

THE SHELTERING ARMS, INC. AND SUBSIDIARY

**CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2019 AND 2018**

**and
SUPPLEMENTARY INFORMATION**

**with
INDEPENDENT AUDITORS' REPORT**

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INDEPENDENT AUDITORS' REPORT

**The Board of Directors of
The Sheltering Arms, Inc. and Subsidiary**

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of The Sheltering Arms, Inc. and Subsidiary (the "Center"), a nonprofit organization, which comprise the consolidated statements of financial position as of December 31, 2019 and 2018, and the related consolidated statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Center's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Sheltering Arms, Inc. and Subsidiary as of December 31, 2019 and 2018, and the changes in its net assets and its cash flows for the years then ended in accordance with GAAP.

Emphasis of Matter

As discussed in Note K to the financial statements, the Center has experienced a decrease in net assets in previous years from operations. Management's evaluation of the events and conditions and management's plans to mitigate those matters are also described in Note K. Our opinion is not modified with respect to that matter.

Report on Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated the date of this report on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Center's internal control over financial reporting and compliance.

Smith & Howard

April 6, 2021

THE SHELTERING ARMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2019 AND 2018

ASSETS

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 920,734	\$ 532,264
Cash and cash equivalents - restricted	423,445	434,403
Interest reserve	192,100	237,300
Grants receivable	733,751	987,083
Unconditional promises to give	272,500	266,337
Prepaid expenses	17,486	-
Investments	5,860,280	5,224,959
Investments held under nonqualified retirement agreements	-	383,568
Property and equipment, net	27,268,458	28,364,009
Notes receivable	6,448,530	6,448,530
	<u>\$ 42,137,284</u>	<u>\$ 42,878,453</u>

LIABILITIES AND NET ASSETS

Accounts payable	\$ 700,800	\$ 1,859,110
Accrued payroll	421,601	301,570
Accrued expenses and other liabilities	93,895	45,000
Obligations under nonqualified retirement agreements	-	383,568
Line of credit	1,550,000	1,000,000
Notes payable, net of debt issuance costs	12,515,623	12,601,335
Total Liabilities	<u>15,281,919</u>	<u>16,190,583</u>
Net Assets		
Without donor restrictions		
Undesignated	6,586,501	5,543,790
Invested in property and equipment, net of related debt	14,752,835	15,762,674
	<u>21,339,336</u>	<u>21,306,464</u>
With donor restrictions	<u>5,516,029</u>	<u>5,381,406</u>
Total net assets	<u>26,855,365</u>	<u>26,687,870</u>
	<u>\$ 42,137,284</u>	<u>\$ 42,878,453</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2019

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Public Support and Revenues and Gains:			
Public Support:			
Government grants and fees	\$ 19,238,876	\$ -	\$ 19,238,876
United Way	225,833	385,000	610,833
Contributions	2,313,810	-	2,313,810
Corporate and foundation grants	913,958	325,000	1,238,958
Net assets released from restrictions:			
United Way	385,000	(385,000)	-
Satisfaction of program restrictions	1,039,111	(1,039,111)	-
Total Public Support	<u>24,116,588</u>	<u>(714,111)</u>	<u>23,402,477</u>
Revenues and Gains:			
Rental income	99,372	-	99,372
Special events and fundraising	122,506	-	122,506
Parent tuition	4,736,026	-	4,736,026
Training and fees	37,574	-	37,574
Investment return, net	69,639	848,734	918,373
Miscellaneous revenue	93,837	-	93,837
Total Revenues and Gains:	<u>5,158,954</u>	<u>848,734</u>	<u>6,007,688</u>
Total Public Support, Revenues and Gains	<u>29,275,542</u>	<u>134,623</u>	<u>29,410,165</u>
Expenses			
Program services	26,211,338	-	26,211,338
Management and general	2,308,009	-	2,308,009
Fundraising	723,323	-	723,323
Total Expenses	<u>29,242,670</u>	<u>-</u>	<u>29,242,670</u>
Change in Net Assets	32,872	134,623	167,495
Net Assets, Beginning of Year	<u>21,306,464</u>	<u>5,381,406</u>	<u>26,687,870</u>
Net Assets, End of Year	<u>\$ 21,339,336</u>	<u>\$ 5,516,029</u>	<u>\$ 26,855,365</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2018

