

**EASTER SEALS TENNESSEE, INC.
AND AFFILIATE**

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

August 31, 2010

EASTER SEALS TENNESSEE, INC. AND AFFILIATE

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Easter Seals Tennessee, Inc. and Affiliate
Nashville, Tennessee

We have audited the accompanying consolidated statement of financial position of Easter Seals Tennessee, Inc. and Affiliate (a not-for-profit organization) as of August 31, 2010, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 audit provides 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 Easter Seals Tennessee, Inc. and Affiliate as of August 31, 2010, and the changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Frasier, Dean & Howard, PLLC

October 28, 2010

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
August 31, 2010

Assets	
Current assets:	
Cash and cash equivalents	\$ 307,513
Accounts receivable	336,264
Prepaid expenses	24,598
	<hr/>
Total current assets	668,375
Property and equipment, net	214,183
	<hr/>
Total assets	<u><u>\$ 882,558</u></u>
Liabilities and Net Assets (Deficit)	
Current liabilities:	
Accounts payable	\$ 162,731
Reorganization claims payable	201,377
Accrued expenses	198,645
Advanced payments - State of Tennessee	252,000
Notes payable, current	57,650
	<hr/>
Total current liabilities	872,403
Advanced payments - State of Tennessee	1,731,066
Accrued expenses, net of current portion	75,000
Notes payable, net of current portion	88,100
	<hr/>
Total liabilities	2,766,569
Net deficit:	
Unrestricted	(1,884,011)
	<hr/>
Total net deficit	(1,884,011)
	<hr/>
Total liabilities and net deficit	<u><u>\$ 882,558</u></u>

See accompanying notes.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
For the Year Ended August 31, 2010

Public support and revenue:	
Public support:	
Contributions	\$ 106,084
Special events, net of event costs of \$30,206	<u>61,512</u>
Total public support	<u>167,596</u>
Revenue:	
Government fees and grants	4,400,319
Gain of sale of camp property	2,638,594
Camp rental	49,827
Contract services	42,592
Other	<u>1,138</u>
Total revenue	<u>7,132,470</u>
Total public support and revenue	<u>7,300,066</u>
Expenses and losses:	
Program services:	
Direct services	4,028,178
Public health education	<u>11,521</u>
Total program services	<u>4,039,699</u>
Supporting services:	
Management and general	458,205
Fundraising	<u>131,892</u>
Total supporting services	<u>590,097</u>
National program fee	<u>151,894</u>
Total expenses and losses	<u>4,781,690</u>
Change in net assets before extraordinary item	<u>2,518,376</u>
Extraordinary item:	
Gain on extinguishment of debt	<u>6,782,639</u>
Change in net assets	9,301,015
Net deficit at beginning of year	<u>(11,185,026)</u>
Net deficit at end of year	<u><u>\$ (1,884,011)</u></u>

See accompanying notes.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended August 31, 2010

	Program Services			Supporting Services		National Program Fee	Total Expenses
	Direct Services	Public Health Education	Total	Management and General	Fundraising		
Salaries and related expenses	\$ 3,359,027	\$ 10,107	\$ 3,369,134	\$ 223,148	\$ 115,425	\$ -	\$ 3,707,707
Professional fees	71,097	214	71,311	138,245	2,096	-	211,652
Occupancy	117,534	-	117,534	57,528	-	-	175,062
National program fee	-	-	-	-	-	151,894	151,894
Travel and transportation	117,271	353	117,624	2,056	715	-	120,395
Insurance	95,013	286	95,299	5,582	1,834	-	102,715
Telephone	70,439	212	70,651	5,743	1,902	-	78,296
Supplies	69,692	-	69,692	2,388	740	-	72,820
Depreciation and amortization	62,968	189	63,157	4,912	2,105	-	70,174
Rental and maintenance of equipment	15,862	48	15,910	3,310	2,819	-	22,039
Utilities	19,315	58	19,373	-	-	-	19,373
Miscellaneous	5,150	-	5,150	7,189	-	-	12,339
Membership and support payments	3,668	-	3,668	3,582	894	-	8,144
Building and grounds maintenance	6,549	20	6,569	32	32	-	6,633
Conferences, conventions and meetings	6,126	18	6,144	1,372	101	-	7,617
Advertising	5,032	15	5,047	2,391	-	-	7,438
Specific assistance	2,981	-	2,981	-	-	-	2,981
Postage and shipping	312	1	313	727	1,904	-	2,944
Printing and publications	142	-	142	-	1,325	-	1,467
Total functional expenses	\$ 4,028,178	\$ 11,521	\$ 4,039,699	\$ 458,205	\$ 131,892	\$ 151,894	\$ 4,781,690

