

CHILD & FAMILY RESOURCES, INC.

Audited Financial Statements

For the year ended June 30, 2008

CHILD & FAMILY RESOURCES, INC.

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INDEPENDENT AUDITORS' REPORT

To the Boards of Directors
Child & Family Resources, Inc.

We have audited the accompanying statement of financial position of Child & Family Resources, Inc. (a nonprofit organization) as of June 30, 2008, and the related statement 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. The prior year summarized comparative information has been derived from the Organization's 2007 financial statements. Those financial statements were audited by other auditors whose report dated November 28, 2007, expressed a qualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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.

As discussed in Note 1 to the financial statements, the Organization's financial statements do not include the accounts of an affiliated organization that the Organization has determined is subject to consolidation. In our opinion, the Organization's financial statements should include the accounts of the affiliated organization as required by accounting principles generally accepted in the United States of America. The effect of this departure from U.S. generally accepted accounting principles on financial position, changes in net assets and cash flows have not been determined.

In our opinion, except for the effects of not consolidating the affiliated organization as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Child & Family Resources, Inc. as of June 30, 2008 and the changes in its net assets and its cash flows for the year then ended in conformity with generally accepted accounting principles accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 3, 2008 on our consideration of Child & Family Resources, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Ludwig Klewer & Co. PLLC

October 3, 2008

CHILD & FAMILY RESOURCES, INC.
STATEMENT OF FINANCIAL POSITION
June 30, 2008
(with comparative totals for 2007)

ASSETS

	2008	2007
Current assets:		
Cash and cash equivalents	\$ 620,175	\$ 448,600
Grants and accounts receivable	1,797,007	1,974,641
Investments	550,818	572,953
Note receivable, related party	100,000	100,000
Prepaid expenses	24,365	40,532
Total current assets	3,092,365	3,136,726
Property and equipment, net	3,169,568	2,712,884
Other assets	60,062	35,199
Total assets	\$ 6,321,995	\$ 5,884,809

LIABILITIES AND NET ASSETS

Current liabilities:		
Accounts payable	\$ 1,245,938	\$ 1,289,556
Accrued expenses	668,144	557,741
Deferred revenue	-	60,508
Line of credit	266,000	260,000
Capital lease payable, current portion	10,058	-
Long-term debt, current portion	23,780	-
Total current liabilities	2,213,920	2,167,805
Capital lease payable, non-current portion	17,674	-
Long-term debt, non-current portion	451,333	-
Total liabilities	2,682,927	2,167,805
Net assets:		
Unrestricted:		
General operating	874,427	894,745
Investment in property and equipment	2,666,723	2,712,884
Total unrestricted net assets	3,541,150	3,607,629
Temporarily restricted	97,918	109,375
Total net assets	3,639,068	3,717,004
Total liabilities and net assets	\$ 6,321,995	\$ 5,884,809

See independent auditors' report and accompanying notes.

CHILD & FAMILY RESOURCES, INC.

STATEMENT OF ACTIVITIES
 For the year ended June 30, 2008
 (with comparative totals for 2007)

	Unrestricted	Temporarily Restricted	2008 Total	2007 Total
Support and revenue:				
Contracts from governmental agencies	\$ 16,066,122	\$ 5,000	\$ 16,071,122	\$ 13,073,569
Other grants	863,880	48,850	912,730	2,245,542
Parent fees	748,824	-	748,824	830,989
United Way	174,422	139,200	313,622	259,673
Contributions	310,813	-	310,813	143,836
Other revenue	84,648	-	84,648	50,214
Special events, net	46,283	-	46,283	74,193
Investment income, net	471	-	471	82,288
Net assets released from restrictions:				
Satisfaction of grant restrictions	204,507	(204,507)	-	-
Total support and revenue	18,499,970	(11,457)	18,488,513	16,760,304
Expenses:				
Program services	16,573,231	-	16,573,231	14,672,494
Supporting services:				
General and administration	1,829,015	-	1,829,015	1,792,432
Fund-raising	164,203	-	164,203	134,870
Total expenses	18,566,449	-	18,566,449	16,599,796
Changes in net assets	(66,479)	(11,457)	(77,936)	160,508
Net assets, beginning of year, restated	3,607,629	109,375	3,717,004	3,556,496
Net assets, end of year	<u>\$ 3,541,150</u>	<u>\$ 97,918</u>	<u>\$ 3,639,068</u>	<u>\$ 3,717,004</u>

See independent auditors' report and accompanying notes.

