EXCEPTIONAL CHILDREN'S FOUNDATION
AND AFFILIATES

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

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INDEPENDENT AUDITORS' REPORT

To the Audit Committee
EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES
Culver City, California

We have audited the accompanying consolidated statements of financial position of Exceptional Children's Foundation and Affiliates (collectively, the "Foundation") as of June 30, 2012 and 2011, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (the "U.S.") and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Exceptional Children's Foundation and Affiliates as of June 30, 2012 and 2011, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the U.S.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2012, on our consideration of the Foundation'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 audit.

RBZ, LLP

October 24, 2012

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2012 AND 2011

ASSETS

	2012	2011
Current Assets		
Cash and cash equivalents	$ 2,523,576	$ 2,996,909
Investments	10,351,947	10,922,181
Accounts receivable	3,049,017	3,631,610
Pledges receivable, current portion	318,500	-
Inventory	160,045	179,808
Prepaid expenses and other assets	162,408	110,373
	16,565,493	17,840,881
Other Assets		
Pledges receivable, net of current portion	600,000	-
Restricted deposits and funded reserves	310,947	323,263
Fixed assets, net	17,878,829	16,304,690
Deferred financing costs, net	99,555	108,280
	18,889,331	16,736,233
	$ 35,454,824	$ 34,577,114

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2012 AND 2011

LIABILITIES AND NET ASSETS

	2012	2011
Current Liabilities		
Line of credit	$ 2,302,956	$ 2,102,758
Current portion of long-term debt	633,393	649,986
Accounts payable and accrued expenses	1,406,924	1,472,623
	4,343,273	4,225,367
Long-Term Debt, net of current portion	4,966,120	4,812,072
Total Liabilities	9,309,393	9,037,439
Commitments and Contingencies (Notes 6 and 13)		
Net Assets		
Unrestricted		
General	1,443,712	3,887,815
Board-designated	8,708,585	8,910,765
Designated for land and buildings	12,173,317	10,834,867
	22,325,614	23,633,447
Temporarily restricted	2,819,817	906,228
Permanently restricted	1,000,000	1,000,000
Total Net Assets	26,145,431	25,539,675
	$ 35,454,824	$ 34,577,114

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public Support				
Contributions	$ 1,518,575	$ 2,356,350	$ -	$ 3,874,925
Fundraising events, net of direct costs of $19,719	167,620	12,035	-	179,655
Net Assets Released from Restrictions	464,715	(464,715)	-	-
	2,150,910	1,903,670	-	4,054,580
Revenue, Gains and Losses				
Tuition and fees	17,863,759	-	-	17,863,759
Contract sales	1,742,232	-	-	1,742,232
Rents	694,725	-	-	694,725
Merchandise sales	42,416	-	-	42,416
Interest and dividends, net	441,742	924	35,771	478,437
Realized gains on sales of investments	314,560	656	25,395	340,611
Unrealized losses on investments	(637,903)	(1,329)	(51,498)	(690,730)
Reclassification of investment earnings	-	9,668	(9,668)	-
Miscellaneous	43,994	-	-	43,994
	20,505,525	9,919	-	20,515,444
	22,656,435	1,913,589	-	24,570,024
Functional Expenses				
Program services	21,183,722	-	-	21,183,722
Management and general	2,368,604	-	-	2,368,604
Fundraising	411,942	-	-	411,942
	23,964,268	-	-	23,964,268
Changes in Net Assets	(1,307,833)	1,913,589	-	605,756
Net Assets, beginning of year	23,633,447	906,228	1,000,000	25,539,675
Net Assets, end of year	$ 22,325,614	$ 2,819,817	$ 1,000,000	$ 26,145,431

