

FINANCIAL STATEMENTS

Covenant House California

Year Ended June 30, 2006 With Summarized Financial Information
for the Year Ended June 30, 2005

Covenant House California

Financial Statements

Year Ended June 30, 2006

With Summarized Financial Information for the Year Ended June 30, 2005

Contents

Report of Independent Auditors.....1

Statements of Financial Position.....2

Statement of Activities.....3

Statement of Functional Expenses4

Statements of Cash Flows.....5

Notes to Financial Statements.....6

Report of Independent Auditors

The Board of Directors
Covenant House California

We have audited the accompanying statement of financial position of Covenant House California (the Organization) as of June 30, 2006, and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of Covenant House California's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from Covenant House California's 2005 financial statements and, in our report dated September 9, 2005, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Organization's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Covenant House California at June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

September 15, 2006, except for Note 8
as to which the date is January 11, 2007

Covenant House California
Statements of Financial Position

	June 30	
	2006	2005
Assets		
Cash and cash equivalents	\$ 1,020,059	\$ 65,080
Investments	5,407,159	7,679,614
Short-term contributions receivable, net	253,442	208,188
Grants receivable	531,915	462,500
Due from parent/affiliates	–	600
Other receivables	45,379	1,119
Inventory and prepaid expenses	55,763	140,867
Deposit for building acquisition	–	500,000
Property, plant and equipment, net	8,281,761	4,945,093
Long-term contributions receivable, net	198,998	421,667
Other assets	10,075	–
Total assets	<u>\$ 15,804,551</u>	<u>\$ 14,424,728</u>
Liabilities and net assets		
Accounts payable, accrued expenses and refundable advances	\$ 588,207	\$ 438,075
Other liabilities	32,574	12,037
Due to parent	381,118	248,005
Deferred revenue	1,186,121	–
Total liabilities	<u>2,188,020</u>	<u>698,117</u>
Net assets:		
Unrestricted:		
Undesignated	2,351,568	5,745,136
Designated for property, plant and equipment	8,281,761	4,945,093
Board designated	2,564,372	2,448,382
Total unrestricted	<u>13,197,701</u>	<u>13,138,611</u>
Temporarily restricted	418,830	588,000
Total net assets	<u>13,616,531</u>	<u>13,726,611</u>
Total liabilities and net assets	<u>\$ 15,804,551</u>	<u>\$ 14,424,728</u>

See accompanying notes.

Covenant House California

Statement of Activities

Year Ended June 30, 2006

With Summarized Financial Information for the Year Ended June 30, 2005

	Unrestricted	Temporarily Restricted	2006 Total	2005 Total
Contributions, revenue and reclassifications:				
Contributions:				
Contributions from individuals, foundations and corporations, including legacies and bequests of \$421,452 (\$440,180 in 2005)	\$ 6,311,101	\$ 281,364	\$ 6,592,465	\$ 6,334,904
Government grants and contracts	1,491,070	473,538	1,964,608	1,553,853
Contributed services and merchandise	82,583	-	82,583	63,384
Support from Parent	36,000	-	36,000	41,684
Special events revenue, less direct benefit to donor costs of \$214,766 (\$180,829 in 2005)	390,002	-	390,002	365,228
Total contributions	8,310,756	754,902	9,065,658	8,359,053
Revenue:				
Investment income:				
Interest and dividends	362,713	-	362,713	222,040
Net unrealized gain	11,622	-	11,622	76,269
Net realized loss	(30,241)	-	(30,241)	(64,738)
Other income	12,089	-	12,089	11,301
Total revenue	356,183	-	356,183	244,872
Total contributions and revenue	8,666,939	754,902	9,421,841	8,603,925
Reclassifications:				
Net assets released from restrictions	924,072	(924,072)	-	-
Total contributions, revenue and reclassifications	9,591,011	(169,170)	9,421,841	8,603,925
Expenses:				
Program services:				
Shelter and crisis care	3,333,876	-	3,333,876	3,223,481
Outreach	406,274	-	406,274	428,290
Medical Services	500,560	-	500,560	537,508
Community service center	1,718,817	-	1,718,817	1,766,258
Public education	57,906	-	57,906	56,023
Rights of Passage/Supportive Apartments	1,282,315	-	1,282,315	1,251,845
Total program services	7,299,748	-	7,299,748	7,263,405
Supporting services:				
Management and general	455,343	-	455,343	325,257
Fundraising	1,776,830	-	1,776,830	1,616,863
Total supporting services	2,232,173	-	2,232,173	1,942,120
Total expenses	9,531,921	-	9,531,921	9,205,525
Changes in net assets	59,090	(169,170)	(110,080)	(601,600)
Net assets at beginning of year	13,138,611	588,000	13,726,611	14,328,211
Net assets at end of year	\$ 13,197,701	\$ 418,830	\$ 13,616,531	\$ 13,726,611

See accompanying notes.