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Public Support and Revenues and Gains:			
Public Support:			
Government grants and fees	\$ 20,044,429	\$ -	\$ 20,044,429
United Way	2,862	385,000	387,862
Contributions	1,449,664	-	1,449,664
Corporate and foundation grants	743,876	185,000	928,876
Net assets released from restrictions:			
United Way	570,298	(570,298)	-
Satisfaction of program restrictions	1,072,318	(1,072,318)	-
Total Public Support	<u>23,883,447</u>	<u>(1,072,616)</u>	<u>22,810,831</u>
Revenues and Gains:			
Rental income	97,811	-	97,811
Special events and fundraising	264,134	-	264,134
Parent tuition	4,788,185	-	4,788,185
Training and fees	31,796	-	31,796
Investment return, net	(925)	(223,665)	(224,590)
Miscellaneous revenue	188,201	-	188,201
Total Revenues and Gains:	<u>5,369,202</u>	<u>(223,665)</u>	<u>5,145,537</u>
Total Public Support, Revenues and Gains	<u>29,252,649</u>	<u>(1,296,281)</u>	<u>27,956,368</u>
Expenses			
Program services	28,767,635	-	28,767,635
Management and general	2,326,571	-	2,326,571
Fundraising	495,259	-	495,259
Total Expenses	<u>31,589,465</u>	<u>-</u>	<u>31,589,465</u>
Change in Net Assets	(2,336,816)	(1,296,281)	(3,633,097)
Net Assets, Beginning of Year	<u>23,643,280</u>	<u>6,677,687</u>	<u>30,320,967</u>
Net Assets, End of Year	<u>\$ 21,306,464</u>	<u>\$ 5,381,406</u>	<u>\$ 26,687,870</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED DECEMBER 31, 2019

	Program Services	Supporting Services		Total
		Management and General	Fundraising	
Salaries	\$ 15,492,476	\$ 1,343,000	\$ 373,051	\$ 17,208,527
Payroll taxes	1,157,881	101,320	27,706	1,286,907
Employee benefits	2,534,303	74,015	29,843	2,638,161
Professional fees	406,163	312,111	279,335	997,609
Food and kitchen supplies	1,278,748	-	-	1,278,748
Supplies	569,816	9,333	6,256	585,405
Telephone	333,075	10,885	4,668	348,628
Postage	868	2,330	1,959	5,157
Repairs and maintenance	1,158,666	25,452	-	1,184,118
Rent	1,089,484	3,476	-	1,092,960
Utilities	461,968	4,661	-	466,629
Transportation costs	61,443	12,847	-	74,290
Conferences and meetings	140,936	32,001	505	173,442
Membership dues	4,903	6,656	-	11,559
Subscriptions	-	18,315	-	18,315
Insurance	229,277	49,455	-	278,732
Training	25,060	26,929	-	51,989
Permits and fees	95,461	39,648	-	135,109
Interest expense	294,370	16,464	-	310,834
Depreciation	876,440	219,111	-	1,095,551
Total Expenses	<u>\$ 26,211,338</u>	<u>\$ 2,308,009</u>	<u>\$ 723,323</u>	<u>\$ 29,242,670</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
Cash Flows from Operating Activities:		
Change in net assets	\$ 167,495	\$ (3,633,097)
Adjustments to reconcile change in net assets to net cash required by operating activities:		
Depreciation	1,095,551	1,117,999
Bad debt expense	-	132,797
Amortization on debt issuance cost	14,288	14,288
Net realized and unrealized (gain) loss on investments	(817,080)	453,446
(Increase) decrease in assets:		
Grants receivable	253,332	128,728
Unconditional promises to give	(6,163)	338,362
Prepaid expenses	(17,486)	16,791
Increase (decrease) in liabilities:		
Accounts payable	(1,158,310)	150,342
Accrued payroll	120,031	(51,370)
Accrued expenses and other liabilities	48,895	(25,579)
Total adjustments	<u>(466,942)</u>	<u>2,275,804</u>
Net cash required by operating activities	<u>(299,447)</u>	<u>(1,357,293)</u>
Cash Flows from Investing Activities:		
Purchases of property and equipment	-	(197,573)
Purchase of investments	(94,241)	(217,027)
Proceeds from sale of investments	<u>276,000</u>	<u>983,555</u>
Net cash provided by investing activities	<u>181,759</u>	<u>568,955</u>
Cash Flows from Financing Activities:		
Borrowings on line of credit	550,000	500,000
Principal payments on notes payable	<u>(100,000)</u>	<u>(481,000)</u>
Net cash provided by financing activities	<u>450,000</u>	<u>19,000</u>
Change in Cash, Cash Equivalents , Restricted Cash, and Interest Reserve	332,312	(769,338)
Cash, Cash Equivalents, Restricted Cash, and Interest Reserve, Beginning of Year	<u>1,203,967</u>	<u>1,973,305</u>
Cash, Cash Equivalents, Restricted Cash, and Interest Reserve, End of Year	<u>\$ 1,536,279</u>	<u>\$ 1,203,967</u>
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the year for interest	<u>\$ 296,546</u>	<u>\$ 266,672</u>
Reconciliation of Cash, Restricted Cash and Interest Reserve to Financial Statements:		
Cash and cash equivalents	\$ 920,734	\$ 532,264
Restricted Cash	423,445	434,403
Interest Reserve	<u>192,100</u>	<u>237,300</u>
	<u>\$ 1,536,279</u>	<u>\$ 1,203,967</u>