See accompanying notes.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Year Ended August 31, 2010

Cash flows from operating activities:	
Change in net assets	\$ 9,301,015
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Depreciation	70,174
Net gain on sale of property	(2,638,594)
Net gain on extinguishment of debt	(6,782,639)
Changes in operating assets and liabilities:	
Accounts receivable	141,214
Prepaid expenses	(16,385)
Accounts payable	(103,778)
Accrued expenses	(760)
Advanced payments - State of Tennessee	(320,699)
Net cash used in operating activities	<u>(350,452)</u>
Cash flows from investing activities:	
Net proceeds from sale of camp property	2,837,415
Purchases of property and equipment	<u>(34,824)</u>
Net cash provided by investing activities	<u>2,802,591</u>
Cash flows from financing activities:	
Payments on notes payable	<u>(2,163,905)</u>
Net cash used in financing activities	<u>(2,163,905)</u>
Net increase in cash and cash equivalents	288,234
Cash and cash equivalents at beginning of year	<u>19,279</u>
Cash and cash equivalents at end of year	<u><u>\$ 307,513</u></u>
Supplemental disclosure of cash flow information:	
Reorganization items:	
Non-cash investing and financing activity:	
Notes payable reduced through reorganization proceedings	<u><u>\$ 4,944,903</u></u>

See accompanying notes.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
August 31, 2010

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES

Easter Seals Tennessee, Inc. and Affiliate (“Easter Seals”) is a not-for-profit organization organized in Nashville, Tennessee in 1923. Easter Seals provides programs and services to children and adults with disabilities throughout Tennessee. Easter Seals owns a membership interest in Easter Seals West Tennessee, LLC (“West”). West was formed in 2004 in connection with obtaining a credit facility secured by certain assets (primarily accounts receivable and equipment) related to Easter Seals West Tennessee operations. West operates as a single member limited liability company wholly owned by Easter Seals.

Principles of Consolidation

The financial statements include the accounts of Easter Seals and West. All significant inter-entity transactions and balances have been eliminated in consolidation.

Accounting Standards Codification

The Financial Accounting Standards Board (“FASB ASC”) became the sole authoritative source of generally accepted accounting principles in the United States of America for periods ending after September 15, 2009. The FASB ASC incorporates all authoritative literature previously issued by a standard setter. Adoption of the FASB ASC has no effect on Easter Seals’ consolidated financial statements.

Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Easter Seals 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 Easter Seals and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions. Easter Seals currently has no temporarily restricted net assets.

Permanently restricted net assets – net assets subject to donor-imposed stipulations that they be maintained permanently by Easter Seals. Generally, donors of these assets may permit Easter Seals to use all or part of the income earned for general or specific purposes. Easter Seals currently has no permanently restricted net assets.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES
(Continued)

Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, Easter Seals considers all cash funds, cash bank accounts and highly liquid debt instruments with an original maturity when purchased of three months or less to be cash and cash equivalents.

Accounts Receivable

Accounts receivable are considered fully collectible. Accordingly, no allowance for doubtful accounts has been provided.

Property and Equipment

Easter Seals generally capitalizes an asset if its life is estimated to be one year or greater and the cost is \$500 or greater. Property and equipment are recorded at cost when purchased or at fair value as of the date contributed. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets.

