

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED FINANCIAL STATEMENTS

AND

INDEPENDENT AUDITOR'S REPORT

JUNE 30, 2014 AND 2013

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED FINANCIAL STATEMENTS
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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, 2014 and 2013, 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, 2014 and 2013, 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.

EMPHASIS OF A MATTER

As discussed in Note 8 to the financial statements, the Organization is in default on certain covenants of its loan agreement at June 30, 2014, primarily related to a cash flow coverage ratio. The lender and the Organization have entered into a forbearance agreement through October 31, 2015 while the Organization seeks alternative financing. While the Organization believes it will be able to secure alternative financing, it cannot predict the outcome of the negotiations. Our opinion is not modified with respect to that matter.

Kraft CPAs PLLC

Nashville, Tennessee
May 4, 2015

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
<u>ASSETS</u>		
Cash	\$ 132,496	\$ 69,570
Accounts receivable	43,996	19,965
Prepaid expenses and other assets	38,372	21,043
Inventories	11,636,308	14,042,222
Investments	500,800	800,224
Property and equipment, net	3,209,332	3,364,491
Mortgage loan costs, net	25,752	29,345
TOTAL ASSETS	<u>\$ 15,587,056</u>	<u>\$ 18,346,860</u>
<u>LIABILITIES AND NET ASSETS</u>		
<u>LIABILITIES</u>		
Accounts payable and accrued expenses	\$ 435,575	\$ 666,855
Deposits	73,544	246,081
Obligation under line of credit	310,000	-
Notes payable	2,283,553	2,386,778
TOTAL LIABILITIES	<u>3,102,672</u>	<u>3,299,714</u>
<u>NET ASSETS</u>		
Unrestricted net assets		
Invested in property and equipment, less related debt	925,779	977,713
Unrestricted donated inventory	7,461,786	10,701,975
Undesignated	117,415	267,936
Total unrestricted net assets	<u>8,504,980</u>	<u>11,947,624</u>
Temporarily restricted net assets	<u>3,979,404</u>	<u>3,099,522</u>
TOTAL NET ASSETS	<u>12,484,384</u>	<u>15,047,146</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 15,587,056</u>	<u>\$ 18,346,860</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2014

	Unrestricted	Temporarily Restricted	Total
SUPPORT AND REVENUE			
In-kind contributions			
Shoes:			
Corporate shoe donations	\$ 13,224,333	\$ 3,979,404	\$ 17,203,737
Retail store shoe drives	2,631,600	-	2,631,600
Community shoe drives	3,935,895	-	3,935,895
Clothing and other relief item donations	12,159,813	-	12,159,813
Total in-kind contributions	31,951,641	3,979,404	35,931,045
Micro-enterprise program fees	2,438,438	-	2,438,438
Contributions	1,140,515	-	1,140,515
International volunteer travel fees	322,061	-	322,061
Investment income	40,942	-	40,942
Other income	13,811	-	13,811
Net assets released from restriction	3,099,522	(3,099,522)	-
TOTAL SUPPORT AND REVENUE	39,006,930	879,882	39,886,812
EXPENSES			
Program services	40,997,301	-	40,997,301
Management and general	599,666	-	599,666
Fundraising	852,607	-	852,607
TOTAL EXPENSES	42,449,574	-	42,449,574
CHANGE IN NET ASSETS	(3,442,644)	879,882	(2,562,762)
NET ASSETS, BEGINNING OF YEAR	11,947,624	3,099,522	15,047,146
NET ASSETS, END OF YEAR	\$ 8,504,980	\$ 3,979,404	\$ 12,484,384

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2013

	Unrestricted	Temporarily Restricted	Total
SUPPORT AND REVENUE			
In-kind contributions			
Shoes:			
Corporate shoe donations	\$ 16,860,883	\$ 3,099,522	\$ 19,960,405
Retail store shoe drives	10,782,378	-	10,782,378
Community shoe drives	5,795,895	-	5,795,895
Clothing and other relief item donations	8,015,262	-	8,015,262
 Total in-kind contributions	 41,454,418	 3,099,522	 44,553,940
 Micro-enterprise program fees	 2,018,506	 -	 2,018,506
Contributions	1,329,012	-	1,329,012
International volunteer travel fees	412,805	-	412,805
Investment income	230,204	-	230,204
Other income	31,692	-	31,692
Net assets released from restriction	4,638,170	(4,638,170)	-
 TOTAL SUPPORT AND REVENUE	 50,114,807	 (1,538,648)	 48,576,159
 EXPENSES			
Program services	43,675,235	-	43,675,235
Management and general	1,065,728	-	1,065,728
Fundraising	913,809	-	913,809
 TOTAL EXPENSES	 45,654,772	 -	 45,654,772
 CHANGE IN NET ASSETS	 4,460,035	 (1,538,648)	 2,921,387
 NET ASSETS, BEGINNING OF YEAR	 7,487,589	 4,638,170	 12,125,759
 NET ASSETS, END OF YEAR	 \$ 11,947,624	 \$ 3,099,522	 \$ 15,047,146

