

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

JUNE 30, 2011 AND 2010

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED FINANCIAL STATEMENTS

AND

INDEPENDENT AUDITORS' REPORT

JUNE 30, 2011 AND 2010

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated statements of financial position of Soles4Souls, Inc. and Supporting Organization (collectively, the "Organization") as of June 30, 2011 and 2010, and the related consolidated statements of activities, cash flows and functional expenses for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Soles4Souls, Inc. and Supporting Organization as of June 30, 2011 and 2010, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*KraftCPAs PLLC*

Nashville, Tennessee  
May 15, 2012

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2011

	<u>2011</u>	<u>2010</u>
<u>ASSETS</u>		
Cash	\$ 87,042	\$ 20,220
Accounts receivable	8,597	11,436
Prepaid expenses and other assets	130,197	57,059
Inventories	9,629,440	13,536,483
Investments	5,907,926	5,725,659
Property and equipment, net	<u>3,638,342</u>	<u>1,382,378</u>
TOTAL ASSETS	<u>\$ 19,401,544</u>	<u>\$ 20,733,235</u>

LIABILITIES AND NET ASSETS

<u>LIABILITIES</u>		
Accounts payable and accrued expenses	\$ 622,323	\$ 558,949
Deposits	354,252	117,966
Inventory promised for distribution	1,579,200	-
Investment margin loan	750,000	-
Obligation under line of credit	93,078	300,100
Notes payable	<u>2,501,606</u>	<u>867,030</u>
TOTAL LIABILITIES	<u>5,900,459</u>	<u>1,844,045</u>
<u>NET ASSETS</u>		
Unrestricted net assets		
Invested in property and equipment, less related debt	1,136,736	515,348
Unrestricted donated shoe inventory	6,571,332	7,930,173
Undesignated	<u>4,314,109</u>	<u>4,837,359</u>
Total unrestricted net assets	12,022,177	13,282,880
Temporarily restricted net assets	<u>1,478,908</u>	<u>5,606,310</u>
TOTAL NET ASSETS	<u>13,501,085</u>	<u>18,889,190</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 19,401,544</u>	<u>\$ 20,733,235</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT AND REVENUE			
In-kind contributions			
Shoes:			
Corporate shoe donations	\$ 24,841,316	\$ 1,478,908	\$ 26,320,224
Public shoe donations	6,867,610	-	6,867,610
Clothing donations	19,558,353	-	19,558,353
Other relief item donations	7,099,233	-	7,099,233
Total in-kind contributions	<u>58,366,512</u>	<u>1,478,908</u>	<u>59,845,420</u>
Micro-enterprise program fees	3,225,226	-	3,225,226
Contributions	2,171,173	-	2,171,173
International volunteer travel fees	362,038	-	362,038
Investment income	1,017,591	-	1,017,591
Other income	54,780	-	54,780
Net assets released from restriction	<u>5,606,310</u>	<u>(5,606,310)</u>	<u>-</u>
TOTAL SUPPORT AND REVENUE	<u>70,803,630</u>	<u>(4,127,402)</u>	<u>66,676,228</u>
EXPENSES			
Program services	69,956,550	-	69,956,550
Management and general	1,092,067	-	1,092,067
Fundraising	<u>1,015,716</u>	<u>-</u>	<u>1,015,716</u>
TOTAL EXPENSES	<u>72,064,333</u>	<u>-</u>	<u>72,064,333</u>
CHANGE IN NET ASSETS	(1,260,703)	(4,127,402)	(5,388,105)
NET ASSETS, BEGINNING OF YEAR	<u>13,282,880</u>	<u>5,606,310</u>	<u>18,889,190</u>
NET ASSETS, END OF YEAR	<u>\$ 12,022,177</u>	<u>\$ 1,478,908</u>	<u>\$ 13,501,085</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2010