The accompanying notes are an integral part of these consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE A – NATURE OF BUSINESS

The Sheltering Arms, Inc. was organized in 1888 and chartered by the State of Georgia. The Sheltering Arms, Inc. is a nonprofit organization dedicated to providing services in the following areas:

- Early childhood care and education – nationally accredited child care, Early and Preschool Head Start, and a Georgia pre-kindergarten program with a combined capacity of 2,395 children through 16 neighborhood centers in 5 metropolitan Atlanta counties, serving over 3,500 children
- Comprehensive support services for families
- Professional development through the Georgia Training Institute, a training institute focused on professional development for child care teachers, administrators and staff who work with families
- Community outreach

The Sheltering Arms NMTC, LLC was formed in 2016 to manage funds related to the New Market Tax Credit (NMTC) program obtained to help construct the Barack and Michelle Obama Center. The Sheltering Arms NMTC, LLC is a wholly owned subsidiary of The Sheltering Arms, Inc.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Principles of Consolidation

The consolidated financial statements include the accounts of The Sheltering Arms, Inc. and The Sheltering Arms NMTC, LLC (collectively, the "Center"). All significant inter-company accounts and transactions have been eliminated.

The Center follows accounting standards set by the Financial Accounting Standards Board ("FASB"). The FASB sets accounting principles generally accepted in the United States of America ("GAAP").

Accounting Pronouncement Adopted

In June 2018, the FASB issued Accounting Standards Update ("ASU") 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this update provide a framework for evaluating whether the transfer of assets constitutes a contribution or an exchange transaction. This amendment also provides additional clarification as to whether or not a contribution is conditional. The Center adopted ASU 2018-08 in 2019. There was no material impact to the consolidated financial position, statement of activities and changes in net assets, or net assets of the Center as a result of implementation.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Presentation

Net assets, along with revenues, expenses, gains and losses, are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Center and changes therein are classified and reported as follows:

- 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 Center.
- Net Assets with Donor Restrictions – Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that such resources be maintained in perpetuity.

Cash and Cash Equivalents, Restricted Cash, and Interest Reserve

For purposes of the consolidated financial statements, the Center considers all liquid instruments having initial maturities of three months or less to be cash equivalents.

