

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

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

**August 31, 2004 and 2003**

## TABLE OF CONTENTS

Independent Auditor's Report .....	2 – 3
Financial Statements:	
Statements of Financial Position .....	4
Statements of Activities .....	5 – 6
Statements of Functional Expenses .....	7 – 8
Statements of Cash Flows .....	9
Notes to Financial Statements .....	10 – 18



**F R A S I E R , D E A N & H O W A R D , P L L C**

CERTIFIED PUBLIC ACCOUNTANTS

3310 WEST END AVENUE, SUITE 550  
NASHVILLE, TENNESSEE 37203  
PHONE 615-383-6592, FAX 615-383-7094

**INDEPENDENT AUDITOR'S REPORT**

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

We have audited the accompanying consolidated statement of financial position of Easter Seals Tennessee, Inc. and affiliate (a nonprofit organization) as of August 31, 2004, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended. We have also audited the statement of financial position of Easter Seals Tennessee, Inc. as of August 31, 2003, and the related 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 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 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 audits provide a reasonable basis for our opinion.

In our opinion, the 2004 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, 2004, 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. Also, in our opinion, the 2003 financial statements present fairly, in all material respects, the financial position of Easter Seals Tennessee, Inc. as of August 31, 2003, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Organization will continue as a going concern. As discussed in Note 13 to the financial statements, the Organization has a working capital deficiency of \$2,920,260 at August 31, 2004, and has incurred a significant decrease in net assets. Additionally, the Organization is working with its senior lender with the objective of restructuring its debt. In connection therewith, the January and February 2005 interest payments have not been made. Most of Easter Seals' debt obligations contain cross default provisions. The failure to make required debt payments

during 2005 could have the effect of making most of Easter Seals' debt obligations callable by the lenders. However, no such calls have been made as of the issuance of this report. These conditions raise substantial doubt about the Organization's ability to continue as a going concern. Management's plans, as more fully described in Note 13, include working with its lenders to obtain revised loan agreements to permit the realization of assets and the liquidation of liabilities in the ordinary course of business, reducing operating costs, and obtaining additional financing as necessary. However, the ultimate outcome is uncertain. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*Frasier, Dean & Howard, PLLC*

October 27, 2004

(February 11, 2005 as to Note 13)

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**STATEMENTS OF FINANCIAL POSITION**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

Assets	2004	2003
Current assets:		
Cash and cash equivalents	\$ 174,191	\$ 46,753
Accounts receivable, net	885,533	727,749
Investments	222,500	-
Prepaid expenses	26,969	18,058
Contributions receivable, net	286,456	446,306
Total current assets	1,595,649	1,238,866
Contributions receivable, net	178,228	143,186
Property and equipment, net	8,476,213	8,849,021
Loan costs, net of accumulated amortization of \$37,627 and \$25,627, respectively	181,869	182,975
Total assets	<u>\$10,431,959</u>	<u>\$10,414,048</u>
<b>Liabilities and Net Assets (Deficit)</b>		
Current liabilities:		
Accounts payable	\$ 320,164	\$ 540,747
Accrued expenses	548,844	305,656
Accrued interest	28,343	96,006
Deferred revenue	371,350	385,437
Note payable - line of credit	23,631	-
Current portion of long-term debt	2,913,233	15,400
Accrued pension liability	191,035	158,707
Total current liabilities	4,396,600	1,501,953
Accrued pension liability, net of current portion	103,877	225,707
Long-term debt, net of current portion	6,320,999	7,606,030
Estimated fair value of interest rate swap agreement	-	243,000
Short term obligation expected to be refinanced	-	574,159
Total liabilities	<u>10,821,476</u>	<u>10,150,849</u>
Net assets (deficit):		
Unrestricted	(864,151)	(336,447)
Temporarily restricted	474,634	599,646
Total net assets (deficit)	<u>(389,517)</u>	<u>263,199</u>
Total liabilities and net assets (deficit)	<u>\$10,431,959</u>	<u>\$10,414,048</u>