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT AND REVENUE			
In-kind contributions			
Shoes:			
Corporate shoe donations	\$ 53,637,927	\$ 5,606,310	\$ 59,244,237
Public shoe donations	9,068,133	-	9,068,133
Clothing and other relief items	<u>3,398,257</u>	<u>-</u>	<u>3,398,257</u>
Total in-kind contributions	66,104,317	5,606,310	71,710,627
Micro-enterprise program fees	2,892,597	-	2,892,597
Contributions	1,805,779	-	1,805,779
Investment income	639,003	-	639,003
Other income	59,683	-	59,683
Net assets released from restriction	<u>1,160,589</u>	<u>(1,160,589)</u>	<u>-</u>
TOTAL SUPPORT AND REVENUE	<u>72,661,968</u>	<u>4,445,721</u>	<u>77,107,689</u>
EXPENSES			
Program services	64,238,354	-	64,238,354
Management and general	919,720	-	919,720
Fundraising	<u>1,071,700</u>	<u>-</u>	<u>1,071,700</u>
TOTAL EXPENSES	<u>66,229,774</u>	<u>-</u>	<u>66,229,774</u>
CHANGE IN NET ASSETS	6,432,194	4,445,721	10,877,915
NET ASSETS, BEGINNING OF YEAR	<u>6,850,686</u>	<u>1,160,589</u>	<u>8,011,275</u>
NET ASSETS, END OF YEAR	<u>\$ 13,282,880</u>	<u>\$ 5,606,310</u>	<u>\$ 18,889,190</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2011

	<u>2011</u>	<u>2010</u>
OPERATING ACTIVITIES		
Change in net assets	\$ (5,388,105)	\$ 10,877,915
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Realized and unrealized gains on investments, net	(905,743)	(542,123)
Depreciation	118,828	110,719
(Increase) decrease in:		
Accounts receivable	2,839	3,333
Prepaid expenses and other assets	(73,138)	(16,266)
Inventories	3,907,043	(11,518,293)
Increase (decrease) in:		
Accounts payable and accrued expenses	63,374	210,661
Deposits	236,286	117,966
Inventory promised for distribution	<u>1,579,200</u>	<u>-</u>
TOTAL ADJUSTMENTS	<u>4,928,689</u>	<u>(11,634,003)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(459,416)</u>	<u>(756,088)</u>
INVESTING ACTIVITIES		
Purchase of investments	(2,571,387)	(2,768,257)
Proceeds from sale of investments	3,294,863	4,042,738
Purchase of property and equipment	<u>(695,106)</u>	<u>(380,877)</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>28,370</u>	<u>893,604</u>
FINANCING ACTIVITIES		
Repayments of notes payable	(45,110)	(25,145)
Borrowings on investment margin loan	750,000	-
Net payments on line of credit	<u>(207,022)</u>	<u>(97,756)</u>
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	<u>497,868</u>	<u>(122,901)</u>
NET INCREASE IN CASH	66,822	14,615
CASH - BEGINNING OF YEAR	<u>20,220</u>	<u>5,605</u>
CASH - BEGINNING OF YEAR	<u>\$ 87,042</u>	<u>\$ 20,220</u>
NONCASH INVESTING AND FINANCING ACTIVITIES		
Purchase of warehouse facility (2011) and new headquarters facility (2010)	\$ 2,171,699	\$ 1,013,650
Less proceeds of mortgage loan from bank	<u>(1,646,699)</u>	<u>(813,650)</u>
Net cash paid at closing	<u>\$ 525,000</u>	<u>\$ 200,000</u>
Purchase of vehicle financed with note payable	<u>\$ 32,987</u>	<u>\$ -</u>
SUPPLEMENTAL CASH FLOW DISCLOSURE		
Cash paid during the year for interest	<u>\$ 74,170</u>	<u>\$ 41,592</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2011