CHILD & FAMILY RESOURCES, INC.

STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2008
(with comparative totals for 2007)

	Early Childcare and Education Services	Family and Community Services	Total Program Services	General and Administrative	Fund-raising	2008 Total	2007 Total
Personnel costs	\$ 1,580,376	\$ 4,366,497	\$ 5,946,873	\$ 696,173	\$ 79,841	\$ 6,722,887	\$ 5,934,756
Employee related costs	351,287	965,373	1,316,660	135,063	14,488	1,466,211	1,269,989
Materials and supplies	387,363	416,158	803,521	150,193	48,137	1,001,851	967,643
Other operating expenses	178,474	200,137	378,611	468,636	5,913	853,160	707,732
Occupancy costs	125,887	480,550	606,437	54,672	5,767	666,876	517,254
Travel and related	113,457	397,348	510,805	24,335	1,964	537,104	472,092
Professional and outside services	77,597	163,275	240,872	267,183	4,678	512,733	578,208
Equipment	26,032	83,933	109,965	31,533	3,415	144,913	101,599
Assistance to individuals	41	60,348	60,389	1,227	-	61,616	81,437
Payments to subrecipients and providers	3,048,632	3,550,466	6,599,098	-	-	6,599,098	5,969,086
Total expenses	\$ 5,889,146	\$ 10,684,085	\$ 16,573,231	\$ 1,829,015	\$ 164,203	\$ 18,566,449	\$ 16,599,796

See independent auditors' report and accompanying notes.

CHILD & FAMILY RESOURCES, INC.

STATEMENT OF CASH FLOWS
For the year ended June 30, 2008
(with comparative totals for 2007)

	2008	2007
Cash flows from operating activities:		
Change in net assets	\$ (77,936)	\$ 160,508
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	268,484	237,227
Net realized and unrealized loss (gain) on investments	38,400	(52,784)
Changes in operating assets and liabilities:		
Grants and accounts receivable	177,634	(470,253)
Prepaid expenses	16,167	14,731
Other assets	(24,863)	2,590
Accounts payable	(43,618)	402,658
Accrued expenses	110,403	23,251
Deferred revenue	(60,508)	(130,764)
Total adjustments	<u>482,099</u>	<u>26,656</u>
Net cash provided by operating activities	404,163	187,164
Cash flows from investing activities:		
Purchases of property and equipment	(210,116)	(358,901)
Purchases of investments	(185,981)	(142,738)
Proceeds from sale of investments	169,716	126,652
Collections on note receivable	-	50,000
Net cash used in investing activities	<u>(226,381)</u>	<u>(324,987)</u>
Cash flows from financing activities:		
Advances on line of credit, net	6,000	260,000
Principal payments on capital lease	(3,268)	-
Principal payments on long-term debt	(8,939)	-
Net cash (used in) provided by financing activities	<u>(6,207)</u>	<u>260,000</u>
Net change in cash and cash equivalents	171,575	122,177
Cash and cash equivalents, beginning of year	448,600	326,423
Cash and cash equivalents, end of year	<u>\$ 620,175</u>	<u>\$ 448,600</u>
Supplemental disclosure of statement of cash flow information:		
Cash paid for interest	<u>\$ 26,868</u>	<u>\$ 21,643</u>
Purchase of equipment with capital lease payable	<u>\$ 31,000</u>	<u>\$ -</u>
Property and equipment purchased with long-term debt	<u>\$ 484,052</u>	<u>\$ -</u>

See independent auditors' report and accompanying notes.

CHILD & FAMILY RESOURCES, INC.