See accompanying notes.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**CONSOLIDATED STATEMENT OF ACTIVITIES**  
For the Year Ended August 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenue:			
Public support:			
Contributions	\$ 1,142,924	\$ 244,448	\$ 1,387,372
Special events (including in-kind donations of \$54,425)	336,966	-	336,966
Less: direct benefit costs (including in-kind expenses of \$54,425)	(86,359)	-	(86,359)
Donated goods and services, at fair value	4,529	-	4,529
Bequests	4,481	-	4,481
Total public support	<u>1,402,541</u>	<u>244,448</u>	<u>1,646,989</u>
Revenue:			
Government fees and grants	4,904,389	-	4,904,389
Child development center	320,935	-	320,935
Contract services	123,799	-	123,799
Program service fees	1,571,681	-	1,571,681
Camp rental	270,810	-	270,810
Membership fees	141,352	-	141,352
Other	22,155	-	22,155
Investment income, net	1,594	-	1,594
Total revenue	<u>7,356,715</u>	<u>-</u>	<u>7,356,715</u>
Net assets released from restrictions:			
Expiration of time restrictions	369,460	(369,460)	-
Total public support and revenue	<u>9,128,716</u>	<u>(125,012)</u>	<u>9,003,704</u>
Expenses:			
Program services:			
Direct services	8,509,486	-	8,509,486
Public health education	49,934	-	49,934
Total program services	<u>8,559,420</u>	<u>-</u>	<u>8,559,420</u>
Supporting services:			
Management and general	491,980	-	491,980
Fundraising	461,089	-	461,089
Total supporting services	953,069	-	953,069
National program fee	143,931	-	143,931
Total expenses	<u>9,656,420</u>	<u>-</u>	<u>9,656,420</u>
Change in net assets	(527,704)	(125,012)	(652,716)
Net assets at beginning of year	(336,447)	599,646	263,199
Net assets at end of year	<u>\$ (864,151)</u>	<u>\$ 474,634</u>	<u>\$ (389,517)</u>

See accompanying notes.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**STATEMENT OF ACTIVITIES**  
**For the Year Ended August 31, 2003**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenue:			
Public support:			
Contributions	\$ 1,320,442	\$ 68,251	\$ 1,388,693
Special events	309,468	-	309,468
Less: direct benefit costs	(135,960)	-	(135,960)
Donated goods and services, at fair value	5,621	-	5,621
Bequests	23,272	-	23,272
Total public support	<u>1,522,843</u>	<u>68,251</u>	<u>1,591,094</u>
Revenue:			
Government fees and grants	3,490,973	-	3,490,973
Child development center	17,608	-	17,608
Contract services	91,352	-	91,352
Program service fees	1,214,097	-	1,214,097
Camp rental	199,300	-	199,300
Membership fees	134,453	-	134,453
Other	27,209	-	27,209
Investment return, net	4,348	-	4,348
Total revenue	<u>5,179,340</u>	<u>-</u>	<u>5,179,340</u>
Net assets released from restrictions:			
Expiration of time restrictions	1,276,990	(1,276,990)	-
Total public support and revenue	<u>7,979,173</u>	<u>(1,208,739)</u>	<u>6,770,434</u>
Expenses:			
Program services:			
Direct services	6,698,102	-	6,698,102
Public health education	10,262	-	10,262
Total program services	<u>6,708,364</u>	<u>-</u>	<u>6,708,364</u>
Supporting services:			
Management and general	485,741	-	485,741
Fundraising	502,503	-	502,503
Total supporting services	<u>988,244</u>	<u>-</u>	<u>988,244</u>
National program fee	140,318	-	140,318
Interest rate swap valuation decline	243,000	-	243,000
Total expenses	<u>8,079,926</u>	<u>-</u>	<u>8,079,926</u>
Change in net assets	(100,753)	(1,208,739)	(1,309,492)
Net assets at beginning of year	(235,694)	1,808,385	1,572,691
Net assets at end of year	<u>\$ (336,447)</u>	<u>\$ 599,646</u>	<u>\$ 263,199</u>

See accompanying notes.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES**  
For the Year Ended August 31, 2004