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 1,565,470	\$ 644,437	\$ 263,259	\$ 2,473,166
Contract labor	73,941	46,033	107,265	227,239
Employee benefits and payroll taxes	<u>238,341</u>	<u>98,115</u>	<u>40,081</u>	<u>376,537</u>
 Total personnel costs	 <u>1,877,752</u>	 <u>788,585</u>	 <u>410,605</u>	 <u>3,076,942</u>
 In-kind distributions:				
Shoes	35,500,805	-	-	35,500,805
Clothing and other relief items	7,958,513	-	-	7,958,513
Items to the micro-enterprise programs	<u>21,992,368</u>	<u>-</u>	<u>-</u>	<u>21,992,368</u>
Total in-kind distributions	65,451,686	-	-	65,451,686
Other distribution expenses	332,336	-	-	332,336
Advertising and promotion	636,143	-	102,009	738,152
Auto expenses	30,656	2,160	2,160	34,976
Depreciation	89,119	17,824	11,885	118,828
Direct mail	-	-	291,302	291,302
Events	96,743	-	88,564	185,307
Insurance	52,309	10,462	6,975	69,746
Interest	47,432	20,414	6,324	74,170
Miscellaneous	20,392	58,057	53	78,502
Supplies and equipment	85,696	7,386	4,924	98,006
Postage, shipping and delivery	138,916	1,634	22,880	163,430
Professional fees	416,987	132,943	21,809	571,739
Rent	134,103	25,985	17,324	177,412
Repairs and maintenance	40,806	2,959	2,433	46,198
Telephone and utilities	86,144	8,064	10,875	105,083
Travel	<u>419,330</u>	<u>15,594</u>	<u>15,594</u>	<u>450,518</u>
 TOTAL EXPENSES	 <u>\$ 69,956,550</u>	 <u>\$ 1,092,067</u>	 <u>\$ 1,015,716</u>	 <u>\$ 72,064,333</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2010

	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Salaries	\$ 1,059,999	\$ 468,895	\$ 213,935	\$ 1,742,829
Contract labor	113,960	11,767	178,219	303,946
Employee benefits and payroll taxes	<u>155,150</u>	<u>48,850</u>	<u>25,280</u>	<u>229,280</u>
Total personnel costs	<u>1,329,109</u>	<u>529,512</u>	<u>417,434</u>	<u>2,276,055</u>
In-kind distributions:				
Shoes, clothing and other relief items	34,461,903	-	-	34,461,903
Items to the micro-enterprise programs	<u>26,166,034</u>	<u>-</u>	<u>-</u>	<u>26,166,034</u>
	60,627,937	-	-	60,627,937
Other distribution expenses	412,879	-	-	412,879
Advertising and promotion	722,425	-	87,904	810,329
Auto expenses	37,693	-	-	37,693
Depreciation	83,039	16,608	11,072	110,719
Direct mail	-	-	267,336	267,336
Events	60,386	-	172,081	232,467
Insurance	31,450	6,290	4,193	41,933
Interest	36,025	3,340	2,227	41,592
Miscellaneous	45,182	36,674	10,000	91,856
Supplies and equipment	75,487	7,821	2,566	85,874
Postage, shipping and delivery	207,250	2,438	34,135	243,823
Professional fees	208,719	259,089	24,177	491,985
Rent	139,117	25,656	17,103	181,876
Repairs and maintenance	26,333	9,970	1,207	37,510
Telephone and utilities	74,229	8,581	6,524	89,334
Travel	<u>121,094</u>	<u>13,741</u>	<u>13,741</u>	<u>148,576</u>
TOTAL EXPENSES	<u>\$ 64,238,354</u>	<u>\$ 919,720</u>	<u>\$ 1,071,700</u>	<u>\$ 66,229,774</u>

See accompanying notes to consolidated financial statements.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2011 AND 2010

NOTE 1 - ORGANIZATION AND NATURE OF ACTIVITIES

Soles4Souls, Inc. ("S4S") was founded in 2006 as an Alabama not-for-profit corporation. S4S's mission is to impact as many lives as possible by providing shoes, apparel, and other basic needs. S4S partners with organizations around the world to provide basic necessities that most of us take for granted, but are critical to people living daily in abject poverty, or recovering from the effects of natural disasters. S4S facilitates donations of shoes, apparel, and other goods from manufacturers, wholesalers, retailers, and the general public. Since inception, S4S has provided over 16 million pairs of shoes to people in need in over 127 countries.