Covenant House California
Statement of Functional Expenses

Year Ended June 30, 2006
With Summarized Financial Information for the Year Ended June 30, 2005

	Program Services							Supporting Services				Total	
	Shelter and Crisis Care	Outreach	Medical Services	Community Service Center	Public Education	Rights of Passage/ Supportive Apartments	Total	Management and General	Fundraising	Direct Cost of Special Events	Total	2006	2005
Salaries and wages	\$ 1,802,417	\$ 206,928	\$ 248,695	\$ 844,315	\$ 40,498	\$ 617,693	\$ 3,760,546	\$ 93,303	\$ 273,746	\$ -	\$ 367,049	\$ 4,127,595	\$ 4,183,451
Payroll taxes	334,686	36,598	36,936	124,378	3,645	99,537	635,780	4,903	29,805	-	34,708	670,488	836,185
Employee benefits	268,678	30,473	37,051	102,129	4,084	88,000	530,415	16,489	29,414	-	45,903	576,318	557,320
Total salaries and related expenses	2,405,781	273,999	322,682	1,070,822	48,227	805,230	4,926,741	114,695	332,965	-	447,660	5,374,401	5,576,956
Accounting fees	-	-	-	-	-	-	-	36,000	-	-	36,000	36,000	31,000
Legal fees	-	-	-	-	-	-	-	-	16,052	-	16,052	16,052	-
Medical fees	1,575	350	72,081	350	-	875	75,231	-	-	-	-	75,231	76,942
Consulting fees	586	60	1,260	180	120	60	2,266	180	42,266	58,087	100,533	102,799	119,461
Supplies	23,676	1,265	7,970	16,972	574	8,950	59,407	1,198	4,869	3,046	9,113	68,520	86,123
Telephone	33,038	3,512	3,648	29,245	920	11,635	81,998	1,809	12,008	-	13,817	95,815	141,636
Postage and printing	12,150	2,469	2,027	6,094	769	6,839	30,348	567	1,205,491	38,555	1,244,613	1,274,961	1,113,872
Occupancy:													
Fuel and utilities	46,841	4,891	5,425	39,309	18	24,639	121,123	4,885	72	-	4,957	126,080	130,894
Repairs and maintenance	24,895	2,872	3,178	31,549	-	11,711	74,205	2,768	-	-	2,768	76,973	54,630
Contributed facilities	-	-	-	-	-	-	-	163	-	-	163	163	-
Rents and other	61,219	163	163	121,081	-	77,230	259,856	132	-	-	132	259,988	218,176
Equipment	41,749	4,897	4,651	55,427	225	25,243	132,192	3,838	1,551	-	5,389	137,581	133,266
Transportation	15,057	1,775	1,170	16,611	1,802	4,438	40,853	1,874	6,481	-	8,355	49,208	68,904
Specific assistance to individuals:													
Food	152,019	38,648	12,882	34,903	-	104,377	342,829	-	-	86,440	86,440	429,269	302,018
Medical	994	-	12,913	286	-	-	14,193	-	-	-	-	14,193	13,140
Clothing,allowances and other	50,969	14,320	3,817	89,678	1,397	29,709	189,890	580	507	-	1,087	190,977	190,567
Contributed clothing and merchandise	26,206	3,214	2,396	5,572	-	7,240	44,628	794	1,780	-	2,574	47,202	27,165
Temporary help	19,214	11,340	90	17,447	-	359	48,450	179	-	-	179	48,629	75,453
Other purchased services	103,217	8,887	12,515	79,005	99	45,121	248,844	8,276	138,463	28,638	175,377	424,221	335,366
Dues,licenses and permits	2,037	487	1,453	2,183	127	924	7,211	256	722	-	978	8,189	11,389
Subscriptions and publications	781	127	127	607	15	398	2,055	33	1,092	-	1,125	3,180	2,237
Staff recruitment	17,612	4,451	2,452	13,347	1,721	7,855	47,438	1,549	1,246	-	2,795	50,233	33,251
Insurance	54,558	12,473	5,039	32,616	-	27,882	132,568	4,701	-	-	4,701	137,269	126,644
Contributed services	9,391	129	2,520	5,659	-	14,789	32,488	67	953	-	1,020	33,508	31,218
Miscellaneous	6,551	1,266	919	6,962	534	3,142	19,374	1,212	5,923	-	7,135	26,509	34,817
Bank charges and fees	-	-	-	-	-	-	-	115,268	225	-	115,493	115,493	135,753
Bad debts	-	-	-	-	-	-	-	131,701	-	-	131,701	131,701	-
Interest	-	-	-	-	-	-	-	20,795	-	-	20,795	20,795	-
Total functional expenses before depreciation and amortization	3,110,116	391,595	481,378	1,675,905	56,548	1,218,646	6,934,188	453,519	1,772,666	214,766	2,440,951	9,375,139	9,070,878
Depreciation and amortization	223,760	14,679	19,182	42,912	1,358	63,669	365,560	1,824	4,164	-	5,988	371,548	315,476
Total functional expenses	3,333,876	406,274	500,560	1,718,817	57,906	1,282,315	7,299,748	455,343	1,776,830	214,766	2,446,939	9,746,687	9,386,354
Less cost of direct benefit to donors	-	-	-	-	-	-	-	-	-	214,766	214,766	214,766	180,829
Total expenses reported by function on the statement of activities	\$ 3,333,876	\$ 406,274	\$ 500,560	\$ 1,718,817	\$ 57,906	\$ 1,282,315	\$ 7,299,748	\$ 455,343	\$ 1,776,830	\$ -	\$ 2,232,173	\$ 9,531,921	\$ 9,205,525