	Program Services			Supporting Services			National Program Fee	Total Expenses
	Direct Services	Public		Management and General	Fund- raising	Total		
		Health Education	Total					
Salaries and related expenses	\$ 6,370,187	\$ 29,295	\$ 6,399,482	\$ 34,648	\$ 365,654	\$ 400,302	\$ -	\$ 6,799,784
Depreciation and amortization	428,494	8,190	436,684	44,250	13,180	57,430	-	494,114
Professional fees	327,990	3,230	331,220	22,624	9,358	31,982	-	363,202
Interest	-	-	-	335,431	-	335,431	-	335,431
Insurance	219,475	900	220,375	-	3,440	3,440	-	223,815
Supplies	190,528	11	190,539	820	8,382	9,202	-	199,741
Travel and transportation	169,626	284	169,910	1,432	4,336	5,768	-	175,678
Building and grounds maintenance	157,540	2,460	160,000	3,755	3,913	7,668	-	167,668
Utilities	138,908	2,484	141,392	837	3,936	4,773	-	146,165
National program fee	-	-	-	-	-	-	143,931	143,931
Specific assistance	137,056	-	137,056	-	-	-	-	137,056
Rental and maintenance of equipment	74,105	1,572	75,677	2,698	4,937	7,635	-	83,312
Occupancy	81,090	-	81,090	-	-	-	-	81,090
Telephone	57,617	1,032	58,649	144	1,985	2,129	-	60,778
Bad debts	49,692	-	49,692	3	756	759	-	50,451
Printing and publications	29,082	138	29,220	935	15,449	16,384	-	45,604
Letter of credit fees	-	-	-	40,518	-	40,518	-	40,518
Miscellaneous	28,863	-	28,863	2,660	642	3,302	-	32,165
Advertising	21,214	-	21,214	42	2,010	2,052	-	23,266
Postage and shipping	15,054	11	15,065	939	6,129	7,068	-	22,133
Planned Giving Program	-	-	-	-	12,895	12,895	-	12,895
Conferences, conventions and meetings	8,797	249	9,046	162	2,722	2,884	-	11,930
Membership and support payments	4,168	78	4,246	82	1,365	1,447	-	5,693
Total functional expenses	\$ 8,509,486	\$ 49,934	\$ 8,559,420	\$ 491,980	\$ 461,089	\$ 953,069	\$ 143,931	\$ 9,656,420

See accompanying notes.



**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
For the Year Ended August 31, 2003

	Program Services			Supporting Services			National Program Fee	Interest Rate Swap Valuation Decline	Total Expenses
	Direct Services	Public Health Education	Total	Management and General	Fund-raising	Total			
Salaries and related expenses	\$ 4,870,298	\$ 219	\$ 4,870,517	\$ 52,162	\$ 394,191	\$ 446,353	\$ -	\$ -	\$ 5,316,870
Professional fees	295,084	1,013	296,097	30,776	13,675	44,451	-	-	340,548
Depreciation and amortization	253,903	4,257	258,160	41,612	15,446	57,058	-	-	315,218
Interest	-	-	-	285,567	-	285,567	-	-	285,567
Interest rate swap valuation decline	-	-	-	-	-	-	-	243,000	243,000
Insurance	227,399	480	227,879	3,657	10,247	13,904	-	-	241,783
Supplies	187,034	-	187,034	2,828	17,562	20,390	-	-	207,424
Specific assistance	146,875	-	146,875	-	-	-	-	-	146,875
National program fee	-	-	-	-	-	-	140,318	-	140,318
Travel and transportation	127,923	-	127,923	2,386	6,183	8,569	-	-	136,492
Utilities	102,252	1,236	103,488	1,152	3,936	5,088	-	-	108,576
Building and grounds maintenance	91,027	1,224	92,251	2,610	3,900	6,510	-	-	98,761
Bad debts	78,789	-	78,789	8,553	90	8,643	-	-	87,432
Rental and maintenance of equipment	61,825	780	62,605	2,161	4,821	6,982	-	-	69,587
Occupancy	68,652	-	68,652	-	-	-	-	-	68,652
Printing and publications	46,041	303	46,344	2,563	6,183	8,746	-	-	55,090
Telephone	49,349	516	49,865	709	2,002	2,711	-	-	52,576
Letter of credit fees	-	-	-	43,145	-	43,145	-	-	43,145
Advertising	33,491	-	33,491	337	50	387	-	-	33,878
Miscellaneous	25,122	-	25,122	2,958	-	2,958	-	-	28,080
Postage and shipping	17,584	78	17,662	1,161	5,915	7,076	-	-	24,738
Planned Giving Program	-	-	-	-	15,311	15,311	-	-	15,311
Conferences, conventions and meetings	11,410	-	11,410	1,116	2,027	3,143	-	-	14,553
Membership and support payments	4,044	156	4,200	288	964	1,252	-	-	5,452
Total functional expenses	\$ 6,698,102	\$ 10,262	\$ 6,708,364	\$ 485,741	\$ 502,503	\$ 988,244	\$ 140,318	\$ 243,000	\$ 8,079,926

