

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT

JUNE 30, 2016 AND 2015

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Soles4Souls, Inc.
Nashville, Tennessee

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Soles4Souls, Inc. and supporting organization (collectively the "Organization"), which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of activities, cash flows and functional expenses, 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; 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.

AUDITOR'S 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 auditor's 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 entity'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 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 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 consolidated financial position of Soles4Souls, Inc. and supporting organization as of June 30, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Jonathan CPAs PLLC". The signature is written in a cursive, flowing style.

Nashville, Tennessee
February 22, 2017

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
<u>ASSETS</u>		
Cash	\$ 298,447	\$ 143,931
Accounts receivable	484,092	131,692
Prepaid expenses and other assets	20,470	90,623
Inventories	6,727,661	10,551,369
Investments	-	502,704
Property and equipment, net	<u>2,910,766</u>	<u>3,054,514</u>
TOTAL ASSETS	<u>\$ 10,441,436</u>	<u>\$ 14,474,833</u>
<u>LIABILITIES AND NET ASSETS</u>		
LIABILITIES		
Accounts payable and accrued expenses	\$ 405,272	\$ 432,140
Deposits	52,951	138,894
Obligation under line of credit	-	345,000
Notes payable	<u>2,150,491</u>	<u>2,172,488</u>
TOTAL LIABILITIES	<u>2,608,714</u>	<u>3,088,522</u>
NET ASSETS		
Unrestricted net assets		
Invested in property and equipment, less related debt	760,275	882,026
Unrestricted donated inventory	2,935,701	1,893,871
Undesignated	<u>358,085</u>	<u>69,781</u>
Total unrestricted net assets	4,054,061	2,845,678
Temporarily restricted net assets	<u>3,778,661</u>	<u>8,540,633</u>
TOTAL NET ASSETS	<u>7,832,722</u>	<u>11,386,311</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 10,441,436</u>	<u>\$ 14,474,833</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
GIFTS IN KIND (GIK) CONTRIBUTIONS			
Shoes:			
Corporate shoe donations	\$ 10,996,299	\$ 2,412,916	\$ 13,409,215
Retail store shoe drives	7,137,284	-	7,137,284
Community shoe drives	4,628,221	-	4,628,221
Clothing and other relief item donations	11,158,408	872,647	12,031,055
Net assets released from restriction	<u>8,047,535</u>	<u>(8,047,535)</u>	<u>-</u>
Total GIK contributions	41,967,747	(4,761,972)	37,205,775
PROGRAM SERVICE EXPENSE - GIK distributions	<u>(40,925,917)</u>	<u>-</u>	<u>(40,925,917)</u>
NET CHANGE IN GIK INVENTORY	<u>1,041,830</u>	<u>(4,761,972)</u>	<u>(3,720,142)</u>
SUPPORT AND REVENUE			
Micro-enterprise program fees	3,159,740	-	3,159,740
Contributions	1,210,346	-	1,210,346
International volunteer travel fees	356,556	-	356,556
Interest income	818	-	818
Other income	<u>10,993</u>	<u>-</u>	<u>10,993</u>
TOTAL SUPPORT AND REVENUE	<u>4,738,453</u>	<u>-</u>	<u>4,738,453</u>
EXPENSES			
Program services, excluding GIK distributions above	3,080,845	-	3,080,845
Supporting services			
Management and general	733,478	-	733,478
Fundraising	<u>757,577</u>	<u>-</u>	<u>757,577</u>
Total supporting services	<u>1,491,055</u>	<u>-</u>	<u>1,491,055</u>
TOTAL EXPENSES	<u>4,571,900</u>	<u>-</u>	<u>4,571,900</u>
CHANGE IN NET ASSETS	1,208,383	(4,761,972)	(3,553,589)
NET ASSETS, BEGINNING OF YEAR	<u>2,845,678</u>	<u>8,540,633</u>	<u>11,386,311</u>
NET ASSETS, END OF YEAR	<u>\$ 4,054,061</u>	<u>\$ 3,778,661</u>	<u>\$ 7,832,722</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2015