At December 31, 2019 and 2018, the Center had restricted cash and cash equivalents related to the New Market Tax Credit transaction as further discussed in Note I, in the amount of \$423,445 and \$434,403, respectively.

At December 31, 2019 and 2018, the Center had interest reserve accounts for the purpose of interest payments on notes payable related to the New Market Tax Credit transaction in the amount of \$192,100 and \$237,300, respectively.

Risks and Uncertainties

The Center's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, interest reserves, unconditional promises to give, and grants receivable. At times, cash and cash equivalents and interest reserves may exceed federally insured amounts. The Center believes it reduces risks associated with balances in excess of federally insured amounts by maintaining its cash and cash equivalents and interest reserves with major financial institutions with sound financial standing. Management continually monitors receivable balances and believes that its exposure to credit risk is limited. If liquidity issues arise in the global credit and capital markets, it is at least reasonably possible that these changes in risks could materially affect the amounts reported in the accompanying consolidated financial statements.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contributions and Unconditional Promises to Give

Contributions, which include unconditional promises to give (pledges), are recognized as revenue in the period the unconditional promise is received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions upon which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. At December 31, 2019 and 2018, unconditional promises to give were \$272,500 and \$266,337, respectively, and are expected to be collected in 2020. No provision has been made for uncollectible accounts, as management considers all accounts to be currently collectible. Uncollectible accounts are expensed on an individual basis when they are deemed to no longer be collectible.

Grants and Contracts

The Center receives grants from federal and state governments and from various other institutions for purposes specified in each grant. Grant revenue on cost-reimbursement grants is recognized when program expenditures have been incurred and is recorded as direct support from the agencies. Grant revenue is reported as an increase in unrestricted net assets without donor restrictions if there are no stipulated restrictions within the grant agreement or if the restrictions are satisfied in the period in which the grant revenue is recognized. Receivables arise from reimbursements owed through these contracts. The Center's ability to collect amounts due is affected by the acceptance of reimbursable expenses and performance-based outcomes, which meet contract requirements.

Investments

Investments are reported at fair market value in accordance with GAAP. Fair value is determined from quoted market prices of similar instruments. Realized and unrealized gains and losses are reflected in the accompanying consolidated statement of activities and changes in net assets as investment return.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measured on a Recurring Basis

GAAP provisions on fair value measurements and disclosures establish a framework for measuring fair value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation technique used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy under GAAP are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, assets or liabilities;

Level 2 - Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

Level 3 - Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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.

Fair value of assets measured on a recurring basis at December 31, 2019 and 2018 were as follows:

	<u>2019</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$ 811	\$ -	\$ -	\$ 811
Mutual funds	268,452	-	-	268,452
Equity securities	3,357,260	-	-	3,357,260
Bond funds	<u>2,233,757</u>	<u>-</u>	<u>-</u>	<u>2,233,757</u>
	<u>\$ 5,860,280</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,860,280</u>

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Measured on a Recurring Basis (Continued)

	2018			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$ 6,493	\$ -	\$ -	\$ 6,493
Mutual funds	262,664	-	-	262,664
Equity securities	2,859,728	-	-	2,859,728
Bond funds	2,096,074	-	-	2,096,074
	<u>\$ 5,224,959</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,224,959</u>

Fair values for investments are determined by reference to quoted market prices and other relevant information generated by market transactions.

Endowments

GAAP requires the following financial statement disclosures for the Center:

- Classification of net assets

The Center includes the following funds within its endowment funds:

- Net assets without donor restrictions which may be used at the discretion of management.
- Net assets with donor restrictions which may be used in accordance with the donor's wishes.
- The principal (corpus) of restricted funds may be invested and the earnings may be used in accordance with the donor's wishes.