S4S World Headquarters is located in Nashville, Tennessee and its primary warehouse facilities are located in Roanoke and Wadley, Alabama. S4S also maintains a central warehouse location in Las Vegas, Nevada for the convenience of donors in the Western U.S. S4S has engaged Village Northwest Unlimited, a Sheldon, Iowa facility, which offers services and training to 200 individuals with varying types of disabilities including intellectual disabilities, brain injuries, autism, Down syndrome, and others. S4S employs the services of the individuals served at the facility in the preparation of gently used shoes which will then be transported to developing nations through its micro-enterprise program.

In February 2009, Changing the World Foundation, Inc. ("CTWF") was formed as a supporting organization under the laws of the State of Tennessee as a not-for-profit corporation to support and further the charitable purposes of S4S. S4S 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, 2011 AND 2010

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.
- *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, 2011 and 2010.

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.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2011 and 2010.

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. See the Fair Value Measurements policy note for further information on how the values are determined.

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 consist of cash, certificates of deposit, equities, equity funds and fixed income funds. Cash and certificates of deposit are carried at cash value plus accrued interest. 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.

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, 2011 AND 2010

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
Warehouse leasehold improvements	Shorter of estimated useful life or term of lease
Vehicles	5 years
Equipment	3 - 5 years
Furniture and fixtures	7 years

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.

*Donated Inventories* - 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 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, 2011 AND 2010

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements (Continued)

Donated clothing, DVDs, books and other relief supplies are recorded as revenue 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.

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 ("MBE") 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.

Inventory Promised for Distribution

Unconditional promises to give donated inventory are recognized as a liability and in-kind distribution expense in the period the donated inventory is promised to a distribution partner.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 supplies (including hospital beds, water, DVD's, mattresses, high chairs, books, toys etc.) 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. In this way, the Organization focuses on long-term development by distributing shoes and clothing that are inappropriate for crisis relief or that need cleaning or conditioning in order to be useful.

In 2011, the Organization introduced a program that allows volunteers to accompany staff on distribution trips to various countries to experience first-hand providing shoes and clothing to people in desperate situations. Teams visited Haiti, Peru, Honduras, Tanzania, Costa Rica and India on 17 trips in 2011. 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.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Income Taxes

S4S 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.

S4S files U.S. Federal Form 990 for organizations exempt from income tax. S4S's returns for years prior to fiscal year end 2008 are now closed and no longer open to further examination by the Internal Revenue Service. CTWF filed a U.S. Federal Form 990 for the year ended January 31, 2010, and the short-period ended June 30, 2010. Subsequently, CTWF will file a U.S. Federal Form 990 on a June 30 fiscal year end.

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.

Events Occurring After Reporting Date

The Organization has evaluated events and transactions that occurred between June 30, 2011 and May 15, 2012, the date the consolidated financial statements were available to be issued, for possible recognition or disclosure in the consolidated financial statements.

Reclassifications

Certain reclassifications have been made to prior year amounts in order to be comparative with the current year presentation.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 3 - INVENTORIES

Inventories consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Donated shoes:		
New shoes	\$ 5,593,158	\$ 7,473,600
Used shoes	456,251	2,269,429
Donated clothing items	908,834	728,042
Other donated items:		
DVDs	180,510	2,473,785
Books	1,990,338	3,168
Other relief supplies	<u>72,650</u>	<u>114,216</u>
Total donated inventory	9,201,741	13,062,240
Purchased shoes	<u>427,699</u>	<u>474,243</u>
	<u>\$ 9,629,440</u>	<u>\$ 13,536,483</u>

At June 30, 2011, the Organization had promised \$1,579,200 of the book inventory to a distribution partner in the United States. The inventory promised for distribution is recorded as a liability in the Consolidated Statement of Financial Position.