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
OPERATING ACTIVITIES		
Change in net assets	\$ (2,562,762)	\$ 2,921,387
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Realized and unrealized gains on investments, net	(38,982)	(206,335)
Depreciation	161,037	178,176
Amortization of mortgage loan costs	3,593	3,593
Gain on sale of property and equipment	(4,842)	-
(Increase) decrease in:		
Accounts receivable	(24,031)	(2,833)
Prepaid expenses and other assets	(17,329)	(4,211)
Inventories	2,405,914	(4,374,621)
Increase (decrease) in:		
Accounts payable and accrued expenses	(231,280)	(636,126)
Deposits	(172,537)	27,789
TOTAL ADJUSTMENTS	<u>2,081,543</u>	<u>(5,014,568)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(481,219)</u>	<u>(2,093,181)</u>
INVESTING ACTIVITIES		
Purchase of investments	(584,856)	(1,169,392)
Proceeds from sale of investments	923,262	5,923,243
Purchase of property and equipment	(22,845)	(48,847)
Proceeds from sale of property and equipment	10,824	-
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>326,385</u>	<u>4,705,004</u>
FINANCING ACTIVITIES		
Repayments of notes payable	(92,240)	(106,069)
Net borrowings (payments) on investment margin loan	-	(1,980,000)
Net borrowings (payments) on line of credit	310,000	(466,011)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	<u>217,760</u>	<u>(2,552,080)</u>
NET INCREASE IN CASH	62,926	59,743
CASH - BEGINNING OF YEAR	<u>69,570</u>	<u>9,827</u>
CASH - ENDING OF YEAR	<u>\$ 132,496</u>	<u>\$ 69,570</u>
SUPPLEMENTAL CASH FLOW DISCLOSURE		
Cash paid during the year for interest	<u>\$ 116,888</u>	<u>\$ 140,412</u>
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Note paid in full upon sale of vehicle	<u>\$ 10,985</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, 2014

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 1,265,236	\$ 360,935	\$ 317,934	\$ 1,944,105
Employee benefits and payroll taxes	<u>183,278</u>	<u>45,992</u>	<u>46,283</u>	<u>275,553</u>
Total personnel costs	<u>1,448,514</u>	<u>406,927</u>	<u>364,217</u>	<u>2,219,658</u>
In-kind distributions:				
Shoes	11,920,617	-	-	11,920,617
Clothing and other relief items	484,183	-	-	484,183
Items to the micro-enterprise programs	<u>25,932,604</u>	<u>-</u>	<u>-</u>	<u>25,932,604</u>
Total in-kind distributions	38,337,404	-	-	38,337,404
Other distribution expenses	111,468	-	-	111,468
Advertising and promotion	86,592	-	21,648	108,240
Auto expenses	26,666	1,002	1,002	28,670
Bank fees	-	55,282	-	55,282
Depreciation and amortization	123,472	24,695	16,463	164,630
Direct mail	-	-	153,994	153,994
Events	-	-	108,238	108,238
Insurance	127,645	25,529	17,019	170,193
Interest	87,666	17,533	11,689	116,888
Miscellaneous	12,335	34,288	12,335	58,958
Supplies and equipment	27,609	2,033	1,355	30,997
Postage, shipping and delivery	117,497	1,382	19,352	138,231
Professional fees	48,566	964	101,327	150,857
Rent	41,889	-	-	41,889
Repairs and maintenance	25,803	4,123	2,749	32,675
Telephone and utilities	70,334	14,067	9,378	93,779
Travel	<u>303,841</u>	<u>11,841</u>	<u>11,841</u>	<u>327,523</u>
TOTAL EXPENSES	<u>\$ 40,997,301</u>	<u>\$ 599,666</u>	<u>\$ 852,607</u>	<u>\$ 42,449,574</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2013