	Unrestricted	Temporarily Restricted	Total
GIFTS IN KIND (GIK) CONTRIBUTIONS			
Shoes:			
Corporate shoe donations	\$ 8,084,734	\$ 5,369,625	\$ 13,454,359
Retail store shoe drives	5,111,383	-	5,111,383
Community shoe drives	4,823,028	-	4,823,028
Clothing and other relief item donations	8,105,665	3,171,008	11,276,673
Net assets released from restriction	7,533,865	(7,533,865)	-
Total GIK contributions	33,658,675	1,006,768	34,665,443
PROGRAM SERVICE EXPENSE - GIK distributions	(35,672,129)	-	(35,672,129)
NET CHANGE IN GIK INVENTORY	(2,013,454)	1,006,768	(1,006,686)
SUPPORT AND REVENUE			
Micro-enterprise program fees	2,426,443	-	2,426,443
Contributions	1,373,539	-	1,373,539
International volunteer travel fees	370,947	-	370,947
Interest income	1,904	-	1,904
Other income	8,095	-	8,095
TOTAL SUPPORT AND REVENUE BEFORE GIK	4,180,928	-	4,180,928
EXPENSES			
Program services, excluding GIK distributions above	2,781,999	-	2,781,999
Supporting services			
Management and general	684,632	-	684,632
Fundraising	805,684	-	805,684
Total supporting services	1,490,316	-	1,490,316
TOTAL EXPENSES	4,272,315	-	4,272,315
CHANGE IN NET ASSETS	(2,104,841)	1,006,768	(1,098,073)
NET ASSETS, BEGINNING OF YEAR	4,950,519	7,533,865	12,484,384
NET ASSETS, END OF YEAR	\$ 2,845,678	\$ 8,540,633	\$ 11,386,311

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
OPERATING ACTIVITIES		
Change in net assets	\$ (3,553,589)	\$ (1,098,073)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	145,453	154,818
Amortization of debt issuance costs	22,847	3,593
(Increase) decrease in:		
Accounts receivable	(352,400)	(87,696)
Prepaid expenses and other assets	70,153	(52,251)
Inventories	3,823,708	1,084,939
Increase (decrease) in:		
Accounts payable and accrued expenses	(26,868)	(3,435)
Deposits	<u>(85,943)</u>	<u>65,350</u>
TOTAL ADJUSTMENTS	<u>3,596,950</u>	<u>1,165,318</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>43,361</u>	<u>67,245</u>
INVESTING ACTIVITIES		
Accrued interest added to investment balance	(818)	(1,904)
Proceeds from sale of investments	503,522	-
Purchase of property and equipment	<u>(1,705)</u>	<u>-</u>
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	<u>500,999</u>	<u>(1,904)</u>
FINANCING ACTIVITIES		
Repayments of notes payable	(44,844)	(88,906)
Net borrowings (payments) on line of credit	<u>(345,000)</u>	<u>35,000</u>
NET CASH USED IN FINANCING ACTIVITIES	<u>(389,844)</u>	<u>(53,906)</u>
NET INCREASE IN CASH	154,516	11,435
CASH - BEGINNING OF YEAR	<u>143,931</u>	<u>132,496</u>
CASH - ENDING OF YEAR	<u>\$ 298,447</u>	<u>\$ 143,931</u>
SUPPLEMENTAL CASH FLOW DISCLOSURE		
Cash paid during the year for interest	<u>\$ 139,493</u>	<u>\$ 124,537</u>
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Note paid in full upon sale of vehicle	<u>\$ -</u>	<u>\$ 10,985</u>
Note payable incurred with refinance	<u>\$ 2,190,861</u>	<u>\$ -</u>
Debt issuance costs paid included in loan balance	<u>\$ (20,644)</u>	<u>\$ -</u>
Original loan balance repaid with refinance	<u>\$ (2,170,217)</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2016