NOTE 4 - INVESTMENTS

Investments consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Cash	\$ 8,876	\$ 17,003
Certificates of deposit	296,903	1,110,050
Equities	2,974,596	2,395,309
Equity funds	1,284,543	1,020,852
Fixed income	<u>1,343,008</u>	<u>1,182,445</u>
	<u>\$ 5,907,926</u>	<u>\$ 5,725,659</u>

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 4 - INVESTMENTS (CONTINUED)

A certificate of deposit in the amount of \$296,903 at June 30, 2011 (\$810,000 at June 30, 2010) was pledged as collateral on a personal loan of the Organization's Chief Executive Officer ("CEO"). As a condition of that loan, the Organization acts as guarantor on the loan and receives guaranty fees from the CEO equal to the difference between 6% and the interest rate on the loan times the outstanding balance, but in no event less than the market rate for such guarantees. The guaranty rate was 2.5% at June 30, 2011 and 2010. In addition, the Organization had a lien on certain real property owned by the Organization's CEO sufficient to secure its guaranty. The guaranty fees received by the Organization amounted to \$17,917 and \$33,815 for the year ended June 30, 2011 and 2010, respectively and is included in other income. On July 14, 2011, the loan for which the Organization was guarantor was satisfied and the collateral was released.

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

	<u>2011</u>	<u>2010</u>
Interest and dividend income	\$ 144,600	\$ 138,222
Realized gains (losses)	211,619	(153,204)
Unrealized gains	<u>694,124</u>	<u>695,327</u>
	1,050,343	680,345
Less: investment fees	<u>(32,752)</u>	<u>(41,342)</u>
Investment income, net	<u>\$ 1,017,591</u>	<u>\$ 639,003</u>

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 5 - FAIR VALUE MEASUREMENTS

Fair values of financial and nonfinancial assets measured on a recurring basis at June 30, 2011 and June 30, 2010 are as follows:

	2011			
	Level 1	Level 2	Level 3	Total
Investments				
Equities:				
Nonfinancial	\$ 12,333	\$ -	\$ -	\$ 12,333
Financial	366,400	-	-	366,400
Utilities	97,072	-	-	97,072
Consumer growth	619,847	-	-	619,847
Consumer staples	154,028	-	-	154,028
Consumer cyclical	242,023	-	-	242,023
Industrial commodities	169,831	-	-	169,831
Capital equipment	277,594	-	-	277,594
Technology	552,104	-	-	552,104
Services	59,784	-	-	59,784
Energy	423,580	-	-	423,580
Total equities	2,974,596	-	-	2,974,596
Equity funds:				
Emerging markets portfolio	187,297	-	-	187,297
Global real estate	239,905	-	-	239,905
International portfolio	857,341	-	-	857,341
Total equity funds	1,284,543	-	-	1,284,543
Fixed income:				
Intermediate duration portfolio	1,343,008	-	-	1,343,008
Total investments valued at fair value	5,602,147	-	-	5,602,147
Donated inventory	-	-	9,201,741	9,201,741
Total assets valued at fair value	\$ 5,602,147	\$ -	\$ 9,201,741	\$ 14,803,888

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 5 - FAIR VALUE MEASUREMENTS (CONTINUED)