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 1,456,567	\$ 483,324	\$ 221,398	\$ 2,161,289
Employee benefits and payroll taxes	<u>221,244</u>	<u>64,847</u>	<u>35,609</u>	<u>321,700</u>
Total personnel costs	<u>1,677,811</u>	<u>548,171</u>	<u>257,007</u>	<u>2,482,989</u>
In-kind distributions:				
Shoes	13,993,630	-	-	13,993,630
Clothing and other relief items	1,663,449	-	-	1,663,449
Items to the micro-enterprise programs	<u>24,522,240</u>	<u>-</u>	<u>-</u>	<u>24,522,240</u>
Total in-kind distributions	40,179,319	-	-	40,179,319
Other distribution expenses	299,761	-	-	299,761
Advertising and promotion	201,838	-	23,269	225,107
Auto expenses	25,193	-	-	25,193
Bank fees	-	90,359	-	90,359
Depreciation and amortization	136,327	27,265	18,177	181,769
Direct mail	-	-	266,712	266,712
Events	18,301	-	43,732	62,033
Insurance	102,400	20,480	13,653	136,533
Interest	92,769	35,274	12,369	140,412
Miscellaneous	7,554	43,857	6,905	58,316
Supplies and equipment	38,778	2,111	1,325	42,214
Postage, shipping and delivery	141,464	1,664	23,300	166,428
Professional fees	114,643	265,111	221,376	601,130
Rent	31,177	-	-	31,177
Repairs and maintenance	24,174	2,138	1,552	27,864
Telephone and utilities	72,985	14,597	9,731	97,313
Travel	<u>510,741</u>	<u>14,701</u>	<u>14,701</u>	<u>540,143</u>
TOTAL EXPENSES	<u>\$ 43,675,235</u>	<u>\$ 1,065,728</u>	<u>\$ 913,809</u>	<u>\$ 45,654,772</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013

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.

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.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Consolidation and Basis of Presentation (Continued)

- *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 2014 and 2013 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, 2014 and 2013.

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.

Cash

Cash consists of checking account balances.

Accounts Receivable

Accounts receivable are from micro-enterprise distributors related to cost of shipping and handling. 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, 2014 and 2013.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inventories

Inventories consist primarily of donated new and used footwear, purchased footwear, clothing, DVDs, books, and other relief items. Items are assigned an estimated fair value by management at the time of donation. Management assigns an estimated fair value 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.

Donated clothing, DVDs, books and other relief supplies 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 market, 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.

Investments

Investments at June 30, 2013 consisted of cash, tax managed fund, mutual funds, equities, equity funds and fixed income funds. Cash is carried at cash value plus any accrued interest. Mutual funds, equities, equity funds and fixed income funds are carried at their quoted market value on the last business day of the reporting period. Changes in unrealized gains and losses are recognized currently in the Consolidated Statement of Activities. At June 30, 2014, investments consist of certificates of deposits which are valued at cost plus accrued interest.

Property and 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 \$1,000 or greater and an estimated useful life of at least one year. Costs of maintenance and repairs 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.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment and Depreciation (Continued)

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

Mortgage Loan Costs

Mortgage loan costs are capitalized and amortized on a straight-line basis over a period of 10 years, the life of the related loan. Amortization of the loan costs will be \$3,593 in 2015 and \$22,159 in 2016.

Fair Value Measurements

The Organization classifies its assets and liabilities measured at fair value based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs).

An 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 maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis:

Investments - Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid securities and certain other products, such as mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows and are classified within Level 2.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements (Continued)

No changes in the valuation methodologies have been made since the prior year.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Organization believes its valuation methods are appropriate and consistent with that of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different fair value measurements at the reporting date.

Donated Goods and Services

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

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 / Deposits

Micro-enterprise program handling fees are charged to certain recipient organizations that receive used footwear for redistribution. 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 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.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 supplies (including diapers, DVD's, books, toys for children, and other relief supplies) 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 Organization's behalf to distribute these items providing relief to individuals living in poverty or affected by natural disasters. Through this extensive network, the Organization has distributed shoes, clothing, and other relief supplies to people in more than 127 countries.

The Organization operates a micro-enterprise operation in Haiti and contracts with established micro-enterprise distributors to distribute shoes in Central America, South America and Africa. This program is designed to provide impoverished people in developing nations with the resources to start and maintain their own business.

