

TENNESSEE JUSTICE CENTER, INC.

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

December 31, 2012 and 2011

TENNESSEE JUSTICE CENTER, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Tennessee Justice Center, Inc.
Nashville, Tennessee

We have audited the accompanying financial statements of Tennessee Justice Center, Inc. (a nonprofit organization), which comprise the statements of assets, liabilities and net assets – modified cash basis as of December 31, 2012 and 2011, and the related statements of revenues, expenses and other changes in net assets – modified cash basis for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting as described in Note 1; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the assets, liabilities and net assets of Tennessee Justice Center, Inc. as of December 31, 2012 and 2011 and its revenues, expenses and other changes in net assets for the years then ended in accordance with the modified cash basis of accounting as described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to that matter.

Frazier, Owen & Hart, PLLC

August 2, 2013

TENNESSEE JUSTICE CENTER, INC.
STATEMENTS OF ASSETS, LIABILITIES AND NET ASSETS - MODIFIED CASH BASIS
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 96,163	\$ 62,258
Investments	<u>458,779</u>	<u>606,423</u>
Total current assets	<u>554,942</u>	<u>668,681</u>
Office furniture and equipment	53,575	48,375
Less accumulated depreciation	<u>(42,633)</u>	<u>(38,754)</u>
Office furniture and equipment, net	<u>10,942</u>	<u>9,621</u>
Total assets	<u><u>\$ 565,884</u></u>	<u><u>\$ 678,302</u></u>
Net Assets		
Net assets:		
Unrestricted	<u>\$ 565,884</u>	<u>\$ 678,302</u>
Total net assets	<u><u>\$ 565,884</u></u>	<u><u>\$ 678,302</u></u>

See accompanying notes.

TENNESSEE JUSTICE CENTER, INC.
STATEMENTS OF REVENUES, EXPENSES AND OTHER CHANGES
IN NET ASSETS - MODIFIED CASH BASIS
For the years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Changes in unrestricted net assets:		
Revenues collected:		
Foundation grants	\$ 217,000	\$ 239,000
Contributions	195,817	188,002
Endowment income	8,430	13,850
Miscellaneous	7,608	6,279
Interest	159	211
Honorarium	100	850
Released from restriction for purpose accomplished	38,040	65,476
Total unrestricted revenues	<u>467,154</u>	<u>513,668</u>
Expenses paid:		
Salaries	<u>444,168</u>	<u>558,900</u>
Contract services:		
Administrative expense - endowment account	3,901	7,372
Other	2,508	2,771
Interpretation	263	2,494
Public relations	99	27,816
Tennessee Health Care Campaign	-	42,000
Total contract services	<u>6,771</u>	<u>82,453</u>
Other expenses:		
Rent	39,680	38,234
Payroll taxes	34,905	44,640
Employee benefits	34,718	65,186
Equipment maintenance	24,242	21,613
Telephone	15,390	16,285
Copies and printing	11,285	10,949
Miscellaneous	7,977	4,664
Audit	7,000	6,700
Insurance	5,315	5,725
Travel	4,916	3,500
Dues	4,731	3,659
Depreciation	4,078	4,192
Postage	3,921	5,174
Litigation	3,537	67,580
Training	1,716	2,529
Office supplies	1,410	6,319
Law library and publications	515	348
Mother's Day reception	160	1,026
Taxes and licenses	-	2,142
Total other expenses	<u>205,496</u>	<u>310,465</u>
Total expenses paid	<u>656,435</u>	<u>951,818</u>

See accompanying notes.

TENNESSEE JUSTICE CENTER, INC.
STATEMENTS OF REVENUES, EXPENSES AND OTHER CHANGES
IN NET ASSETS - MODIFIED CASH BASIS (Continued)
For the years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Other:		
Realized/unrealized (loss) gain on investments	<u>76,863</u>	<u>(8,867)</u>
Decrease in unrestricted net assets	<u>(112,418)</u>	<u>(447,017)</u>
Changes in temporarily restricted net assets:		
Foundation grants	38,040	40,476
Released from restriction for purpose accomplished	<u>(38,040)</u>	<u>(65,476)</u>
Decrease in temporarily restricted net assets	<u>-</u>	<u>(25,000)</u>
Total change in net assets - modified cash basis	(112,418)	(472,017)
Net assets - modified cash basis at beginning of year	<u>678,302</u>	<u>1,150,319</u>
Net assets - modified cash basis at end of year	<u>\$ 565,884</u>	<u>\$ 678,302</u>

See accompanying notes.