Interpretation of Relevant Law

The Center has interpreted the Georgia Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Center classifies as restricted net assets (a) the original value of gifts donated to the endowment, and (b) the original value of subsequent gifts to the endowment. The remaining portion of the donor-restricted endowment fund that is not classified in restricted net assets is classified as net assets and maintained as such for appropriation for expenditure by the Center in a manner consistent with the standard of prudence prescribed by UPMIFA and donors' restriction.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interpretation of Relevant Law (Continued)

In accordance with UPMIFA, the Center considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund.
- (2) The purposes of the Center and the donor-restricted endowment fund.
- (3) General economic conditions.
- (4) The possible effect of inflation and deflation.
- (5) The expected total return from income and the appreciation of investments.
- (6) Other resources of the Center.
- (7) The investment policies of the Center.

Investment Policy and Guidelines

The goal for the endowment's investment pool is to provide a real total return that preserves the purchasing power of the endowment's assets, while generating an income stream to support the endowment's activities. The endowment's real total return will be sought from an investment strategy that provides an opportunity for superior total returns within acceptable levels of risk and volatility.

For the long-term, the primary investment objective for the endowment pool is to earn a total return (net of portfolio management fees), within prudent levels of risk, which is sufficient to maintain in real terms the purchasing power of the endowment's assets and support the defined spending policy. The endowment will attempt to achieve annual returns equal to or in excess of the U.S. Treasury Bill return plus 5% within prudent levels of risk.

Spending Policy

The long-term objective of the spending guideline is to maintain the purchasing power of the endowment with the goal of providing a reasonable, predictable, stable, and sustainable level of income to support current operations. The Investment Committee approves an annual spending rate within a range of three to six percent (3%-6%). The Board-approved rate is applied to a three-year average market value to determine the endowment's distributable earnings.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Underwater Endowment Funds

From time to time, certain donor-restricted endowment funds may have fair values less than the amount required to be maintained by donors or by law (underwater endowments). The Center has interpreted UPMIFA to permit spending from underwater endowments in accordance with prudent measures required under law. At December 31, 2019 and 2018, the Center did not have any endowments that were underwater.

Changes in endowment net assets for the years ended December 31, 2019 and 2018 are as follows:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Endowment net assets, December 31, 2017	\$ 144,326	\$ 6,300,607	\$ 6,444,933
Investment return, net	(11,943)	(223,665)	(235,608)
Amounts used in operations	<u>(100,000)</u>	<u>(884,366)</u>	<u>(984,366)</u>
Endowment net assets, December 31, 2018	32,383	5,192,576	5,224,959
Contributions	10,555	-	10,555
Investment return, net	52,032	848,734	900,766
Reclassification of restriction	543,690	(543,690)	-
Amounts used in operations	<u>-</u>	<u>(276,000)</u>	<u>(276,000)</u>
Endowment net assets, December 31, 2019	<u>\$ 638,660</u>	<u>\$ 5,221,620</u>	<u>\$ 5,860,280</u>

Property and Equipment

The Center capitalizes all expenditures for property and equipment in excess of \$5,000. Purchased property and equipment is carried at cost. Donated property and equipment is carried at the approximate fair market value at the date of the donation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Furniture and equipment is depreciated over useful lives of 5 to 15 years, vehicles over 7 to 10 years, building improvements over 10 to 40 years, and buildings over 40 to 50 years. Upon retirement or disposal of property and equipment, the costs and related accumulated depreciation are eliminated, and any gain or loss is included in the accompanying consolidated statement of activities and changes in net assets.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long-Lived Assets

The Center evaluates its long-lived assets held for use in operations, including real estate, for indicators of impairment and if impaired, records such assets at the lower of cost or fair value in accordance with GAAP. There were no impairment losses incurred by the Center in 2019 and 2018.

Compensated Absences

Employees of the Center are entitled to paid vacations, sick days and other time off depending on job classification, length of service and other factors. The information is not available to estimate the amount of compensation for future absences and, accordingly, no liability has been recorded in the accompanying consolidated financial statements. The Center's policy is to recognize the costs of compensated absences when paid to employees.