Through its Travel4Souls program, volunteers from across the United States join the Organization's 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, Honduras, Guatemala, Jamaica and Tanzania on 17 trips in 2014 (18 trips in 2013). Shoes and clothing were distributed to children and families in orphanages, schools, villages and tent cities.

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 the Organization's 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, 2014 AND 2013

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. Soles4Souls and CTWF's tax returns for years prior to fiscal year end 2011 are now closed and no longer open to further examination by the Internal Revenue Service.

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.

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, 2014 and May 4, 2015, 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, 2014 AND 2013

NOTE 3 - INVENTORIES

Inventories consisted of the following at June 30:

	<u>2014</u>	<u>2013</u>
Donated shoes:		
New shoes	\$ 4,887,437	\$ 8,025,158
Used shoes	1,420,460	1,351,978
Donated clothing items	4,347,638	3,249,630
Other donated items:		
Other relief supplies	<u>785,655</u>	<u>1,174,731</u>
Total donated inventory	11,441,190	13,801,497
Purchased shoes	<u>195,118</u>	<u>240,725</u>
	<u>\$ 11,636,308</u>	<u>\$ 14,042,222</u>

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

	<u>2014</u>	<u>2013</u>
Beginning of year	\$ 13,801,497	\$ 9,423,736
Contributions received	35,931,045	44,553,940
Donated inventory distributed in programs	<u>(38,291,352)</u>	<u>(40,176,179)</u>
End of year	<u>\$ 11,441,190</u>	<u>\$ 13,801,497</u>

At June 30, temporarily restricted net assets consist entirely of donated shoe inventory restricted for distribution outside of the United States and amounts to \$3,979,404 and \$3,099,522, respectively for 2014 and 2013.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 4 - INVESTMENTS

Investments consisted of the following at June 30:

	<u>2014</u>	<u>2013</u>
Cash	\$ -	\$ 2,432
Certificates of deposit	500,800	-
Federal government tax managed fund	-	345,895
Mutual funds	-	8,475
Equities	-	158,164
Equity funds	-	115,529
Fixed income	-	169,729
	<u>\$ 500,800</u>	<u>\$ 800,224</u>

Investment income (loss) consisted of the following for the year ended June 30:

	<u>2014</u>	<u>2013</u>
Interest and dividend income	\$ 7,458	\$ 40,844
Realized gains (losses)	38,982	(163,399)
Unrealized gains	-	369,734
	<u>46,440</u>	<u>247,179</u>
Less: investment fees	<u>(5,498)</u>	<u>(16,975)</u>
Investment income (loss), net	<u>\$ 40,942</u>	<u>\$ 230,204</u>

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 5 - FAIR VALUE MEASUREMENTS

Fair values of financial and nonfinancial assets measured on a recurring basis at June 30, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Mutual funds	\$ 8,475	\$ -	\$ -	\$ 8,475
Federal government tax managed fund	345,895	-	-	345,895
Equities:				
Nonfinancial	1,913	-	-	1,913
Financial	31,132	-	-	31,132
Utilities	5,674	-	-	5,674
Consumer growth	31,430	-	-	31,430
Consumer staples	12,825	-	-	12,825
Consumer cyclical	19,415	-	-	19,415
Industrial commodities	5,171	-	-	5,171
Capital equipment	11,829	-	-	11,829
Technology	23,055	-	-	23,055
Services	3,063	-	-	3,063
Energy	12,657	-	-	12,657
Total equities	<u>158,164</u>	<u>-</u>	<u>-</u>	<u>158,164</u>
Equity funds:				
Emerging markets portfolio	12,126	-	-	12,126
Global real estate	47,184	-	-	47,184
International portfolio	56,219	-	-	56,219
Total equity funds	<u>115,529</u>	<u>-</u>	<u>-</u>	<u>115,529</u>
Fixed income:				
Intermediate duration portfolio	169,729	-	-	169,729
Total investments valued at fair value	<u>\$ 797,792</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 797,792</u>

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30:

	<u>2014</u>	<u>2013</u>
Land	\$ 238,800	\$ 238,800
Building and improvements	3,198,378	3,198,378
Vehicles	121,152	205,986
Equipment	204,625	181,779
Furniture and fixtures	<u>140,147</u>	<u>140,147</u>
	3,903,102	3,965,090
Less: accumulated depreciation	<u>(693,770)</u>	<u>(600,599)</u>
	<u>\$ 3,209,332</u>	<u>\$ 3,364,491</u>

NOTE 7 - LINES OF CREDIT

In October 2013, the Organization obtained a line of credit in the amount of \$300,000 with interest at a rate of 3.75% annually that is secured by a \$300,000 certificate of deposit. The balance on this line was \$300,000 at June 30, 2014. The line of credit was renewed in December 2014 through December 2015 and bears interest at the rate of 3.5% annually.