	2010			
	Level 1	Level 2	Level 3	Total
Investments				
Equities:				
Nonfinancial	\$ 22,907	\$ -	\$ -	\$ 22,907
Financial	350,325	-	-	350,325
Utilities	70,784	-	-	70,784
Consumer growth	592,318	-	-	592,318
Consumer staples	177,876	-	-	177,876
Consumer cyclical	240,180	-	-	240,180
Industrial commodities	57,381	-	-	57,381
Capital equipment	199,657	-	-	199,657
Technology	418,283	-	-	418,283
Services	17,723	-	-	17,723
Energy	247,875	-	-	247,875
Total equities	2,395,309	-	-	2,395,309
Equity funds:				
Emerging markets portfolio	146,895	-	-	146,895
Global real estate	190,696	-	-	190,696
International portfolio	683,261	-	-	683,261
Total equity funds	1,020,852	-	-	1,020,852
Fixed income:				
Intermediate duration portfolio	1,182,445	-	-	1,182,445
Total investments valued at fair value	4,598,606	-	-	4,598,606
Donated inventory	-	-	13,062,240	13,062,240
Total assets valued at fair value	\$ 4,598,606	\$ -	\$ 13,062,240	\$ 17,660,846

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 5 - FAIR VALUE MEASUREMENTS (CONTINUED)

The following is a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended June 30:

	<u>Donated Inventory</u>	
	<u>2011</u>	<u>2010</u>
Beginning of year	\$ 13,062,240	\$ 1,841,982
Contributions received	59,845,420	71,710,627
Donated inventory distributed in programs	<u>(63,705,919)</u>	<u>(60,490,369)</u>
End of year	<u>\$ 9,201,741</u>	<u>\$ 13,062,240</u>

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Land	\$ 238,800	\$ 195,200
Building and improvements	3,123,993	927,948
Vehicles	242,486	209,500
Equipment	132,704	114,244
Furniture and fixtures	<u>171,479</u>	<u>87,778</u>
	3,909,462	1,534,670
Less: accumulated depreciation	<u>(271,120)</u>	<u>(152,292)</u>
	<u>\$ 3,638,342</u>	<u>\$ 1,382,378</u>

NOTE 7 - INVESTMENT MARGIN LOAN

As of June 30, 2011, the Organization had an outstanding investment margin loan against its brokerage account in the amount of \$750,000. The interest rate on the margin loan is 2.5% per annum on the average monthly outstanding balance.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 8 - LINES OF CREDIT

At June 30, 2010, the Organization had a line of credit in the amount of \$300,100, which was secured by a certificate of deposit in approximately the same amount. The interest rate was 3.75% per annum and matured March 23, 2011. The line of credit was not renewed.

In November 2010, the Organization obtained an unsecured line of credit in the amount of \$100,000. The interest rate was based on the U.S. Prime rate, not to fall below 5%. The balance at June 30, 2011 was \$93,078. This line of credit was paid off in September 2011 when the Organization refinanced certain notes payable.

NOTE 9 - NOTES PAYABLE

Notes payable consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Note payable to a bank for purchase of headquarters facility in January 2010 in the original principal amount of \$813,650. Monthly principal and interest payments of \$5,638 are scheduled through December 2014 and the balance due January 2015. The rate of interest is 5.51% per annum.	\$ 780,506	\$ 804,175
Note payable to a bank for purchase of a warehouse facility in Wadley, Alabama in May 2011. Monthly interest and principal payments of \$11,737 are scheduled through April 2016 and the balance due May 2016. The rate of interest is 5.85% per annum.	1,646,700	-
Note payable to a bank for purchase of a vehicle. Monthly principal and interest payments of \$1,602 are due through January 2014. The rate of interest is 4.88% and the note is collateralized by the vehicle.	46,417	62,855
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.	<u>27,983</u>	<u>-</u>
Total notes payable	<u>\$ 2,501,606</u>	<u>\$ 867,030</u>

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 9 - NOTES PAYABLE (CONTINUED)

The original notes payable for the headquarters facility and the warehouse facility were collateralized by the underlying real estate and an investment account not to fall below \$1,400,000. The notes required a debt service ratio and a specified amount of liquid assets.

The notes payable for the headquarters facility and the warehouse facility were refinanced and consolidated into a \$2.5 million note in September 2011. The new note requires monthly principal and interest payments of \$16,250 and the rate of interest is 4.75%. The note matures September 2021. The note is collateralized by the real estate of both facilities. In addition, the Organization obtained a line of credit in the amount of \$500,000 that matures September 2012. The rate of interest is the bank's prime rate per annum. The note requires a specified cash flow coverage ratio.