	<u>Program Services</u>		<u>Supporting Services</u>		<u>Total</u>
	<u>Programs</u>	<u>Gifts in Kind (GIK)</u>	<u>Management and General</u>	<u>Fundraising</u>	
Salaries	\$ 1,315,159	\$ -	\$ 403,574	\$ 347,649	\$ 2,066,382
Employee benefits and payroll taxes	206,853	-	56,695	54,967	318,515
Total personnel costs	<u>1,522,012</u>	<u>-</u>	<u>460,269</u>	<u>402,616</u>	<u>2,384,897</u>
In-kind distributions:					
Shoes	103,894	1,680,196	-	-	1,784,090
Clothing and other relief items	-	678,532	-	-	678,532
Items to the micro-enterprise programs	-	<u>38,567,189</u>	-	-	<u>38,567,189</u>
Total in-kind distributions	103,894	40,925,917	-	-	41,029,811
Other distribution expenses	270,441	-	-	-	270,441
Advertising and promotion	79,404	-	-	19,850	99,254
Auto expenses	21,461	-	1,167	1,167	23,795
Bank fees	-	-	51,614	-	51,614
Depreciation and amortization	126,225	-	25,245	16,830	168,300
Direct mail	-	-	-	158,971	158,971
Events	-	-	-	55,394	55,394
Insurance	106,870	-	21,374	14,249	142,493
Interest	104,620	-	20,924	13,949	139,493
Miscellaneous	48,490	-	52,414	6,464	107,368
Supplies and equipment	26,021	-	2,512	1,675	30,208
Postage, shipping and delivery	69,128	-	13,825	9,217	92,170
Professional fees	53,334	-	55,391	33,484	142,209
Rent	45,877	-	-	-	45,877
Repairs and maintenance	39,533	-	3,598	2,399	45,530
Telephone and utilities	57,500	-	11,500	7,667	76,667
Travel	<u>406,035</u>	<u>-</u>	<u>13,645</u>	<u>13,645</u>	<u>433,325</u>
TOTAL EXPENSES	<u>\$ 3,080,845</u>	<u>\$ 40,925,917</u>	<u>\$ 733,478</u>	<u>\$ 757,577</u>	<u>\$ 45,497,817</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2015

	<u>Program Services</u>		<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
	<u>Programs</u>	<u>Gifts in Kind (GIK)</u>			
Salaries	\$ 1,128,183	\$ -	\$ 367,858	\$ 386,845	\$ 1,882,886
Employee benefits and payroll taxes	189,164	-	54,654	65,486	309,304
 Total personnel costs	 1,317,347	 -	 422,512	 452,331	 2,192,190
In-kind distributions:					
Shoes	78,253	7,959,954	-	-	8,038,207
Clothing and other relief items	-	1,277,112	-	-	1,277,112
Items to the micro-enterprise programs	-	26,435,063	-	-	26,435,063
Total in-kind distributions	78,253	35,672,129	-	-	35,750,382
Other distribution expenses	190,510	-	-	-	190,510
Advertising and promotion	39,675	-	-	9,918	49,593
Auto expenses	22,941	-	1,017	1,017	24,975
Bank fees	-	-	48,425	-	48,425
Depreciation and amortization	118,809	-	23,761	15,841	158,411
Direct mail	-	-	-	131,864	131,864
Events	-	-	-	38,525	38,525
Insurance	125,863	-	25,173	16,782	167,818
Interest	93,402	-	18,681	12,454	124,537
Miscellaneous	41,876	-	24,384	5,579	71,839
Supplies and equipment	27,733	-	1,946	1,297	30,976
Postage, shipping and delivery	87,400	-	17,480	11,653	116,533
Professional fees	137,787	-	75,234	87,225	300,246
Rent	3,317	-	-	-	3,317
Repairs and maintenance	26,764	-	2,197	1,465	30,426
Telephone and utilities	61,331	-	12,266	8,177	81,774
Travel	408,991	-	11,556	11,556	432,103
 TOTAL EXPENSES	 \$ 2,781,999	 \$ 35,672,129	 \$ 684,632	 \$ 805,684	 \$ 39,944,444

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2016 AND 2015

NOTE 1 - ORGANIZATION AND NATURE OF ACTIVITIES

Soles4Souls, Inc. (“Soles4Souls”) was founded in 2006 as an Alabama not-for-profit corporation. Soles4Souls is a global not-for-profit institution dedicated to fighting the devastating impact and perpetuation of poverty. The organization advances its anti-poverty mission by collecting new and used shoes and clothes from individuals, schools, faith-based institutions, civic organizations and corporate partners, then distributing those shoes and clothes both via direct donations to people in need and by provisioning qualified micro-enterprise programs designed to create jobs in poor and disadvantaged communities.