Additionally, the Organization obtained a second line of credit in May 2014 in the amount of \$200,500 that is secured by a \$200,000 certificate of deposit. The balance on the second line of credit was \$10,000 on June 30, 2014. The second agreement matures on May 4, 2015 and bears interest at the rate of 3.4% annually. The Organization is in the process of renewing this line of credit.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 8 - NOTES PAYABLE

Notes payable consisted of the following at June 30:

	2014	2013
<p>Mortgage payable on the headquarters facility located in Nashville, Tennessee and the warehouse facility located in Wadley, Alabama. Monthly payments of principal and interest in the amount of \$16,250 are scheduled through September 2021 when the unpaid principal balance matures. The rate of interest is 4.75% per annum. The loan is secured by a deed of trust on the real estate properties.</p>	\$ 2,281,408	\$ 2,364,349
<p>Note payable to a bank for purchase of a vehicle. Monthly principal and interest payments of \$1,602 were due through January 2014, at which time the loan was paid in full. The rate of interest was 4.88% and the note was collateralized by the vehicle.</p>	-	10,985
<p>Note payable for the purchase of a vehicle. This note was refinanced in September 2011 and requires monthly principal and interest payments of \$795 through September 2014. The rate of interest is 3.25% and is collateralized by the vehicle.</p>	2,145	11,444
<p>Total notes payable</p>	\$ 2,283,553	\$ 2,386,778

The mortgage payable for the headquarters facility and the warehouse facility were refinanced and consolidated into a \$2.5 million note in September 2012. The note is collateralized by the real estate of both facilities, and requires a specified cash flow coverage ratio. The Organization was not in compliance with the cash flow coverage ratio as of June 30, 2014. In prior years, the Organization has been out of compliance with this covenant and the lender has issued a waiver. However, on March 19, 2015, the lender issued a default letter, thereby declaring the loan in default and the entire balance of the note to be immediately due and payable.

On April 30, 2015, the Organization entered into a forbearance agreement (the "Forbearance Agreement") whereby the lender agrees to forbear from exercising its remedies under the note until October 31, 2015, provided that the Organization complies with certain conditions of forbearance relating to correctness of representations and warranties and financial reporting requirements as outlined in the Forbearance Agreement. During the forbearance period, the interest rate on the underlying indebtedness has been increased to 6.25%.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 8 - NOTES PAYABLE (CONTINUED)

At this time, management intends to fully comply with the conditions of forbearance. While the Organization cannot predict the outcome of the negotiations, management believes that it will be able to secure alternative financing on or before October 31, 2015.

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

Year ending June 30,

2015	\$ 90,957
2016	<u>2,192,596</u>
	<u>\$ 2,283,553</u>

Total interest expense on all indebtedness for the year ended June 30, 2014 amounted to \$116,888 (\$140,412 in 2013).

NOTE 9 - 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 \$76,875 for the year ended June 30, 2014 (\$76,980 in 2013) 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, 2014 and 2013.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2014 AND 2013

NOTE 10 - CONCENTRATIONS AND CREDIT RISK

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

The Organization maintains cash and certificates of deposit 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.

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

During 2014, the Organization:

- Received 37% of its shoe donations from three shoe manufacturers.
- Received 61% of its clothing donations from three manufacturers.
- Utilized 3 distribution partners to distribute 99% of its shoe and clothing distributions.
- Received micro-enterprise programs fees from three companies that represent 97% of total micro-enterprise programs fees.

During 2013, the Organization:

- Received 38% of its shoe donations from two shoe manufacturers.
- Received 58% of its clothing donations from three manufacturers.
- Received 73% of the other relief supplies from three manufacturers.
- Utilized 3 distribution partners to distribute 99% of its shoe and clothing distributions.
- Received micro-enterprise programs fees from three companies that represent 98% of total micro-enterprise programs fees.