Annual principal maturities of notes payable, including the refinanced agreements, are as follows:

Year ending June 30,

2012	\$ 83,464
2013	107,982
2014	104,892
2015	90,931
2016	93,123
Thereafter	<u>2,021,214</u>
	<u>\$ 2,501,606</u>

Total interest expense on all indebtedness for the year ended June 30, 2011 amounted to \$74,170 (\$41,592 in 2010).

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 10 - LEASES

At June 30, 2011, the Organization leased two warehouse facilities under noncancelable operating leases in Roanoke, AL. Rental payments range from \$500 to \$1,000 per month and expire through various lease terms ranging from November 2012 to February 2013. The Organization leased warehouse space in Wadley, AL from February 2010 through May 2011. On May 29, 2011, the Organization purchased this warehouse. (See Note 9.)

Future minimum rental payments under noncancelable operating leases at June 30, 2011 are as follows:

Year ending June 30,

2012	\$ 18,000
2013	<u>10,500</u>
	<u>\$ 28,500</u>

Total rent expense on all leases amounted to \$177,412 in 2011 (\$181,876 in 2010).

NOTE 11 - EMPLOYEE BENEFIT PLAN

Effective August 1, 2007, the Organization implemented a Section 401(k) Safe Harbor plan which covers substantially all employees upon completion of 3 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 \$106,648 for the year ended June 30, 2011 (\$53,710 in 2010) 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, 2011.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 12 - TEMPORARILY RESTRICTED NET ASSETS

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

	<u>2011</u>	<u>2010</u>
Inventory restricted for distribution:		
International (outside the U.S.)	\$ 1,478,908	\$ 3,030,443
Haiti	<u>-</u>	<u>2,575,867</u>
	<u>\$ 1,478,908</u>	<u>\$ 5,606,310</u>

NOTE 13 - 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. As of June 30, 2011, the Organization's cash and certificates of deposits exceeded FDIC limits by approximately \$51,000.

Investments are subject to market risk, the risk inherent in a fluctuating market. The broker/dealer custodian of the Organization's securities is covered by the Securities Investor Protection Corporation ("SIPC"), which insures investor losses attributable to bankruptcy or fraudulent practices of brokerage firms. Coverage is limited to \$500,000, including up to \$250,000 in cash held for the purpose of securities transactions, and not for the purpose of earning interest. In the event of a SIPC liquidation, the custodian also maintains an additional \$24.5 million of insurance for securities, which are protected by the SIPC with a commercial insurer, totaling \$25 million or such lesser amount as is actually in the account value.

Donated shoes, clothing and other relief items and micro-enterprise program fees are subject to concentration risk. During 2011, the Organization:

- Received 11% of its shoe donations from one shoe manufacturer.
- Received 41% of its clothing donations from two manufacturers.
- Received 54% of the other relief supplies from one of its distribution partners.
- Utilized two distribution partners to distribute 33% of its shoe and clothing distributions.
- Received micro-enterprise programs fees from three companies that represent 100% of total micro-enterprise programs fees.

SOLES4SOULS, INC. AND SUPPORTING ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2011 AND 2010

NOTE 14 - COMMITMENTS AND SUBSEQUENT EVENTS

The Organization has entered into employment contracts with certain key employees. The contracts contain provisions for severance compensation ranging from three months to in excess of one year in the event the employee is terminated without cause (excluding disability or death), along with any amounts earned, accrued or owed but not yet paid under the terms of the contract, and any other benefits in accordance with applicable plans and programs of The Organization.

On April 1, 2012, S4S and CEO Wayne Elsey entered into a separation agreement to terminate Elsey's employment contract. The total financial obligation to the organization pursuant to this agreement is \$406,250.