NOTES TO FINANCIAL STATEMENTS

1. Organization

Child & Family Resources, Inc. (the Organization) was incorporated in Arizona in August 1970 as a private nonprofit, community-based organization whose goal is to promote the strength and stability of families, to afford children and youth a supportive environment and maximize the child's physical, intellectual and emotional development. The Organization documents community needs, develops innovative solutions and programs to resolve unmet needs and implements programs where there are no available resources. The mission of the Organization is to enhance the quality of life for children and their families. Child & Family Resources, Inc. operates primarily in southern Arizona with offices in Tucson, Phoenix, Sierra Vista, Douglas, Nogales, Yuma and Safford.

In March 2006, the Organization entered an affiliation agreement with Tucson Nursery Schools and Child Care Centers, Inc. (TNS), which provides low cost child care for low-income working families, in order to further the Organization's mission. TNS is a corporation organized to operate exclusively for education, scientific, literary and charitable purposes. The agreement required each organization to complete certain administrative and legal steps in order to complete the formal affiliation. In July 2006, the Organization completed all steps of the agreement and the Organization became the sole member of TNS.

The Organization is required to consolidate the accounts of TNS under U.S. generally accepted accounting principles. However, the Organization has determined that excluding TNS is a more meaningful financial presentation. As a result, the financial statements do not include the accounts of TNS. The effect of this departure on the financial statements has not been determined.

2. Summary of Significant Accounting Policies

Financial Statement Presentation

The Organization reports information regarding its financial position and activities according to the three classes of net assets (unrestricted, temporarily restricted, and permanently restricted net assets) based upon the existence or absence of donor-imposed restrictions.

- Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations. A portion of the unrestricted net assets have been designated by the board of directors as expended for property and equipment to reflect the total carrying value after accumulated depreciation of all property and equipment, net of directly related liabilities. Remaining unrestricted net assets are available for general operations of the Organization.
- Temporarily restricted net assets – Net assets that are subject to donor-imposed stipulations that may or will be met either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.
- Permanently restricted net assets – Net assets that are subject to donor-imposed stipulations that they be maintained permanently by the Organization. No amounts have been reflected in the financial statements for permanently restricted support because the Organization has received no such gifts or contributions.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increase those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

CHILD & FAMILY RESOURCES, INC.

NOTES TO FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, Continued

Public Support and Revenue

Grants and other contributions of cash and other assets are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Donated Services, Materials and Facilities

Donated materials and facilities are valued at their fair market value. Donated services are recognized in the financial statements at their fair market value if the following criteria are met:

- The services require specialized skills and are provided by individuals possessing those skills;
- The services would typically need to be purchased if not donated.

Although the Organization utilizes the services of many outside volunteers, the fair value of these services is not recognized in the accompanying financial statements since they do not meet the criteria for recognition under generally accepted accounting principles.

Use of Estimates

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

Functional Allocation of Expenses

The costs of providing the various programs have been summarized on a functional basis in the statement of activities. Expenses that can be identified with a specific program are allocated directly according to their natural classification. Other expenses that are common to several functions are allocated by other reasonable methods.

Income Taxes

Child & Family Resources, Inc. is nonprofit organizations under Internal Revenue Code Section 501(c)(3), and as such are exempt from both Federal and Arizona income taxes. Therefore, no provision has been made for income taxes in the accompanying financial statements.

Child & Family Resources, Inc. is also a public charity under the Internal Revenue Code Sections 509(a)(1). This classification allows for donations to the organization to be deductible as charitable contributions on income tax returns.

Cash and Cash Equivalents

The Organization considers all highly-liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

Grants and Accounts Receivable

The Organization grants unsecured credit under contracts to its customers that are primarily governmental agencies in Arizona. The Organization considers accounts over 30 days past due to be delinquent. At June 30, 2008, the balance of accounts receivable included \$1,604,521 of amounts over 30 days past due. Based on historical collections, accounts receivable are considered fully collectible by management; therefore, no allowance for doubtful accounts has been provided.

CHILD & FAMILY RESOURCES, INC.

NOTES TO FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, Continued

Property and Equipment

Purchased property and equipment is recorded at cost. 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 assets 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, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Organization reclassifies temporarily restricted net assets to unrestricted net assets at that time.