See accompanying notes.

Covenant House California

Statements of Cash Flows

	Years Ended June 30	
	2006	2005
Operating activities		
Changes in net assets	\$ (110,080)	\$ (601,600)
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities:		
Discount on pledges receivables	36,414	–
Depreciation and amortization	371,548	315,476
Net realized and unrealized loss (gain) on investments	18,619	(11,531)
Contributions restricted for capital improvements and renovation	(754,902)	(447,005)
Changes in operating assets and liabilities:		
Receivables	27,326	(339,363)
Prepaid expenses	85,104	74,869
Deposits and other assets	489,925	(500,000)
Accounts payable, accrued expenses and refundable advances	150,132	(56,116)
Due to Parent	133,713	271,790
Other liabilities	20,537	(36,249)
Net cash provided by (used in) operating activities	468,336	(1,329,729)
Investing activities		
Purchase of investments	–	(557,818)
Proceeds from sales and maturities of investments, net	2,253,836	1,111,254
Purchases of property and equipment and construction in progress	(3,708,216)	(124,448)
Net cash (used in) provided by investing activities	(1,454,380)	428,988
Financing activities		
Deferred revenue	1,186,121	–
Contributions restricted for capital improvements	754,902	447,005
Net cash provided by investing activities	1,941,023	447,005
Net increase (decrease) in cash and cash equivalents	954,979	(453,736)
Cash and cash equivalents at beginning of year	65,080	518,816
Cash and cash equivalents at end of year	\$ 1,020,059	\$ 65,080

See accompanying notes.

Covenant House California

Notes to Financial Statements

June 30, 2006

1. Organization

Covenant House California (CHC or the Organization), a not-for-profit organization which was incorporated in October 1986, is an affiliate of Covenant House (the Parent), providing shelter and crisis care and outreach services to youth in the Los Angeles and Oakland, California, areas. The Parent is the sole member of CHC and is itself a private, not-for-profit agency, which, through its affiliates, offered shelter, food, clothing, counseling, medical attention, crisis intervention and other services to over 61,000 runaway and homeless youths during fiscal year 2006.

Covenant House Western Avenue (CHWA) is a separate corporation and an affiliate of CHC. It was established solely for the purpose to hold land upon which a building for CHC's programs in Los Angeles, California, was constructed. CHC has entered into an agreement with CHWA to lease the land for twenty years beginning January 1, 2004 at \$1 per year. CHC is responsible for all related taxes, repairs and maintenance and utility costs.