In February 2009, Changing the World Foundation, Inc. (“CTWF”) was formed as a supporting organization as a Tennessee not-for-profit corporation to support and further the charitable purposes of Soles4Souls. Soles4Souls has an economic interest in CTWF combined with control through a majority voting interest of the Board of CTWF. CTWF had no activity during the fiscal year ended June 30, 2016 and is in the process of being formally dissolved.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of Soles4Souls, Inc. and Changing the World Foundation, Inc. (collectively the “Organization”). The accompanying consolidated financial statements are presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“GAAP”). All significant intercompany accounts and transactions have been eliminated in consolidation.

Resources are classified as unrestricted, temporarily restricted or permanently restricted net assets, based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* are free of donor-imposed restrictions. All revenues, gains and losses that are not temporarily or permanently restricted by donors are included in this classification. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donors’ stipulations results in the release of the restriction.
- *Temporarily restricted net assets* are limited as to use by donor-imposed restrictions that expire with the passage of time or that can be satisfied by use for the specific purpose. Temporarily restricted net assets in 2016 and 2015 consisted entirely of donated inventory restricted for distribution outside the United States of America.
- *Permanently restricted net assets* are amounts required by donors to be held in perpetuity, including gifts requiring that the principal be invested and the income or specific portions thereof be used for operations. The Organization had no permanently restricted net assets as of June 30, 2016 and 2015.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contributions and Support

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are restricted by the donor for future periods or for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a restriction is fulfilled (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted and reported in the Consolidated Statement of Activities as net assets released from restrictions. However, if a restriction is fulfilled in the same time period in which the contribution is received, the support is reported as unrestricted.

The Organization reports any gifts of equipment or materials as unrestricted support unless explicit donor restrictions specify how the assets must be used. Gifts of long-lived assets with explicit restrictions as to how the assets are to be used or funds restricted for the acquisition of long-lived assets are reported as restricted support. Expirations of donor restrictions are recognized when the donated or acquired long-lived assets are placed in service.

Certificate of Deposits

Investments at June 30, 2015 consisted of certificates of deposits which were valued at cost plus accrued interest.

Accounts Receivable

Accounts receivable are from micro-enterprise distributors. The Organization does not charge interest on past due accounts. Accounts receivable are deemed to be fully collectible by management and no allowance for bad debts is considered necessary at June 30, 2016 and 2015.

Inventories

Inventories consist primarily of donated new and used footwear, purchased footwear, clothing and other relief items. Management assigns an estimated fair value at the time of donation based on previous experience in the shoe industry and the donor's product, which approximates a range between cost and wholesale. Most donations of new product consist of mixed styles and types, for which management assigns an average fair value as follows: \$30 for men's shoes, \$27 for women's shoes and \$16 for children's shoes. Used shoes obtained through retail stores and community shoe drives are valued at \$4 per pair, which is measured in poundage assuming an average weight of 1.25 lbs. per pair.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inventories (continued)

Donated clothing and other relief items are recorded at their estimated fair value as provided by the donor or, in the absence of donors' valuations, based on the Organization's estimate of wholesale values considering their condition and utility for use, at the time the goods are received from the donor. The Organization values donated new clothing at an average fair value of \$12 per item.

Purchased inventory is valued at the lower of cost or net realizable value, determined by the first-in first-out (FIFO) method. Provision is made to reduce any excess, obsolete or slow moving inventory to net realizable value.

Property, Equipment and Depreciation

Property and equipment are reported at cost, net of accumulated depreciation, and include improvements that significantly add to productive capacity or extend useful lives. It is the Organization's policy to capitalize expenditures for assets with a cost of \$3,000 or greater and an estimated useful life of at least one year. Costs of maintenance and repairs that don't meet the capitalization criteria are charged to expense. When depreciable assets are disposed of, the cost and related accumulated depreciation are removed from the accounts, and any gain (except trade-ins) or loss is recognized. Gains on trade-ins are applied to reduce the cost of the new acquisition.