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Tennessee Justice Center, Inc. (the “Organization”) is a nonprofit corporation established to provide free or below-cost civil legal services to indigent Tennesseans, through advocacy of all types, all in accordance with the statutes of Tennessee and the Rules of Professional Conduct, as adopted by the Supreme Court of Tennessee. Such legal services shall be provided with funds provided by both public and private sources, and through voluntary services. The Organization has offices in Nashville, Tennessee, from which it serves clients throughout Tennessee.

Basis of Presentation

The Organization prepares its financial statements on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under the modified cash basis of accounting, support and revenue are recognized when received rather than when earned and expenses are recorded when paid rather than when the obligation is incurred.

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

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Organization and/or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization.

All contributions are considered to be available for use unless specifically restricted by the donor. Amounts received that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those classifications of net assets. There were no temporarily restricted or permanently restricted net assets at December 31, 2012 and 2011.

Cash and Cash Equivalents

The Organization considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. At times throughout the year, the Organization’s cash in bank accounts may be in excess of federally insured limits.

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2012 and 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

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

Office Furniture and Equipment

Office furniture and equipment are recorded at cost. Depreciation is computed over the estimated useful lives of depreciable assets using the straight-line method. The estimated useful lives of office furniture and equipment range from three to seven years.

Income Taxes

The Organization has qualified as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code and therefore is not subject to federal income tax. Accordingly, no provision for income taxes has been made in the accompanying financial statements. In addition, the Organization has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of section 509(a) of the Internal Revenue code.

The Organization follows Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") guidance concerning the accounting for uncertainty in income taxes recognized in an entity's financial statements. This guidance prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax years that remain open for examination include years ended December 31, 2009 through December 31, 2012. There are no tax penalties or interest reported in the accompanying financial statements.

Subsequent Events

The Organization evaluated subsequent events through August 2, 2013, when these financial statements were available to be issued. Other than described in Note 8, the Organization is not aware of any significant events that occurred subsequent to the statement of assets, liabilities and net assets – modified cash basis date but prior to the filing of this report that would have a material impact on the financial statements.

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2012 and 2011

NOTE 2 – FAIR VALUE MEASUREMENTS AND INVESTMENTS

The Organization has adopted the fair value measurement topic of the FASB ASC, which establishes a framework for measuring fair value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of the fair value hierarchy are described below:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.
- Level 2 Inputs to the valuation methodology include the following:
- quoted prices for similar assets or liabilities in active markets;
 - quoted prices for identical or similar assets or liabilities in inactive markets;
 - inputs other than quoted prices that are observable for the asset or liability;
 - inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

- Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. A description of the valuation methodologies used for assets measured at fair value is as follows:

Money market instruments: Valued at the net asset value of shares held by the Organization at year end.

Equity securities and mutual funds: Valued at the closing price reported on the active market on which the individual securities are traded.

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 other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2012 and 2011

NOTE 2 – FAIR VALUE MEASUREMENTS AND INVESTMENTS (Continued)

The following table sets forth by level, within the fair value hierarchy, the Organization's assets at fair value as of December 31:

	2012			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$ 19,584	\$ -	\$ -	\$ 19,584
Equity securities:				
Common stock – energy	13,090	-	-	13,090
Common stock – materials	7,224	-	-	7,224
Common stock – industrials	40,719	-	-	40,719
Common stock – consumer discretionary	57,747	-	-	57,747
Common stock – consumer staples	19,930	-	-	19,930
Common stock – health care	16,174	-	-	16,174
Common stock – financials	8,533	-	-	8,533
Common stock – information technology	109,849	-	-	109,849
Common stock – foreign	18,922	-	-	18,922
Common stock – exchange traded	47,727	-	-	47,727
Total equity securities	<u>339,915</u>	<u>-</u>	<u>-</u>	<u>339,915</u>
Mutual funds:				
International stock fund	39,979	-	-	39,979
Total return bond fund	59,301	-	-	59,301
Total mutual funds	<u>99,280</u>	<u>-</u>	<u>-</u>	<u>99,280</u>
Total assets at fair value	<u>\$ 458,779</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 458,779</u>

	2011			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money market funds	\$ 93,019	\$ -	\$ -	\$ 93,019
Equity securities:				
Common stock – energy	26,739	-	-	26,739
Common stock – materials	13,748	-	-	13,748
Common stock – industrials	48,077	-	-	48,077
Common stock – consumer discretionary	48,172	-	-	48,172
Common stock – consumer staples	19,963	-	-	19,963
Common stock – health care	17,049	-	-	17,049
Common stock – financials	13,730	-	-	13,730
Common stock – information technology	101,528	-	-	101,528
Common stock – foreign	24,307	-	-	24,307
Common stock – exchange traded	58,087	-	-	58,087
Total equity securities	<u>371,400</u>	<u>-</u>	<u>-</u>	<u>371,400</u>