CHC is affiliated with the following additional not-for-profit organizations through common control by its Parent:

- Covenant House Alaska
- Covenant House Florida
- Covenant House Georgia
- Covenant House Michigan
- Covenant House Missouri
- Covenant House New Jersey
- Covenant House New Orleans
- Covenant House Pennsylvania/Under 21
- Covenant House Texas
- Covenant House Toronto
- Covenant House Vancouver
- Covenant House Washington, D.C.
- Covenant House Western Avenue
- Covenant International Foundation
- Association Casa Alianza (Guatemala)
- Casa Alianza De Honduras
- Casa Alianza Internacional
- Casa Alianza Nicaragua
- Fundacion Casa Alianza Mexico, I.A.P.
- Testamentum
- Under 21

Covenant House California

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies

Summarized Financial Information for Fiscal 2005

The accompanying financial statements include certain prior year summarized comparative information in total but not by net asset class or functional category. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States. Accordingly, such information should be read in conjunction with the financial statements of the Organization for the year ended June 30, 2005, from which the summarized information was derived.

Fund Accounting and Net Asset Classification

To ensure compliance with restrictions placed on the resources available to the Organization, the Organization's accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources are classified for accounting and reporting into funds established according to their nature and purposes. In the financial statements, funds that have similar characteristics have been combined into two net asset categories: temporarily restricted and unrestricted.

- Temporarily restricted net assets contain time and donor-imposed restrictions that permit the Organization to use or expend the assets as specified. The restrictions are satisfied either by the passage of time or by actions of the Organization.
- Unrestricted net assets are not restricted by donors, or the donor-imposed restrictions have expired. The Organization's Board of Directors has designated a portion of the unrestricted net assets of the Organization for facility improvements and program development as follows:

	June 30	
	2006	2005
Building/parking lot	\$ 2,494,000	\$ 2,394,382
Computer upgrades	54,000	54,000
Program development	16,372	-
Total	<u>\$ 2,564,372</u>	<u>\$ 2,448,382</u>

Board-designated funds are included in investments.

Covenant House California

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition

The Organization records earned revenues on an accrual basis; investment income is recognized in accordance with policies enumerated below. In addition, the Organization records as unrestricted revenues the following types of contributions, when they are received unconditionally at their fair value: cash, promises to give (pledges), grants, certain contributed services and gifts of other assets. Multi-year pledges receivable are recorded at present value based on the expected collection date using an estimated discount rate. Conditional contributions and grants are recognized as revenue when the conditions on which they depend have been substantially met. The Organization also raises funds through special events, such as galas. Event revenues, net of related costs, are recorded as unrestricted contributions since such funds can be used for general operations. Costs to generate restricted and unrestricted donations and grants are expensed as incurred.

As of June 30, 2006 and 2005, the Organization had been approved for a number of government cost reimbursable grants, in which conditions stipulated in the grant agreements have not been met. Accordingly, these grants are considered conditional promises to give and are not included in the accompanying financial statements. Awards approved that have not been earned as of June 30, 2006, totaled \$1,890,000, and are expected to be received over the next year. Revenue from cost reimbursable grants is recorded to the extent of expenses incurred applicable to the grant.

Temporarily Restricted Contributions

CHC records contributions as temporarily restricted if they are received with donor stipulations that limit their use either through purpose or time restrictions. When donor restrictions expire, that is, when a time restriction ends or a purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. It is the Organization's policy to record temporarily restricted contributions received and expended in the same accounting period in the unrestricted net asset class activity.

Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and contributions that the donor requires to be used to acquire long-lived assets (e.g., building improvements, furniture, fixtures and equipment) are reported as temporarily restricted. Absent explicit donor restrictions on how long those long-lived assets must be maintained, CHC reflects

Covenant House California

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

the expiration of the donor-imposed restriction when the donated or acquired long-lived assets have been placed in service, at which time temporarily restricted net assets are released from restrictions.

Contributed Services and Merchandise

Contributed services are recognized as revenue if the services received, create or enhance nonfinancial assets, require specialized skills provided by individuals possessing those skills, and typically need to be purchased if not provided by donation. Contributed services are recorded at the fair market value of the services provided. Contributed services and promises to contribute services that do not meet the above criteria are not recognized as revenues and are not reported in the accompanying financial statements.

Contributions of clothing and merchandise are valued at the estimated fair market value at the date of receipt and recognized as revenue when received and expensed from inventory when used.