Depreciation is computed under the straight-line method over the estimated useful lives of depreciable assets, as follows:

Building and improvements	10 - 30 years
Vehicles	5 years
Equipment	3 - 5 years
Furniture and fixtures	7 years

Debt Issuance Costs

Debt issuance costs related to a recognized debt liability are presented in the Consolidated Statements of Financial Position as a direct reduction of the carrying amount of the debt liability. Debt issuance costs are amortized on a straight-line basis over the life of the related debt liability. Amortization of the loan costs are expected to be \$7,684 in 2017, \$7,684 in 2018 and \$4,588 in 2019.

Donated Goods and Services

Donated goods, including donated shoes, clothing, DVDs, books and other relief items, are recorded as gifts in kind (GIK) in the period received at their estimated fair value, if there is an objective and measurable basis for determining such value.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Donated Goods and Services (continued)

Donated services are recognized if they create or enhance nonfinancial assets or the donated service requires specialized skills, was performed by a donor who possesses such skills, and would have been purchased by the Organization if not donated. Such services are recognized at fair value as support and expense in the period the services were performed.

A number of unpaid volunteers have made significant contributions of their time to assist the Organization in implementing various programs. The value of contributed time is not reflected in these financial statements since it is not susceptible to objective measurement or valuation.

Micro-enterprise Program Fees

Recipient organizations that receive used footwear for redistribution are charged a micro-enterprise product fee. Such fees are recognized as revenue at the time the product is shipped to the recipient organization. Amounts collected in advance of shipment are classified initially as deposits in the Consolidated Statement of Financial Position and recognized as revenue in the period the product is shipped.

Advertising

The Organization uses advertising to promote its programs and raise awareness. All advertising costs are expensed when incurred.

Program and Supporting Services

The following program and supporting services are included in the accompanying consolidated financial statements:

Program Services - facilitates the donation and collection of new and used shoes, new and used clothing and other relief items from footwear, clothing and other manufacturers, retailers and individuals. These items are distributed to people in need locally, nationally and internationally through a network of volunteer organizations and in cooperation with other charitable organizations, referred to as distribution partners, who work on the Soles4Souls' behalf to distribute these items providing relief to individuals living in poverty or affected by natural disasters. Through this extensive network, Soles4Souls has distributed shoes and clothing, and other relief supplies to people in more than 127 countries.

Soles4Souls partners with non-governmental organizations (NGOs) in Haiti, Honduras and Moldova who run micro-enterprise operations as well as contracts with established micro-enterprise distributors to distribute shoes and clothing in Central America, South America, Africa and Asia. This program is designed to provide impoverished people in developing nations with the resources to start and maintain their own business.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program and Supporting Services (continued)

Program Services (continued)

Through its Travel4Souls program, volunteers from across the United States join the Soles4Souls staff on distribution trips to various countries to experience first-hand providing shoes and clothing to people in desperate situations. Teams visited Haiti, Costa Rica, Jamaica, Dominican Republic, Guatemala, Honduras, Cuba and Tanzania on 19 trips in 2016 (17 trips in 2015). Shoes and clothing were distributed to children and families in orphanages, schools, villages and tent cities.

The Gifts in Kind (GIK) category segregates Soles4Souls' valuation of donated/collected goods and distribution of those goods based on the fair value for those goods.

Management and General - Includes the functions necessary to ensure an adequate working environment and costs not identifiable with a single program. Applicable costs include those associated with providing coordination and articulation of Soles4Souls' program strategy, business management, general record keeping, budgeting, and related purposes.

Fundraising - Includes costs of activities directed towards appeals for financial support, including special events. Other activities include the cost of solicitations and creation and distribution of fund raising materials.

Allocation of Functional Expenses

Expenses that can be directly attributed to a particular function are charged to that function. Certain costs have been allocated among more than one program or activity based on objectively evaluated financial and non-financial data or reasonable subjective methods determined by management.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

Soles4Souls and CTWF qualify as not-for-profit organizations exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, income taxes are not provided for either organization.