See accompanying notes.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended August 31, 2004 (consolidated) and 2003 (unconsolidated)**

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ (652,716)	\$ (1,309,492)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	494,114	315,218
Net gain on property disposal	350	2,073
Realized/unrealized losses on investments, net	-	(2,873)
Receipts of donated investments	(222,500)	-
Changes in operating assets and liabilities:		
Accounts receivable, net	(157,784)	(240,399)
Contributions receivable, net	124,808	735,624
Prepaid expenses	(8,911)	27,910
Accounts payable	(220,583)	330,100
Accrued expenses	175,525	186,906
Estimated fair value of interest rate swap agreement	(243,000)	243,000
Deferred revenue	(14,087)	172,480
Accrued pension liability	(89,502)	99,115
Net cash (used in) provided by operating activities	<u>(814,286)</u>	<u>559,662</u>
Cash flows from investing activities:		
Purchases of investments	-	(14,035)
Proceeds from sale of investments	-	34,147
Purchases of property and equipment	(109,657)	(3,538,531)
Proceeds from disposal of property and equipment	<u>-</u>	<u>4,250</u>
Net cash used in investing activities	<u>(109,657)</u>	<u>(3,514,169)</u>
Cash flows from financing activities:		
Proceeds from borrowings	3,170,394	3,352,283
Payments on notes payable	(2,108,120)	(873,404)
Payment of loan costs	<u>(10,893)</u>	<u>-</u>
Net cash provided by financing activities	<u>1,051,381</u>	<u>2,478,879</u>
Net increase (decrease) in cash and cash equivalents	127,438	(475,628)
Cash and cash equivalents at beginning of year	<u>46,753</u>	<u>522,381</u>
Cash and cash equivalents at end of year	<u><u>\$ 174,191</u></u>	<u><u>\$ 46,753</u></u>
Supplemental disclosure of cash flow information:		
Interest paid	<u><u>\$ 403,094</u></u>	<u><u>\$ 277,216</u></u>
Non-cash investing and financing activity:		
Receipts of donated investments	<u><u>\$ 222,500</u></u>	<u><u>\$ -</u></u>

See accompanying notes.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**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 2004 financial statements include the accounts of Easter Seals and West TN. All significant inter-entity transactions and balances have been eliminated in consolidation.

**Basis of Presentation**

Easter Seals has adopted Statement of Financial Accounting Standards (“SFAS”) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, Easter Seals is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. In addition, Easter Seals is required to present a statement of cash flows. Net assets of Easter Seals are presented 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 statements of activities as net assets released from restrictions.

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.

**Cash and Cash Equivalents**

For purposes of the statements 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.

**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 or at fair value as of the date purchased or contributed. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

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

**Loan Costs**

Costs relating to the issuance of bond indebtedness and debt refinancing are amortized over the term of the debt agreements using the straight-line method. Amortization expense totaled \$12,000 and \$7,631 in 2004 and 2003, respectively.