The cost of repairs and maintenance is charged to expense in the year incurred. Expenditures that increase the useful lives of the assets are capitalized and depreciated. The Organization's policy is to capitalize expenditures for property and equipment that exceed \$1,000. Property and equipment is depreciated using the straight-line method over the following estimated useful lives of the assets:

Buildings	40 years
Building improvements	10 years
Leasehold improvements	10 years
Furniture, fixtures and equipment	3-15 years
Vehicles	5 years

Investments

In accordance with generally accepted accounting principles applicable to nonprofit organizations, investments in marketable securities with readily determinable fair values and all investments in debt securities are valued at their fair values in the statements of financial position. Unrealized gains and losses are included with the change in net assets.

Reclassifications

Certain items from 2007 have been reclassified to conform to the 2008 financial statement presentation.

3. Concentration of Risk

At June 30, 2008 the Federal Deposit Insurance Corporation (FDIC) insured cash accounts at banks up to \$100,000. Effective October 2008, the FDIC increased this amount to \$250,000. Investments held by other institutions are covered up to \$500,000 under insurance provided by the Securities Investor Protection Corporation (SIPC). However, SIPC does not protect against losses in market value. It is the opinion of management that the solvency of the referenced financial institutions is not of concern at this time. At June 30, 2008, the Organization had cash and investments in the amount of \$760,593 at various banks and institutions in excess of FDIC and SIPC limitations in place at that time.

4. Grants and Accounts Receivable

Grants and accounts receivable at June 30, 2008 consist of:

Arizona Department of Economic Security	\$ 1,055,664
Arizona Department of Education	300,616
Other governmental agencies	107,619
Other receivables	333,108
Total grants and accounts receivable	<u>\$ 1,797,007</u>

CHILD & FAMILY RESOURCES, INC.
NOTES TO FINANCIAL STATEMENTS

5. Investments

Investments at June 30, 2008 are stated at fair value and consist of:

	Cost	Fair Value
Stocks	\$ 260,077	\$ 261,696
Bonds	227,232	231,837
Mutual funds	60,799	57,285
Total mutual funds	\$ 548,108	\$ 550,818

Investment income consists of:

Interest and dividend income	\$ 38,871
Realized and unrealized (loss) gain, net	(38,400)
Total investment income, net	\$ 471

6. Property and Equipment

Property and equipment at June 30, 2008 consists of:

Land	\$ 436,433
Buildings and improvements	2,882,737
Furniture, fixtures and equipment	1,222,545
Leasehold improvements	109,155
Total property and equipment, at cost or donated value	4,650,870
Less accumulated depreciation	(1,481,302)
Property and equipment, net	\$ 3,169,568

7. Line of Credit

The Organization has a revolving line of credit with JP Morgan Chase Bank, which matures in February 2009. The available credit limit was increased from \$350,000 to \$650,000 in June 2007. Interest is payable monthly at the prime rate (5% and 8.25% at June 30, 2008 and 2007) less .75%. If the Organization defaults on any terms of the note, the interest rate increases to the prime rate plus 3%. The line of credit is primarily collateralized by grants and accounts receivable. The outstanding balance at June 30, 2008 was \$266,000.

Under the terms of this agreement, the Organization is required to maintain a debt service coverage ratio of at least 1.00. At June 30, 2008, the Organization was in compliance with the debt service coverage ratio.

CHILD & FAMILY RESOURCES, INC.
NOTES TO FINANCIAL STATEMENTS

8. Capital Lease Payable

The Organization is obligated under a capital lease. The total cost of office equipment under this lease is \$31,000 and accumulated depreciation is \$2,583 at June 30, 2008.