Soles4Souls and CTWF each file a U.S. Federal Form 990 for organizations exempt from income tax.

Management performs an evaluation of all income tax positions taken or expected to be taken in the course of preparing the Organization's income tax returns to determine whether the income tax positions meet a "more likely than not" standard of being sustained under examination by the applicable taxing authorities. Management has performed its evaluation of all income tax positions taken on all open income tax returns and has determined that there were no positions taken that do not meet the "more likely than not" standard. Accordingly, there are no provisions for income taxes, penalties or interest receivable or payable relating to uncertain income tax positions in the accompanying consolidated financial statements.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Authoritative Accounting Guidance

In April 2015, Financial Accounting Standards Board ("FASB") issued guidance requiring 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, consistent with debt discounts. This Accounting Standards Update ("ASU") will be effective for the Organization for fiscal years beginning after December 15, 2015. Early adoption is permitted, and retrospective application is required. The Organization elected to early adopt this ASU. The adoption of this standard does not have a material impact on the Organization's financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Authoritative Accounting Guidance (Continued)

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14 which defers the effective date of ASU 2014-09 one year making it effective for annual reporting periods beginning after December 15, 2018. The Organization has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the financial statements.

In August 2016, the FASB issued ASU 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, which simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. Among other changes, the ASU replaces the three current classes of net assets with two new classes, “net assets with donor restrictions” and “net assets without donor restrictions”, and expands disclosures about the nature and amount of any donor restrictions. ASU 2016-14 is effective for annual periods beginning after December 15, 2017 and interim periods within fiscal years beginning after December 15, 2018, with early adoption permitted. The Organization is currently evaluating the impact the adoption of this guidance will have on its financial statements.

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

Events Occurring After Reporting Date

The Organization has evaluated events and transactions that occurred between June 30, 2016 and February 22, 2017, the date the consolidated financial statements were available to be issued, for possible recognition or disclosure in the consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 3 - INVENTORIES

Inventories consisted of the following at June 30:

	<u>2016</u>	<u>2015</u>
Donated shoes:		
New shoes	\$ 3,624,139	\$ 5,632,126
Used shoes	1,245,488	1,113,289
Donated clothing items	1,682,955	3,408,463
Other donated items:		
Other relief supplies	<u>161,780</u>	<u>280,626</u>
Total donated inventory	6,714,362	10,434,504
Purchased shoes	<u>13,299</u>	<u>116,865</u>
	<u>\$ 6,727,661</u>	<u>\$ 10,551,369</u>

The following is a reconciliation of the beginning and ending balances of donated inventory for the year ended June 30:

	<u>2016</u>	<u>2015</u>
Beginning of year	\$ 10,434,504	\$ 11,441,190
Contributions received	37,205,775	34,665,443
Donated inventory distributed in programs	<u>(40,925,917)</u>	<u>(35,672,129)</u>
End of year	<u>\$ 6,714,362</u>	<u>\$ 10,434,504</u>

Temporarily restricted net assets consist entirely of donated shoe and clothing inventory restricted for distribution outside of the United States and amounts to \$3,778,661 and \$8,540,633, respectively for June 30, 2016 and 2015.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30:

	<u>2016</u>	<u>2015</u>
Land	\$ 238,800	\$ 238,800
Building and improvements	3,198,378	3,198,378
Vehicles	121,152	121,152
Equipment	206,331	204,625
Furniture and fixtures	<u>140,147</u>	<u>140,147</u>
	3,904,808	3,903,102
Less: accumulated depreciation	<u>(994,042)</u>	<u>(848,588)</u>
	<u>\$ 2,910,766</u>	<u>\$ 3,054,514</u>

NOTE 5 - LINES OF CREDIT

In 2015, the Organization had two available lines of credit totaling \$500,500 on which \$345,000 was outstanding at June 30, 2015. The lines each bore interest at a rate of 3.4% annually and were secured by certificates of deposit in the maximum amount of each line. In December 2015, the certificates of deposit were liquidated and the related lines of credit were repaid.