**Derivative Instruments and Hedging Activities**

Easter Seals has adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities – as Amendment of FASB Statement No. 133*. SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the statement of financial position as either an asset or a liability measured at its estimated fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in the statement of activities. Easter Seals held an interest rate swap agreement, which was considered to be a derivative. Easter Seals recorded the estimated fair value of the interest rate swap agreement as a liability of \$243,000 as of August 31, 2003. As a result, the 2003 statement of activities includes a charge of \$243,000 to reflect the accrual. During 2004, the swap agreement was terminated.

**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.

**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.

**Unconditional Promises to Give**

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. Easter Seals uses the allowance method to determine uncollectible unconditional promises to give.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

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

**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.

**Reclassifications**

Certain reclassifications have been made to 2003 balances to conform with 2004 presentation.

**NOTE 2 – ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following at August 31:

	<u>2004</u>	<u>2003</u>
Accounts receivable	\$ 128,443	\$ 24,701
Grants and fees receivable from state agencies	460,692	479,837
Rehabilitation fees	<u>560,631</u>	<u>513,911</u>
Subtotal	1,149,766	1,018,449
Less: allowance for uncollectibles	(95,120)	(54,519)
Less: contractual allowance	<u>(169,113)</u>	<u>(236,181)</u>
Net accounts receivable	<u>\$ 885,533</u>	<u>\$ 727,749</u>

**NOTE 3 – INVESTMENTS**

During 2004, Easter Seals received 2,500 Class B shares of a privately held corporation. The shares have been recorded at their appraisal value which totaled \$222,500 as of August 31, 2004.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 4 – CONTRIBUTIONS RECEIVABLE**

Contributions receivable are as follows at August 31:

	<u>2004</u>	<u>2003</u>
McWhorter Family Children's Center	\$ 90,000	\$ 277,136
Gross capital campaign receivables	138,657	260,717
United Way allocations	69,237	68,251
Annual gift receivables	<u>203,345</u>	<u>108,901</u>
Subtotal	501,239	715,005
Less: allowance for uncollectibles	(7,533)	(96,491)
Less: discount to net present value	<u>(29,022)</u>	<u>(29,022)</u>
Net contributions receivable	<u>\$ 464,684</u>	<u>\$ 589,492</u>
Receivable in less than one year, net	\$ 286,456	\$ 446,306
Receivable in one to five years, net	<u>178,228</u>	<u>143,186</u>
	<u>\$ 464,684</u>	<u>\$ 589,492</u>

**NOTE 5 – LAND, BUILDINGS AND EQUIPMENT**

Land, buildings and equipment consists of the following at August 31:

	<u>2004</u>	<u>2003</u>
Land	\$ 1,532,557	\$ 1,532,557
Buildings and improvements	7,862,460	7,850,234
Vehicles	723,703	659,484
Equipment	<u>1,244,050</u>	<u>1,212,638</u>
	11,362,770	11,254,913
Less accumulated depreciation	<u>(2,886,557)</u>	<u>(2,405,892)</u>
Total	<u>\$ 8,476,213</u>	<u>\$ 8,849,021</u>

Depreciation expense totaled \$482,114 and \$307,587 in 2004 and 2003, respectively. In 2004 and 2003, vehicles with a depreciated value of \$60,494 and \$36,876, respectively, were purchased primarily with government grant funds. As a result, the vehicles are restricted under the terms of the grant agreement.

During 2002, Easter Seals began construction of the McWhorter Family Children's Center. The facility was completed as of August 31, 2003 at a total cost of approximately \$3.9 million. Easter Seals has funded the project through donor contributions and debt financing. Unconditional promises to give outstanding as of August 31, 2004 and 2003 made in support of the facility totaled \$90,000 and \$277,136, respectively.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 6 – NOTES PAYABLE**