Income Taxes

Easter Seals is exempt from federal and state income taxes under section 501(c)(3) of the Internal Revenue Code and is not a private foundation. Accordingly, no provision for income taxes has been made.

On January 1, 2009, Easter Seals adopted FASB ASC guidance that clarifies 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. This guidance must be applied to all existing tax positions upon initial adoption. Easter Seals has no tax penalties or interest reported in the accompanying consolidated financial statements. Tax years that remain open for examination include years ended August 31, 2007 through August 31, 2010. Adoption of this pronouncement had no impact on Easter Seals' consolidated financial statements.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES
(Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Contributions

Contributions are recognized when the donor makes a promise to give to Easter Seals that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor restrictions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Donated Assets

Donations of property and equipment are recorded as support at their estimated fair value. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, Easter Seals reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. Easter Seals reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Subsequent Events

Easter Seals evaluated subsequent events through October 28, 2010, when these consolidated financial statements were available to be issued. Management is not aware of any significant events that occurred subsequent to the statement of financial position date but prior to the filing of this report that would have a material impact on the consolidated financial statements.

NOTE 2 – PLAN OF REORGANIZATION

In May 2009, Easter Seals filed a petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Middle District of Tennessee. On August 12, 2010, the Bankruptcy Court confirmed the plan of reorganization, allowing Easter Seals to emerge from bankruptcy proceedings. The confirmed plan provided for the following:

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 2 – PLAN OF REORGANIZATION (Continued)

Secured Claims – Secured claims of Ford Motor Credit Corporation were satisfied by the issuance of a \$136,000 secured note (secured by 17 vehicles), payable in 30 monthly installments beginning October 2010, with interest at 4.25% per annum, and by the issuance of a \$9,750 secured note (secured by 1 vehicle), payable in 36 monthly installments beginning October 2010, with interest at 3.5% per annum.

Unsecured Claims of the State of Tennessee – For so long as Easter Seals is approved by the State of Tennessee (“State”) as a provider of services and is actually providing services that are paid by the State, the State shall be entitled to the amount of unsecured claims until the amount is paid in full. The amount to be recouped cannot exceed the profit derived from the provision of the services covered under the provider agreement. Unsecured claims of the State totaled \$1,983,066 at August 31, 2010.

General Unsecured Claims – The holders of approximately \$3,578,000 of general unsecured claims are to receive their pro rata share of \$375,000, resulting in a gain of approximately \$3,203,000 recognized in the statement of activities. Amounts remaining outstanding related to general unsecured claims at August 31, 2010 totaled approximately \$201,000.

In September 2009, Easter Seals entered into an agreement to sell approximately 94 acres including buildings known as Camp Lindahl. The sales price was \$3 million, net of expenses of approximately \$162,000. Easter Seals recognized a gain on the sale of Camp Lindahl of \$2,638,934. In connection with sale of the camp property, an Easter Seals lender agreed to accept a portion of the sale proceeds (\$2,000,000) in full satisfaction of its remaining secured and unsecured claims in the amount of \$5,580,030, resulting in a gain of \$3,580,030 being recognized in the statement of activities. The depreciated value of the property sold was approximately \$198,000.

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable consist of the following at August 31, 2010:

Accounts receivable	\$ 59,354
Fees receivable from state agencies	<u>276,910</u>
Total accounts receivable	<u>\$ 336,264</u>

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following at August 31, 2010:

Leasehold improvements	\$ 6,237
Vehicles	636,306
Equipment	<u>277,479</u>
	920,022
Less accumulated depreciation	<u>(705,839)</u>
Net property and equipment	<u>\$ 214,183</u>

Depreciation expense totaled \$70,174 in 2010.

Fully depreciated assets amounted to approximately \$432,000 at August 31, 2010.