Donated Materials and Services

Donated material and equipment are reflected as contributions at their estimated values at date of receipt. No amounts have been reflected for donated volunteer services because they do not meet the criteria for inclusion in the consolidated financial statements. However, a substantial number of volunteers have donated significant amounts of time to the Center's program services and its fundraising activities.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Functional Expenses Allocation

The cost of providing the Center's various programs and other activities has been summarized on a functional basis in the accompanying consolidated statement of activities and changes in net assets. Expenses are charged directly to program, management and general, or fundraising based on a combination of specific identification and allocation by management. Accordingly, certain costs have been allocated between the program and supporting services benefited. The significant expense that is allocated includes depreciation, which allocated based on an estimate of administration and program space.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Center is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The Center qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization other than a private foundation under Section 509(a)(2). Accordingly, no provisions for federal and state income taxes are reflected in the accompanying consolidated financial statements.

The Center annually evaluates all federal and state income tax positions. This process includes an analysis of whether these income tax positions the Center takes meet the definition of an uncertain tax position under the Income Taxes Topic of the Financial Accounting Standards Codification. In the normal course of business, the Center is subject to examination by the federal and state taxing authorities. In general, the Center is no longer subject to tax examinations for tax years ending before December 31, 2016.

Reclassifications

Certain reclassifications have been made to the 2019 consolidated financial statements to conform with the 2018 presentation.

Subsequent Events

Management has evaluated subsequent events through the date of this report, which is the date the consolidated financial statements were available to be issued.

NOTE C – GRANTS RECEIVABLE

Grants receivable consist of the following at December 31:

	<u>2019</u>	<u>2018</u>
Government grants	\$ 733,751	\$ 943,290
Corporate and foundation grants	-	43,793
	<u>\$ 733,751</u>	<u>\$ 987,083</u>

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE D – PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	<u>2019</u>	<u>2018</u>
Land	\$ 1,855,473	\$ 1,855,473
Buildings and improvements	34,929,269	34,929,269
Equipment	7,323,680	7,323,680
Vehicles	205,712	205,712
	<u>44,314,134</u>	<u>44,314,134</u>
Less: accumulated depreciation	<u>(17,045,676)</u>	<u>(15,950,125)</u>
	<u>\$ 27,268,458</u>	<u>\$ 28,364,009</u>

Depreciation expense for the years ended December 31, 2019 and 2018 was \$1,095,551 and \$1,117,999, respectively.

NOTE E – NOTES RECEIVABLE

As part of the NMTC program (see Note I), the Center entered into agreements to lend \$6,448,530 to two investment funds in December 2016. The notes bear interest at .5%. The note matures in December 2052. Management evaluated the financial condition of the borrower and considers the notes receivable fully collectible.

NOTE F – LEASING TRANSACTIONS

Operating Leases

The Center has non-cancelable operating leases for leased facilities and equipment that expire over future years. Future minimum lease payments required under non-cancelable operating leases for years ending December 31 are as follows:

2020	\$ 34,076
2021	29,076
2022	16,961
	<u>\$ 80,113</u>

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE F – LEASING TRANSACTIONS (Continued)

Facility Leases

The Center leases classroom space at three Center locations, expiring in different years ranging from 2026 to 2030, at a rate ranging from of \$1 to \$10,000 payable per year per the lease agreements. The value of the in-kind rent donated for the years ended December 31, 2019 and 2018 was estimated to be approximately \$988,000 and \$1,083,000 each year and is included within contributions on the consolidated statement of activities and changes in net assets and rent within the statement of functional expenses.

Ground Leases

The Center entered into seven long-term ground lease agreements, for the use of certain real property, expiring in different years ranging from 2037 to 2054. The premises are used for the purpose of operating and maintaining the Center facilities, at a rate of \$0 to \$10 payable per year. The fair value of the leasing arrangement is not considered readily determinable.

For the years ended December 31, 2019 and 2018, rent expense for operating leases not including in-kind rent for facilities was approximately \$72,000 and \$75,000, respectively.