Cash and Cash Equivalents

For the purpose of the statements of cash flows, CHC considers highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

Investments and Investment Income

The Organization has designated its investments as nontrading which are carried at quoted market prices. Realized and unrealized gains (losses) are determined using the specific identification method. Investment income is comprised of interest, dividends, realized and unrealized gains (losses). Interest and dividends are recognized as earned. Investment income is included in increases and decreases in unrestricted net assets unless its use is temporarily or permanently restricted by donors to a specified purpose or for a future period. At June 30, 2006 and 2005, there are no restrictions on the use of investment income.

Covenant House California

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Functional Expense Allocation

The majority of expenses can generally be directly identified with the program or supporting service to which they relate and are charged accordingly. Other expenses, by function, have been allocated among program and supporting services classifications on the basis of square footage of office space occupied, salaries, and other bases determined by the management of CHC.

Property and Equipment

Property and equipment are recorded at cost if purchased or, if donated, at the fair market value at the date of gift, less accumulated depreciation and amortization. Furniture and equipment is depreciated on a straight-line basis over the estimated useful life of five years. Leasehold improvements are amortized on a straight-line basis over the lesser of the term of the lease or their estimated useful lives. The building is depreciated on a straight-line basis over 30 years. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Repair and maintenance costs are expensed in the period incurred.

Fair Value of Financial Instruments

The following methods and assumptions were used by the Organization in estimating the fair value of its financial instruments:

Cash and Cash Equivalents, Receivables, Accounts Payable and Accrued Expenses

The carrying amount reported in the balance sheets for cash and cash equivalents, contributions, pledges and grants receivable, accounts payable, and accrued expenses approximates its fair value.

Marketable Securities

Investments are stated at fair value in the balance sheets, based on quoted market prices. Refer to Note 4 for further discussion.

Covenant House California

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Deferred Revenue

Deferred revenue represents loans from the state of California to acquire or renovate facilities for emergency shelter and transitional housing and will be forgiven at maturity if the Organization uses the facilities for the specified purpose (refer to Note 5 for further discussion). These loans are accounted for as deferred revenue as the Organization anticipates that the condition will be fulfilled.

Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to concentrations of credit risk consist primarily of investments, cash and cash equivalents and receivables. Investments and cash and cash equivalents are managed within guidelines established by the board of directors which, as a matter of policy, limit the amounts which may be invested with one issuer. Concentrations of credit risk with respect to receivables are limited due to the fact that receivables are due from a number of donors and grant agencies. The Organization had no significant concentrations of credit risk as of June 30, 2006.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect additions to, and deductions from, net assets. Significant estimates include allowances for doubtful accounts on grants and contributions receivable and valuation of outstanding pledges. Actual results could differ from those estimates.

3. Components of Program and Supporting Services

Program services include the following:

The *Shelter and Crisis Care* program provides crisis care, shelter, food, clothing and counseling to abandoned and runaway youths in the Los Angeles area.

Covenant House California

Notes to Financial Statements (continued)

3. Components of Program and Supporting Services (continued)

The *Outreach* program is an effort to reach youths who would otherwise not find their way to the shelter. Outreach vans cruise the city streets every night, searching out these youths and providing them with food, a trained counselor and a safe ride to the shelter.

The *Medical Services* center provides on-site comprehensive emergency medical services to both shelter and outreach youths including medical exams, physical exams, routine laboratory testing, pharmacy services, health education, psychological assessment, HIV/AIDS counseling and testing, etc.

Rights of Passage/Supportive Apartments provides transitional home services for up to 18 months for youths, which include education, job placement, and housing.

The *Community Service Center* program provides comprehensive services to youths who left the Covenant House Crisis Center, and other youths in the community who need support to maintain themselves in stable living situations. Services provided include substance abuse counseling and employment skills training.

Public Education program informs and educates the public on how to identify potential “runaway” and “throwaway” adolescents, the public and private resources available to help such adolescents before they leave home, and the public support services available to help these families to improve their home environment.

Supporting services include the following:

Fund-raising services are related to the activities of the development department in raising general and specific contributions.

Management and General services include administration, finance and general support activities. Certain administrative costs that relate to specific programs have been allocated to such programs.

Direct Benefit to Donor Costs are those costs incurred in connection with special events related to items benefiting attendees of special events, such as meals and entertainment.

Covenant House California

Notes to Financial Statements (continued)

4. Investments

Income earned from investments is recorded as unrestricted, except where the instructions of the donor specify otherwise.