NOTE 5 – ADVANCED PAYMENTS – STATE OF TENNESSEE

Advanced payments – State of Tennessee relate to West's programs. The balance due totaled \$1,983,066 at August 31, 2010 and is currently payable in monthly installments of \$21,000 as agreed upon by Easter Seals and the State. Monthly installments are subject to change based on future agreements between Easter Seals and the State. The amount to be recouped cannot exceed the profit derived from the provision of the services covered under the provider agreement.

NOTE 6 – NOTES PAYABLE

Notes payable is comprised of the following at August 31, 2010:

Note payable, due in 30 monthly installments beginning October 2010, interest at 4.25% per annum, secured by vehicles.	\$ 136,000
Note payable, due in 36 monthly installments beginning October 2010, interest at 3.5% per annum, secured by a vehicle.	<u>9,750</u>
	<u>\$ 145,750</u>

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 6 – NOTES PAYABLE (Continued)

The following represents principal maturities of notes payable as of August 31, 2010:

Year ending	
<u>August 31,</u>	
2011	\$ 57,650
2012	57,650
2013	<u>30,450</u>
	<u>\$ 145,750</u>

NOTE 5 – ALLOCATION OF FUNCTIONAL EXPENSES

The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of functional expenses. Accordingly, certain costs have been allocated among program and supporting services based on estimates made by management.

NOTE 6 – CONCENTRATIONS

Easter Seals receives a substantial amount of its support from governmental grants and contracts. During fiscal 2010, Easter Seals received approximately 94% of its support and revenue from government grants and contracts. A significant reduction in the level of this support, if this were to occur, could have an adverse impact on Easter Seals' programs and services. At August 31, 2010, Easter Seals had \$276,910 due in grants and fees receivable from government entities.

NOTE 7 – EMPLOYEE BENEFIT PLANS

During 2003, Easter Seals implemented a defined contribution retirement plan for the benefit of all employees. Employees are allowed to make contributions on a pre-tax basis. The plan provides for Easter Seals to make a discretionary contribution to the plan. No employer contributions were made to the plan during 2010.

Easter Seals also had a noncontributory, defined benefit pension plan covering substantially all employees, which was amended and frozen effective August 31, 2003. In connection with the reorganization plan (Note 2), the bankruptcy court approved a distress termination of the plan. As a result, a settlement agreement and release was entered into by Easter Seals and the Pension Benefit Guaranty Corporation ("PBGC") in which the PBGC was appointed trustee and Easter Seals is required to pay an allowed unsecured claim of approximately \$172,000, which is included in reorganization claims payable in the statement of financial position. In addition, Easter Seals is to pay a settlement amount of \$75,000 to be paid in three annual installments of \$25,000 beginning October 2011, which is included in the statement of financial position as a noncurrent accrued expense.

EASTER SEALS TENNESSEE, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
August 31, 2010

NOTE 8 – LEASE COMMITMENTS

Easter Seals leases certain buildings and office equipment under noncancelable lease agreements, all of which are considered operating leases. Minimum payments for these lease commitments as of August 31, 2010, are as follows:

Year ending <u>August 31,</u>	
2011	\$ 144,127
2012	126,756
2013	47,900
2014	46,800
2015	46,800
Thereafter	<u>-</u>
	<u>\$ 412,383</u>

Rent expense amounted to \$193,735 in 2010.

NOTE 9 – CONTINGENCIES

Easter Seals is subject to various claims and legal actions which arise in the ordinary course of business. Easter Seals has professional liability insurance to protect against such claims or legal actions on a claims-made basis. In the opinion of management, the ultimate resolution of such matters will be adequately covered by the insurance and will not have a material adverse effect on Easter Seals' financial position or results of operations.

NOTE 10 – EXTRAORDINARY ITEM - GAIN ON EXTINGUISHMENT OF DEBT

In connection with the plan of reorganization (Note 2), a gain on extinguishment of debt, included in the statement of activities, resulted from the following:

Gain on settlement of unsecured claims	\$ 3,202,609
Gain on settlement of secured debt in connection with sale of camp property	<u>3,580,030</u>
	<u>\$ 6,782,639</u>