Operating Lease Income

The Center has a cancelable agreement to rent office and classroom space in one of its neighborhood centers. Future minimum rental income under the agreement, for 2020 is \$99,774. The agreement expired in 2020 and is currently a month to month agreement.

NOTE G – RETIREMENT PLANS

The Center maintains a Safe Harbor 401(k) Profit-Sharing Plan. The Plan covers all employees who are at least 21 years of age with one or more years of service. The Center's contribution is based on matching 100% of the first 3% and 50% of the succeeding 2% of salary deferral elected by each eligible employee. The Center's contribution for the years ended December 31, 2019 and 2018 was approximately \$104,000 and \$175,000, respectively.

The Center maintains a supplemental executive retirement plan. The plan provides each participant a defined benefit upon death, disability or retirement. The Center purchases various investments to fund benefit payments to the participants. The investment and related liability at December 31, 2018 was \$383,568. During 2019, the last participant was provided a lump sum payment.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE H – NOTES PAYABLE AND LINE OF CREDIT

Notes Payable

Notes payable include the following at December 31:

	<u>2019</u>	<u>2018</u>
Term note payable (a)	\$ 3,730,000	\$ 3,830,000
Notes payable under New Market Tax Credit (See Note I)	9,300,000	9,300,000
	13,030,000	13,130,000
Debt issuance costs	(514,377)	(528,665)
	<u>\$ 12,515,623</u>	<u>\$ 12,601,335</u>

- (a) The Center has a note payable with a financial institution with an outstanding balance at December 31, 2019 of \$3,730,000. The note has a fixed interest rate of 3.80%, with interest installments paid monthly. Annual principal payments of \$100,000 are paid annually until the maturity date when the remaining principal balance is due. The note matures on September 7, 2022 and is secured by the Center's building facilities and equipment. The term note contains various covenants, which place restrictions on the Center's ability to incur additional indebtedness. In addition, under the covenants, the Center is to maintain certain levels of net assets and meet certain financial ratios as defined in the agreement.

Future principal maturities of the notes payable are as follows for the years ending December 31:

2020	\$ 100,000
2021	100,000
2022	3,530,000
2023	-
Thereafter	9,300,000
	<u>\$ 13,030,000</u>

Line of Credit

The Center has a \$1,000,000 line of credit with a financial institution. The line of credit bears interest at LIBOR plus 2.25%, an effective rate of 4% at December 31, 2019. Subsequent to year end, the line of credit's maturity date was extended to January 30, 2022. Outstanding borrowings under the line of credit were \$1,000,000 at December 31, 2019 and 2018, respectively.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE H – NOTES PAYABLE AND LINE OF CREDIT (Continued)

In July 2019, the Center entered into an additional bridge line of credit with a financial institution for \$1,000,000 with a maturity date of December 31, 2020. Subsequent to year end, the line of credit's maturity date was extended to June 30, 2021. The loan is secured by the anticipated proceeds from the sale of Dorothy Arkwright property, discussed further in Note M. Outstanding borrowings under the line of credit was \$550,000 at December 31, 2019.

The notes payable and line of credit described above have certain financial covenants, including a requirement to provide audited financial statements within a certain amount of time sequent to year end. At December 31, 2019, the Center was in compliance with certain financial covenants but not on providing audited financial statements. The Center received a covenant default waiver from the financial institutions.

NOTE I – NEW MARKET TAX CREDIT FINANCING TRANSACTIONS

During 2016, the Center entered into a New Market Tax Credit (NMTC) program. NMTC financing allows organizations such as the Center to receive low-interest loans or investment capital from certified community development entities (CDEs), which will allow their investors to receive tax credits. To earn the tax credit, the NMTC investor must remain invested for a seven-year period, which will end for the Center's NMTC in 2023. As part of this financing arrangement, the Center issued two notes receivable in the total amount of \$6,448,530 to two investment funds (see Note E). The investment funds in turn made investments in two CDEs and hold a 99.99% investor member interest in the CDEs. The CDEs then made loans totaling \$9,300,000 to The Sheltering Arms NMTC, LLC. The loans bear interest at a rate which ranges from .5% to 1.083% and mature on September 1, 2056.