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2012 and 2011

NOTE 2 – FAIR VALUE MEASUREMENTS AND INVESTMENTS (Continued)

Mutual funds:

International stock fund	51,786	-	-	51,786
Intermediate-term bond	90,218	-	-	90,218
Total mutual funds	<u>142,004</u>	<u>-</u>	<u>-</u>	<u>142,004</u>
Total assets at fair value	<u>\$ 606,423</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 606,423</u>

During 2012 and 2011, interest and dividends from investments totaled \$8,589 and \$14,061, respectively. Net realized and unrealized gains (losses) on investments amounted to \$76,863 and (\$8,867) for the years ended December 31, 2012 and 2011, respectively.

NOTE 3 – TEMPORARILY RESTRICTED NET ASSETS

During the years ended December 31, 2012 and 2011, the Organization received \$32,275 and \$32,976, respectively, restricted for support of the Legal Education, Advocacy, Services and Empowerment (“LEASE”) Program. At December 31, 2012 and 2011, all funds were used for their intended purpose.

During 2012 and 2011, the Organization received \$5,765 and \$7,500, respectively, restricted for the purchase and installation of a new servers. At December 31, 2012 and 2011, all funds were used for their intended purpose.

NOTE 4 – DONATED SERVICES

Contributed professional services are typically recognized as in-kind contributions if the services received (a) create or enhance long-lived assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. During 2012 and 2011, the Organization received approximately \$929,000 and \$4,900,000, respectively, of pro-bono legal representation from various entities on behalf of its clients. In addition, the Organization received in-kind legal research resources valued at \$22,500 during both 2012 and 2011. Because the Organization presents its financial statements on the modified cash basis, these contributions are not reflected in the accompanying financial statements. Additionally, during 2012 and 2011, the Organization received a significant amount of contributed time from board members and other volunteers that did not meet the criteria for financial statement recognition.

NOTE 5 – CONCENTRATIONS

The Organization receives support from various foundations, corporate and individual donors. A reduction in such amounts could have a significant effect on the Organization’s activities.

The Organization received \$181,000, approximately 33% of revenue, and \$215,000, approximately 44% of revenue, from one grantor for the years ended December 31, 2012 and 2011, respectively.

TENNESSEE JUSTICE CENTER, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2012 and 2011

NOTE 6 – OPERATING LEASE

The Organization conducts its operations from office space under an operating lease. The current lease expires in March 2013. Lease expense for office space totaled \$39,680 and \$38,234 for the years ended December 31, 2012 and 2011, respectively.

At December 31, 2012, future minimum lease payments under this non-cancelable operating lease agreement are as follows:

For Year Ended	
<u>December 31,</u>	
2013	\$ <u>8,745</u>
 Total	 \$ <u>8,745</u>

Subsequent to December 31, 2012, the sublease was terminated by mutual agreement without penalty, and the Organization entered into a new lease for the same premises with the building's new owner. See Note 8.

NOTE 7 – CONTINGENT FEES

The Organization is seeking an award of fees and expenses under the Civil Rights Attorneys' Fees Act for its successful representation of 1.2 million TennCare enrollees in class action litigation known as *Binta B. v. Emkes* (formerly known as *C.J. v. Emkes* and *Grier v. Goetz*). In connection therewith, the Sixth Circuit Court of Appeals ruled on March 20, 2013 that TJC's clients' were prevailing parties and were entitled to an award of attorneys' fees under the Civil Rights Attorneys' Fees Award Act. The court reduced the amount of a 2010 award by the trial court and remanded the case for further proceedings. On May 14, 2013, TJC filed a revised fee application seeking \$1,830,522 plus statutorily prescribed interest. On August 2, 2013, the State filed court documents opposing the application and contending that the maximum amount that the Organization is entitled to receive is approximately \$565,000. The Organization believes that its application for a fee award is well supported by the facts and the law, but the ultimate resolution of the dispute is not currently known.

NOTE 8 – SUBSEQUENT EVENT

Subsequent to December 31, 2012, the Organization extended its lease of office space through December 31, 2013. The new lease requires monthly base rental payments of \$3,433 and can be canceled upon 30 days written notice.