The fair values of investment balances at June 30 are as follows:

	<u>2006</u>	<u>2005</u>
Money market funds	\$ 11,469	\$ 286,873
Common stock	–	180,881
Mutual funds	5,389,730	7,211,860
U.S. government securities	5,960	–
	<u>\$ 5,407,159</u>	<u>\$ 7,679,614</u>

At June 30, 2006 and 2005, gross unrealized losses were \$34,444 and \$64,738, respectively. Over the past several years, the public investments markets experienced significant declines. Management continually reviews its investment portfolio and evaluates whether declines in the fair market value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the recommendation of advisors, the length of time the market value has been less than cost and the magnitude of the decline. During the years ended June 30, 2006 and 2005, the Organization concluded that the decline in the fair value of these investments is temporary.

5. Oakland, California, Property Purchase and Hollywood, California, Crisis Shelter Renovations

In September 2005 and September 2004, CHC was awarded two Emergency Housing Assistance grants (EHAP) of \$1,000,000 and \$480,000, respectively, from the state of California through the Department of Housing and Community Development (DHCD). The \$1,000,000 was received and was used towards the acquisition of a \$3.5 million facility in October 2005 to provide emergency shelter, transitional housing and Rights of Passage (ROP) programs in Oakland, California. The \$480,000 was awarded for the rehabilitation of the crisis shelter and ROP programs at the Hollywood, California, facility. In fiscal 2006, CHC incurred \$186,121 towards this project, pending reimbursement by DHCD. The costs expended were recorded as construction-in-process and included in grants receivable at June 30, 2006. Subsequent to June 30, 2006, the Organization incurred an additional \$293,879 through the renovation completion date.

Covenant House California

Notes to Financial Statements (continued)

5. Oakland, California, Property Purchase and Hollywood, California, Crisis Shelter Renovations (continued)

Pursuant to the facility-use restrictions clause and other terms of the DHCD agreements, the grants are structured as loans to CHC, secured by a deed of trust on the properties and bear interest at the rate of 3% simple interest per annum. The loans will be forgiven after a ten-year period (in the case of the \$1,000,000 grant) and a seven-year period (in the case of the \$480,000 grant) if the Organization maintains the facilities for the stipulated purpose throughout the loan term. The DHCD agreements also contain customary requirements, such as maintaining adequate controls over grant funds, record-keeping and submission of semiannual and annual reports on project status. In the event CHC ceases utilization of the facilities for its programs activities, the state of California shall terminate the loans and require the immediate repayment including all outstanding principal and accrued interests.

As CHC's central mission is to provide emergency shelter and transitional housing for homeless youths and the loans do not impose additional conditions other than those ordinarily performed by the Organization in the normal course of operations, the conditions for forgiveness are expected to be met. As such, the Organization has recorded the capital assets acquired as property, plant and equipment at actual cost and the state funds received or receivable as deferred revenue. The deferred revenue is amortized as unrestricted revenue on a straight-line basis over the respective loan terms. No interest expense is accrued since the Organization does not anticipate that repayment will be required. At June 30, 2006, total deferred revenue in the accompanying statement of financial position was \$1,186,121. The amount of revenue recorded in fiscal 2006 was not significant.

6. Related-Party Transactions

The Parent provides financial support as well as management and organizational support for its affiliated organizations. The Organization received \$36,000 and \$42,000 from the Parent in the fiscal years ended 2006 and 2005, respectively. In addition, the Parent conducts fund-raising activities on behalf of certain affiliates for which costs are allocated to the respective affiliates. Contributions arising from these fund-raising activities are recorded by the respective affiliates. In fiscal 2006 and 2005, expenses of \$1,363,296 and \$1,195,353, respectively, were charged by the Parent for such fund-raising and other activities carried out on behalf of the Organization, which are recorded as fund-raising, management, and general activities in the statement of activities.

Covenant House California

Notes to Financial Statements (continued)

6. Related-Party Transactions (continued)

The Parent also allocates costs of other shared services to the Organization, including insurance and telecommunications expenses. Such amounts totaled \$149,794 and \$154,698 for fiscal 2006 and 2005, respectively. Intercompany amounts due from, or payable to, the Parent do not bear interest and are settled periodically. Net amounts due to Parent at June 30, 2006 and 2005, were \$381,118 and \$247,405, respectively.

