upon the expense being incurred. Accordingly, these revenues and costs are recognized when incurred.

The corporation reports grants, contracts, and gifts as temporarily restricted if they are received with stipulations that limit the timing and/or use of the assets. When a restriction expires either due to time and or the stipulation is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However as permitted under

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Support, Contributions, and Grant Revenue (continued)

SFAS No. 116 the corporation follows the practice of recording as unrestricted income all contributions and grants where restrictions lapse in the same fiscal year in which they are received.

Special Events and Fundraising

For special fund-raising events, revenues and expenses are recorded when incurred at gross.

Donated Services and Supplies

The corporation follows the practice of recording donated services only in instances where non-financial assets are thereby created or enhanced or where services are provided which require specialized skills, are provided by such skilled individuals and would typically need to be purchased. In addition, the corporation's programs and fund-raising activities have benefited from the significant amounts of time and goods donated by other volunteers which has been expressed in the financial statements at an equivalent fair market value as In-Kind Donations.

Cash and Cash Equivalents

In reporting cash, the corporation considers all highly liquid assets and any investments with maturities of 90 days or less to be cash equivalents.

Fair value of financial instruments

The recorded value of the Company's financial instruments approximates their fair values. Financial instruments include cash, accounts receivable and accounts payable.

Property and Equipment

Property and equipment are recorded at cost for purchased assets and fair market value at the date of acquisition for donated assets.

Property and equipment acquired with grant funds are considered to be owned by the granting agency and accordingly reflected as program expenditures and are not capitalized by the Company. Donations of assets are recorded as unrestricted support unless the donor stipulates a specific period over which the asset must be used by the Company. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles may require management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates and assumptions, if made.

Economic Concentrations

The corporation's operations are concentrated in San Diego County. During the year ended June 30, 2018, the Company received approximately 26.8% of its revenues from the County of San Diego Grant. Total revenues received were \$237,574.

NOTE 3 – CASH

The Company's cash and cash equivalents as of June 30, 2018 consist of non-interest bearing checking and interest-bearing savings accounts totaling \$29,935.

NOTE 4 – RECEIVABLES

The Company's receivables as of June 30, 2018 consist principally of participant fees totaling \$103,080.

NOTE 5 – COMMITMENTS AND CONTINGENCIES

The corporation receives substantial funding from government agencies which may be restricted under the terms of the related funding agreements. When restricted, expenditures are charged against these restricted funds and are subject to audit by the funding agencies. It is possible future audits will result in expenditure disallowances; however, based on their knowledge of the funding agencies and the fact that no material cost disallowances have occurred in the past, management believes that any such disallowances will not be material.

NOTE 6 – INCOME TAXES

The corporation qualifies for exemption from income taxes under Federal and State Revenue codes. Therefore, no tax provision is necessary and has not been provided for in the financial statements. The corporation is subject to taxation on unrelated business income, if any. There was no unrelated business income for the year ended June 30, 2018.

NOTE 7 – PENSION COSTS

The corporation's employees are not covered by a sponsored pension plan.

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 8 – NOTES PAYABLE

In March of 2017, the Company obtained a loan with the Bank of Southern California for the purchase of a multi-family residence. The loan was for \$420,000, bearing interest at 4.93% and maturing on April 6, 2027. The current outstanding principal amount as of June 30, 2018 was \$409,426.

NOTE 9 – LINE OF CREDIT

During fiscal year 2017-18, the Company opened a revolving line of credit with available credit up to \$274,000 to provide cash flow for its start-up costs related to the new Medi-Cal services. The amount is backed by its Board Restricted investments. The outstanding balance as of June 30, 2018 was \$120,057.

NOTE 10 – SUPPLEMENTARY INFORMATION

During the year ended June 30, 2018 the Company provided services to clients as summarized below:

<u>Program Services</u>	<u>Units of Services Provided to Clients</u>
Bed Nights	13,646 (Including 4,452 Sober Living Bed Nights)

NOTE 11 – BOARD RESTRICTED FUNDS

During the year ended June 30, 2016 the corporation received a one-time donation of \$800,000 from an estate. While the estate did not stipulate any restrictions as to the use of the funds, the board of directors of the corporation has chosen to restrict those funds for the moment as they put together a plan as to how the corporation will best use those funds. The funds are in broker and bank accounts in various investment instruments; The investments are being carried on the books at their cost basis. Any gains or losses in market value will be recorded at the time of redemption.

The Fair Value Measurement of the instruments are measured along the following criteria:

Level 1 input: Quoted prices in active markets for identical assets

Level 2 input: Significant observable inputs

Level 3 input: Significant unobservable inputs

The following methods and assumptions were used to estimate the fair value of each class of financial investments:

- The fair value is determined based on quoted market prices.

THE TWELFTH STEP HOUSE OF SAN DIEGO, INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

NOTE 11 – BOARD RESTRICTED FUNDS (continued)

Fair values of the Association’s financial investments are as follows, and all values are classified as Level 1 inputs:

	Carrying Value	Fair Value
Fixed Income	\$ 202,325	\$ 199,234
Equities	61,702	67,712
Mutual Funds	187,396	192,573
Cash/Money Market	26,307	26,307
Total	<u>\$ 477,730</u>	<u>\$ 485,826</u>

NOTE 12 – SUBSEQUENT EVENTS

On July 1, 2018, Heartland House began accepting Medi-Cal, and providing services through a Behavioral Health Services Contract. Although not finalized with certification by the State of California, the Company is providing clinically sound Substance Use Disorder Services for participation in the Drug Medical Organized Delivery Services.

In addition, the Company obtained a line of credit in order to meet financial obligations during the initial start-up of providing the services noted above. Invoices are rendered on a net 30 basis. The Company expects to pay its line of credit off by June 30, 2019.

The Company’s management has evaluated events from July 1, 2018 through October 8, 2018, the date the financial statements were available to be issued. There have been no other subsequent events that would require recognition or disclosure in the financial statements as of June 30, 2018.