The Organization obtained a new line of credit in September 2016 in the amount of \$200,000 that is cross-collateralized by the deed of trust on the mortgage of the Nashville, Tennessee headquarters facility. The line of credit bears interest at a rate of prime plus 3.5%, with a minimum rate of 4.75% annually, and matures in March 2019.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 6 - NOTES PAYABLE

Notes payable consisted of the following at June 30:

	<u>2016</u>	<u>2015</u>
Mortgage payable on warehouse facility located in Wadley, Alabama. Monthly payments of \$10,039, with final payment in February 2019 of all remaining principal and accrued interest. Interest accrues at a rate of 5.3% per year, and the loan is secured by the underlying property.	\$ 1,469,844	\$ -
Mortgage payable on headquarters facility located in Nashville, Tennessee. Monthly payments of \$4,786, with final payment in February 2019 of all remaining principal and accrued interest. Interest accrues at a rate of 5.3% per year, and the loan is secured by the underlying property.	700,603	-
Mortgage payable on the headquarters facility located in Nashville, Tennessee and the warehouse facility located in Wadley, Alabama. Payments of principal and interest at 6.25% of \$17,957 were due monthly. The loan was secured by a deed of trust on the real estate properties and was refinanced in 2016 as noted above.	-	2,194,647
	2,170,447	2,194,647
Less: loan issuance cost	<u>(19,956)</u>	<u>(22,159)</u>
Total notes payable	<u>\$ 2,150,491</u>	<u>\$ 2,172,488</u>

The loan agreements in effect at year end contain certain financial covenants requiring the maintenance of certain debt service covenants.

Annual principal maturities of notes payable under the terms of the agreements are as follows:

2017	\$ 64,174
2018	67,667
2019	<u>2,038,606</u>
	<u>\$ 2,170,447</u>

Total interest expense on all indebtedness for the year ended June 30, 2016 amounted to \$139,493 (\$124,537 in 2015).

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 7 - EMPLOYEE BENEFIT PLAN

The Organization has a Section 401(k) Safe Harbor plan which covers substantially all employees upon completion of three months of service. The plan allows participants to contribute up to the lesser of 84% of compensation or the amount allowable by the Internal Revenue Code. The Organization makes matching contributions based on a percentage of the participant's contributions up to 6%. Participants are immediately 100% vested in their elective contributions, the Organization's contributions and investment earnings on those balances. Total contributions by the Organization amounted to \$72,729 for the year ended June 30, 2016 (\$72,466 in 2015) and are reported in employee benefits expense in the Consolidated Statement of Functional Expenses.

The plan also provides for the Organization to make discretionary non-elective contributions. The Organization has not made any discretionary contributions to the plan as of June 30, 2016 and 2015.

NOTE 8 - CONCENTRATIONS AND CREDIT RISK

Financial instruments that potentially subject the Organization to concentrations of credit risk consist of cash and accounts receivable.

The Organization maintains cash at financial institutions whose accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to statutory limits. From time to time the Organizations balances may exceed statutory limits. The Organization has not experienced any losses in such accounts and considers this to be a normal business risk.

Accounts receivable are subject to credit risk as they are from concentrated sources. At June 30, 2016, receivables from two MBE distributors totaled \$399,984, or 83% of total accounts receivable.

Donated shoes, clothing and other relief items and micro-enterprise program fees are subject to concentration risk.

During 2016, the Organization:

- Received 35% of its shoe donations from three shoe manufacturers.
- Received 71% of its clothing donations from two manufacturers.
- Utilized four distribution partners to distribute 80% of its total shoe and clothing distributions.
- Utilized four MBE distributors to distribute 85% of items sent to the MBE program.
- Received micro-enterprise programs fees from four companies that represent 77% of total micro-enterprise programs fees.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016 AND 2015

NOTE 8 - CONCENTRATIONS AND CREDIT RISK (CONTINUED)

During 2015, the Organization:

- Received 25% of its shoe donations from one shoe manufacturer.
- Received 63% of its clothing donations from two manufacturers.
- Utilized three distribution partners to distribute 69% of its total shoe and clothing distributions.
- Utilized two MBE distributors to distribute 76% of items sent to the MBE program.
- Received micro-enterprise programs fees from two companies that represent 78% of total micro-enterprise programs fees.