Professional fees associated with the NMTC transaction totaled \$507,481 and are being amortized over the life of the transaction. These costs are netted against the notes payable and amortization of these costs commenced in 2018.

The NMTC loans are not eligible for prepayment and their entire principal amount outstanding is due and payable on the maturity date. The agreements require (the Center) to maintain an interest reserve and the balance of the interest reserve was \$192,100 and \$237,300 at December 31, 2019 and 2018, respectively. The notes may not be prepaid prior to the seventh anniversary of execution at which time the lenders can accelerate repayment. The Sheltering Arms NMTC, LLC would be required to pay \$6,448,530 of principal and any accrued and unpaid interest plus \$1,000 to terminate the debt.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE J – NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are restricted for the following purpose at December 31:

	<u>2019</u>	<u>2018</u>
Subject to expenditure for specified purpose:		
Program support	\$ 101,909	\$ 540,000
United Way	<u>192,500</u>	<u>192,500</u>
	<u>\$ 294,409</u>	<u>\$ 732,500</u>
Subject to spending policy and appropriation:		
Investment in perpetuity (including accumulated amounts above original gift amount of \$3,890,967 in 2019 and 2018), which, once appropriated, is expendable to support:		
Programs	1,356,975	1,066,270
Scholarships	2,356,440	2,301,396
Capital improvements	917,092	781,240
General support	<u>591,113</u>	<u>500,000</u>
	<u>5,221,620</u>	<u>4,648,906</u>
Total net assets with donor restrictions	<u>\$ 5,516,029</u>	<u>\$ 5,381,406</u>

Net assets were released from donor restrictions by incurring expenditures satisfying the restricted purposes. Donor restricted net assets released consisted of the following during the years ended December 31:

	<u>2019</u>	<u>2018</u>
Program Support	\$ 715,294	\$ 757,051
Scholarships	317,037	238,993
United Way Impact	385,000	570,298
Capital improvements	6,780	16,322
General	<u>-</u>	<u>59,952</u>
	<u>\$ 1,424,111</u>	<u>\$ 1,642,616</u>

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
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NOTE K – REALIZATION OF ASSETS

The consolidated financial statements have been prepared on a going concern basis, which assumes that the Center will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of operations. The Center believes it has the assets to operate into the foreseeable future. The Center has developed a cash flow projection which is dependent on the Center being able to continue receiving contributions and extend the maturity dates of the lines of credit as further described in Note H. Management also believes the asset sale as disclosed in Note M is expected to occur during 2021. In prior year, management had an appraisal completed on four of their owned properties, which appraised at approximately \$18,000,000. The Center has been reviewing the options in the event of additional liquidity needs through mortgage options with financial institutions.

NOTE L – LIQUIDITY AND AVAILABILITY OF RESOURCES

For purposes of analyzing resources available to meet general expenditures within one year, the Center considers cash, grants receivable, investments, and unconditional promises to give without donor restriction that will be collected and available in the following year for activities that are ongoing and major to the Center. The Center's financial assets available for general expenditures within one year at December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 920,734	\$ 532,264
Grants receivable	733,751	987,083
Unconditional promises to give	272,500	266,337
Investments	638,660	32,383
	<u>\$ 2,565,645</u>	<u>\$ 1,818,067</u>

As described in Notes H and M, the Center entered into a bridge line of credit of \$1,000,000 which is secured by the Dorothy Arkwright property which will assist in liquidity needs for the near future.

THE SHELTERING ARMS, INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE M – SUBSEQUENT EVENT

The Center has entered into a purchase and sale agreement with a seller on January 16, 2021 for the purchase of the Dorothy Arkwright property. Per the agreement, the closing dated is extended to April 15, 2021.

The Center has experienced a disruption of normal business operations caused from COVID-19 since December 31, 2019. The overall financial impact cannot be determined through the date of this report; however, it is reasonably possible that changes in risks in the near term could occur which could result in a material change to the consolidated financial statements.