7. Tax-Exempt Status

Covenant House California is qualified as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income taxes. As a not-for-profit organization, CHC is exempt from state income taxes under Section 23701-D of the California Bank and Corporation Tax Law. CHC has been classified as a publicly supported charitable organization under Section 509(a)(1) of the Internal Revenue Code and qualifies for the maximum charitable contribution deduction for donors.

8. Pension Plan

CHC participates in a defined benefit pension plan sponsored by the Parent covering substantially all of the employees of the Parent and its domestic affiliates. Benefits are generally based on years of service and final average salary. CHC is allocated annual pension expense by the Parent, which was \$311,301 and \$218,139 for the years ended June 30, 2006 and 2005, respectively. Separate participant data and related pension information for CHC is not available.

Effective December 31, 2006, the Parent froze service credits in the Plan. Compensation increases will continue to apply within the plan structure for those participants who have at least 45 points (age plus years of service). As of June 30, 2006, the Plan's projected benefit obligation is \$7,038,359 greater than its plan assets. The Parent will continue to fund the Plan and the allocation of pension expense by the Parent to the Organization will not change.

In addition, the Parent will adopt a new defined contribution 403(b) savings and retirement plan, effective January 1, 2007. All employees are immediately eligible to enter the 403(b) savings plan. The Parent will match 50 cents for every dollar contributed up to 6.0 % of compensation. All full-time and part-time employees with benefits employed with Covenant House as of December 31, 2006 will immediately receive the employer match. Per diem employees who worked more than 1,000 hours in 2006 are also immediately eligible for the match. In addition, the Parent will add significant employer contributions to the retirement account for all employees

Covenant House California

Notes to Financial Statements (continued)

8. Pension Plan (continued)

who work 1,000 hours in a year. The rate of contribution (percent of compensation) is based upon points. Points equal the sum of age and years of service. The employer contribution percentage ranges are from 1.0% to 9.0% based on points. Employer contributions for the Savings and Retirement Account will be 100% vested after three years of service.

9. Contributions Receivable

CHC is the recipient of several multi-year pledges that are expected to be realized in the following periods:

	<u>2006</u>	<u>2005</u>
In one year or less	\$ 262,192	\$ 366,521
Between one and five years	240,834	350,334
Discount factor of 8.0%	(50,586)	(87,000)
Contributions receivable at present value	<u>\$ 452,440</u>	<u>\$ 629,855</u>

10. Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following at June 30:

	<u>2006</u>	<u>2005</u>
Capital campaign	<u>\$ 418,830</u>	<u>\$ 588,000</u>

Net assets released from restrictions were used for the Shelter and Crisis Care Program.

Covenant House California

Notes to Financial Statements (continued)

11. Lease Commitments

CHC is obligated under certain noncancelable operating lease agreements covering buildings and office equipment that will expire in 2011. Future minimum lease payments due under these obligations for the years ending June 30 are as follows:

2007	\$ 204,432
2008	126,541
2009	120,988
2010	112,145
2011	27,696
	<u>\$ 591,802</u>

12. Allocation of Joint Costs

Covenant House has adopted the requirements of the AICPA's Statement of Position 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Government Entities that Include Fund Raising* (SOP 98-2). The joint costs of certain informational mailings that contain an appeal for funds are allocated between the public education program and fundraising. No such joint costs were incurred during fiscal 2006 or 2005.

13. Government Grants and Contracts

In accordance with the terms of certain government grants, the records of CHC are subject to audit after the date of final payment of the contracts. CHC is liable for any disallowed costs; however, management of CHC believes that the amount of costs disallowed, if any, would not be significant.

14. Commitments and Contingencies

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB FIN 47, *Accounting for Conditional Asset Retirement Obligations – an Interpretation of FASB Statement No. 143*. FIN 47 clarifies that the term "conditional asset retirement obligations" as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlements are conditional on a future event that may or may not be within the control of the entity. FIN 47 indicates that an entity must record a liability for a conditional asset retirement

Covenant House California

Notes to Financial Statements (continued)

14. Commitments and Contingencies (continued)

obligation if the fair value of the obligation can be reasonably estimated and also clarifies when an entity should have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for fiscal years ending after December 15, 2005. As of June 30, 2006, management does not believe that there are significant asset retirement obligations, including obligations to remove asbestos from its properties. There are no plans to sell, remodel or otherwise dispose of the facilities, which would otherwise result in a determinable settlement date and require the Company to estimate and record the fair value of these obligations.