	<u>2004</u>	<u>2003</u>
Notes payable is comprised of the following at August 31:		
Line of credit payable to bank, refinanced during 2004 to provide interest at rate of one-half percent per annum over the bank's prime rate (5.0% at August 31, 2004), payable interest only through maturity (January 3, 2005), at which time remaining principal and interest will be due. The line of credit is secured by a first lien security interest in Easter Seals' accounts receivable, furniture, equipment, capital campaign receipt, machinery, and fixtures, a first priority deed of trust on camp property, and the Woodmont Boulevard facility. The line of credit provides for maximum borrowings of \$300,000.	\$ 23,631	\$ 574,159
Note payable related to Series 1999 Variable Rate Revenue Bonds, interest payable monthly (2.4% at August 31, 2004), principal payments due in varying amounts from August 2005 to August 2019. The note is collateralized by a lien and security interest in premises and equipment, a first priority security interest in cash payments on donor pledges, and a letter of credit in the amount of \$2,570,899.	2,425,000	2,425,000
Term loan payable to bank, refinanced during 2004 to provide interest at 6.0% per annum, secured by all of Easter Seals' accounts, pledges, security interest in premises and equipment and all proceeds from policies of insurance of any of the foregoing; monthly payments of principal and interest in the amount of \$13,712 payable over a three year period with a final maturity of January 3, 2006.	1,981,992	1,473,026
Promissory note payable to bank, interest at 1.0% per annum over the bank's prime rate (5.5% at August 31, 2004), secured by land, buildings and improvements and pledge agreement, and cross collateralization of all other assets, payable interest only through maturity (July 17, 2005), at which time remaining principal and interest will be due. The note provides for maximum borrowings of \$2,750,000. The proceeds of the note were used for the purchase of real property and construction of building and improvements presently utilized as a child development center.	2,750,000	2,500,000

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 6 – NOTES PAYABLE (Continued)**

	<u>2004</u>	<u>2003</u>
Note payable, interest free through July 31, 2005, interest at the prime rate beginning August 2005; secured by real property. Beginning August 2005, principal and interest shall be paid based upon a 20 year amortization schedule. The note matures on August 1, 2025, at which time all remaining principal and interest will be due.	1,100,000	1,100,000
Line of credit payable to bank, interest at rate of 6.0% per annum, payable interest only through maturity (September 11, 2005), at which time remaining principal and interest will be due. The line of credit is secured by all assets and rights of Easter Seals West Tennessee, LLC. The line of credit provides for total borrowings of \$800,000. The credit facility contains various covenants including the requirement to maintain a coverage ratio of not less than 1.10 to be calculated quarterly. West was not in compliance with certain of these covenants at August 31, 2004. However, a waiver of compliance was obtained for the year ended August 31, 2004.	699,001	-
Note payable, interest at prime rate (4.50% at August 31, 2004) payable interest only through the earlier of a) maturity (September 15, 2005), b) the sale, transfer or other disposition of the collateral, or c) the date the indebtedness is accelerated, at which time remaining principal and interest will be due. The note is secured by a second priority lien, security interest and mortgage on the camp property.	<u>278,239</u>	<u>123,404</u>
	<u>\$ 9,257,863</u>	<u>\$8,195,589</u>
Included in the accompanying balance sheet as:		
Notes payable – line of credit	\$ 23,631	\$ -
Short term obligation expected to be refinanced	-	574,159
Long term debt, net of current portion	6,320,999	7,606,030
Current portion of long term debt	<u>2,913,233</u>	<u>15,400</u>
	<u>\$ 9,257,863</u>	<u>\$8,195,589</u>



**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 6 – NOTES PAYABLE (Continued)**

The following is a schedule of future principal maturities of long-term debt as of August 31, 2004:

<u>Year ended</u> <u>August 31,</u>	
2005	\$ 2,936,864
2006	3,078,763
2007	164,170
2008	171,020
2009	182,965
Thereafter	<u>2,724,081</u>
	<u>\$ 9,257,863</u>

**NOTE 7 – LETTER OF CREDIT**

In connection with securing Easter Seals' obligations under its agreement with a bank, a letter of credit in the amount of \$2,570,899 was established for securing the Industrial Development Board of the Metropolitan Government of Nashville and Davidson County Variable Rate Revenue Bonds Series 1999 issued in the original principal amount of \$2,500,000. Easter Seals had no outstanding borrowings associated with this letter of credit at August 31, 2004.