The capital lease payable at June 30, 2008 consists of:

Avaya Financial Services, \$913 per month including interest through December 2010; collateralized by phone system equipment	\$ 27,732
	27,732
Capital leases, current	(10,058)
Capital leases, non-current	\$ 17,674
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The future maximum lease payments due under this capital lease are:	
2009	\$ 10,961
2010	10,961
2011	7,323
	29,245
Total lease payments	29,245
Less imputed interest	(1,513)
Net minimum lease payments	\$ 27,732

9. Long-Term Debt

Long-term debt consists of:

Mortgage payable to a financial institution, due in monthly installments of \$3,053 through February 2013, including interest at 5.75%, collateralized by a deed of trust.	\$ 427,476
Note payable to a financial corporation for purchase of software, hardware and consulting services. Payments are due in monthly installments of \$1,338 through January 2012, including interest at 11%, collateralized by equipment.	47,637
	475,113
Total long-term debt	475,113
Less current portion	(23,780)
Non-current portion	\$ 451,333
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Principal maturities of long-term debt are:	
2009	\$ 23,780
2010	25,799
2011	28,006
2012	23,641
2013	373,887
	373,887
	\$ 475,113

CHILD & FAMILY RESOURCES, INC.

NOTES TO FINANCIAL STATEMENTS

10. Governmental Agency Contract Revenue

Revenue from contracts with governmental agencies during the year ended June 30, 2008 consists of:

Arizona Department of Economic Security	\$ 11,497,291
Arizona Department of Education	3,440,798
U.S. Department of Health and Human Services	546,296
Other government contracts	270,526
Pima County	161,211
City of Tucson	155,000
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Total governmental agency contract revenue	<u>\$ 16,071,122</u>

11. Special Events

Special event activities for the year ended June 30, 2008 consist of:

Revenue	\$ 58,025
Expense	<u>(11,742)</u>
Net revenue	<u>\$ 46,283</u>

12. Operating Leases

The Organization leases offices and facilities for their programs and administrative offices under non-cancelable, long-term operating leases with various expirations through September 2012. One of the leases contains a one-year renewal. Three of the leases allow cancellation with 30-90 days notice if the Organization can prove loss of grant funding for programs operated out of those locations. Rent expense under these operating leases totaled \$216,146 for 2008.

In March 2007, the Organization entered into a sublease agreement to rent out a portion of their facilities through January 2010. The sublease can be canceled by the tenant giving 90 days notice. Total sublease income was \$6,240 for the year ended June 30, 2008.

Future minimum lease payments under these leases are:

2009	\$ 306,610
2010	163,497
2011	62,374
2012	33,832
2013	6,300
	<hr/>
	<u>\$ 572,613</u>

13. Contingent Liabilities

The Organization participates in a number of federal, state and local grant programs and a significant reduction in the level of this support, if it were to occur, would have a material effect on the programs and activities of the Organization. The governmental funding is subject to compliance audits by the respective governmental agencies. Assessments from such audits, if any, are recorded when the amounts of such assessments are reasonably determinable. Certain of the governmental contracts are also subject to termination for convenience clauses. The Organization has received no such termination notices.

CHILD & FAMILY RESOURCES, INC.

NOTES TO FINANCIAL STATEMENTS

14. Related Party Transactions

In February 2006, the Organization loaned \$150,000 to TNS. The loan is unsecured, noninterest bearing and due on demand. At June 30, 2008, the balance of the loan was \$100,000.

15. Post-Employment Benefits

In September 2004, the Organization entered into an agreement whereby it would pay certain post-employment benefits to a former officer for recognition of years of service. An annual stipend of \$25,000 is to be paid in monthly installments for a period not more than five years with the condition that the former officer not engage in fundraising activities within Pima County, Arizona, nor solicit employment of any employees of the Organization. Additionally, a supplemental medical benefit in the amount of \$3,000 per year is due until the death of the former officer.

16. Retirement Plan

The Organization has a 401(k) and defined contribution pension plan. The plan allows eligible employees to contribute a portion of their wages on a pretax basis into the plan. The plan also allows for discretionary matching and/or profit sharing contributions by the Organization. Total contributions for the year ended June 30, 2008 were approximately \$157,000.

17. Restatement

The beginning unrestricted net asset balance has been restated as of June 30, 2007. The previously reported amount of \$3,693,609 has been decreased to \$3,607,629. The decrease in net assets of \$85,980 was made in connection with an overpayment received from the Arizona Department of Education.

The beginning temporarily restricted net asset balance has been restated as of June 30, 2007. The previously reported amount of \$-0- has been increased to \$109,375. The increase was made to properly reflect grant and contribution income that contained time and/or purpose restrictions.