**NOTE 8 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes or periods at August 31:

	<u>2004</u>	<u>2003</u>
Unconditional promises to give due in future periods	\$ 464,684	\$ 589,492
Contributions designated for Nashville Child Development Center	<u>9,950</u>	<u>10,154</u>
	<u>\$ 474,634</u>	<u>\$ 599,646</u>

**NOTE 9 – ALLOCATION OF FUNCTIONAL EXPENSES**

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

**NOTE 10 – CONCENTRATIONS**

Easter Seals receives a substantial amount of its support from governmental grants, contracts, and individual contributions. 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, 2004 and 2003, Easter Seals had \$460,692 and \$479,837, respectively, due in grants and fees receivable from government entities.

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 11 – 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 2004 or 2003.

Easter Seals also has a noncontributory, defined benefit pension plan covering substantially all employees, which was amended and frozen effective August 31, 2003, so that no new employees can enter the plan, and no additional benefits will accrue. Reduced benefits are available for early retirement. The amount funded each year is determined by the plan's actuary based upon required funding levels. The plan's assets are primarily invested in equities, fixed income vehicles and cash.

Easter Seals accounts for its pension plan in accordance with SFAS No. 87 *Employers' Accounting for Pensions* and SFAS No. 132 *Employers Disclosures about Pensions and Other Postretirement Benefits*. The following table sets forth the funded status of the pension plan and amounts recognized in Easter Seals' statements at August 31:

	<u>2004</u>	<u>2003</u>
Benefit obligation	\$ 2,082,968	\$ 1,622,333
Fair value of plan assets	<u>1,153,124</u>	<u>974,028</u>
Funded status	<u>\$ (929,844)</u>	<u>\$ (648,305)</u>
Accrued pension liability recognized in balance sheet	\$ (294,912)	\$ (384,414)
Benefit cost	\$ 69,205	\$ 256,201
Employer contributions	\$ 158,707	\$ 157,086
Plan participants' contributions	-	-
Benefits paid	\$ 41,623	\$ 36,677
Assumptions used in the accounting were:		
Discount rate	6.25%	6.75%
Rate of increase in compensation levels	3.5%	3.5%
Expected long-term rate of return on assets	7.5%	8.5%

**EASTER SEALS TENNESSEE, INC. AND AFFILIATE**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
**August 31, 2004 (consolidated) and 2003 (unconsolidated)**

**NOTE 12 – 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, 2004, are as follows:

<b>Year ended</b> <b><u>August 31,</u></b>	
2005	\$ 29,062
2006	23,463
2007	17,356
2008	13,826
2009	<u>1,782</u>
	<u>\$ 85,489</u>

Rent expense amounted to \$104,123 and \$110,150 in 2004 and 2003, respectively.

**NOTE 13 – GOING CONCERN**

The accompanying financial statements have been prepared assuming that Easter Seals will continue as a going concern. At August 31, 2004, Easter Seals has a working capital deficiency of \$2,920,260 and has incurred a significant decrease in net assets. Easter Seals is working with its senior lender with the objective of restructuring its debt. In connection therewith, the January and February 2005 interest payments have not been made. Most of Easter Seals debt obligations contain cross default provisions. The failure to make required debt payments during 2005 could have the effect of making those Easter Seals debt obligations callable by the lenders. However, no such calls have been made as of the issuance of this report. These conditions raise substantial doubt about Easter Seals' ability to continue as a going concern. Management's plans include working with its lenders to obtain revised loan agreements to permit the realization of assets and the liquidation of liabilities in the ordinary course of business, reducing operating costs, and obtaining additional financing as necessary. It should be noted that the change in net assets improved by \$656,676 from fiscal 2003 to fiscal 2004. Also of relevance is the fact that Easter Seals assets include a camp property that was purchased for \$26,283 and has an appraised value of \$3,225,000. Management believes that Easter Seals will be able to achieve positive cash flow in future periods through further maturity of its programs combined with strategies to reduce debt. However, the ultimate outcome is uncertain. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.