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public Support				
Contributions	$ 922,759	$ 32,239	$ -	$ 954,998
Fundraising events, net of direct costs of $90,871	1,161,075	4,326	-	1,165,401
Net Assets Released from Restrictions	588,112	(588,112)	-	-
	2,671,946	(551,547)	-	2,120,399
Revenue, Gains and Losses				
Tuition and fees	17,557,205	-	-	17,557,205
Contract sales	1,811,155	-	-	1,811,155
Rents	667,739	-	-	667,739
Merchandise sales	44,126	-	-	44,126
Interest and dividends, net	351,306	464	31,581	383,351
Realized gains on sales of investments	316,213	420	28,557	345,190
Unrealized gains on investments	999,420	1,328	90,256	1,091,004
Reclassification of investment earnings	-	150,394	(150,394)	-
Miscellaneous	54,596	-	-	54,596
	21,801,760	152,606	-	21,954,366
	24,473,706	(398,941)	-	24,074,765
Functional Expenses				
Program services	21,366,967	-	-	21,366,967
Management and general	2,328,018	-	-	2,328,018
Fundraising	444,858	-	-	444,858
	24,139,843	-	-	24,139,843
Changes in Net Assets	333,863	(398,941)	-	(65,078)
Net Assets, beginning of year	23,299,584	1,305,169	1,000,000	25,604,753
Net Assets, end of year	$ 23,633,447	$ 906,228	$ 1,000,000	$ 25,539,675

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2012

	Program Services	Management and General	Fundraising	Total
Personnel Expenses				
Rehab and administration				
Salaries	$ 11,569,467	$ 1,326,010	$ 259,818	$ 13,155,295
Payroll taxes	974,762	101,000	20,970	1,096,732
Employee benefits	1,511,596	120,586	26,254	1,658,436
Client payroll				
Payroll	705,891	-	-	705,891
Payroll taxes	55,519	-	-	55,519
Employee benefits	195,075	-	-	195,075
	15,012,310	1,547,596	307,042	16,866,948
Agency support	17,815	3,325	298	21,438
Depreciation and amortization	697,416	51,262	7,842	756,520
Equipment rental and maintenance	137,797	7,901	2,797	148,495
Events and publications	8,257	3,595	12,652	24,504
Facility maintenance	507,180	13,788	1,241	522,209
Facility rent	359,998	2,808	-	362,806
Insurance	117,932	71,787	1,010	190,729
Interest	343,577	57,774	2,842	404,193
Licenses and fees	77,752	21,885	449	100,086
Miscellaneous	82,722	47,367	3,542	133,631
Office supplies	84,320	20,064	4,311	108,695
Other production costs	189,722	-	-	189,722
Production related	284,475	-	-	284,475
Professional services	1,388,583	464,011	48,886	1,901,480
Program supplies	347,482	-	-	347,482
Staff mileage	114,843	3,514	428	118,785
Staff support services	47,460	16,770	981	65,211
Staff training and development	35,024	691	379	36,094
Telephone	186,231	21,362	15,625	223,218
Transportation and auto	852,483	-	-	852,483
Utilities	290,343	13,104	1,617	305,064
	$ 21,183,722	$ 2,368,604	$ 411,942	$ 23,964,268

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2011

	Program Services	Management and General	Fundraising	Total
Personnel Expenses				
Rehab and administration				
Salaries	$ 11,774,132	$ 1,349,531	$ 224,355	$ 13,348,018
Payroll taxes	1,001,264	107,618	17,511	1,126,393
Employee benefits	1,523,006	140,868	24,454	1,688,328
Client payroll				
Payroll	675,736	-	-	675,736
Payroll taxes	53,284	-	-	53,284
Employee benefits	174,705	-	-	174,705
	15,202,127	1,598,017	266,320	17,066,464
Agency support	16,428	2,506	-	18,934
Depreciation and amortization	701,771	50,210	7,668	759,649
Equipment rental and maintenance	138,837	7,327	3,554	149,718
Events and publications	12,341	19,796	99,520	131,657
Facility maintenance	499,095	14,160	1,336	514,591
Facility rent	400,420	2,640	-	403,060
Insurance	118,887	68,970	1,494	189,351
Interest	379,037	57,002	3,074	439,113
Licenses and fees	78,348	49,493	291	128,132
Miscellaneous	82,006	268,642	11,969	362,617
Office supplies	92,285	18,177	6,823	117,285
Other production costs	165,604	-	-	165,604
Production related	323,561	-	-	323,561
Professional services	1,342,387	106,519	27,857	1,476,763
Program supplies	355,725	867	399	356,991
Staff mileage	115,579	3,038	365	118,982
Staff support services	52,845	14,818	864	68,527
Staff training and development	34,030	7,203	511	41,744
Telephone	175,699	23,831	11,101	210,631
Transportation and auto	779,261	27	-	779,288
Utilities	300,694	14,775	1,712	317,181
	$ 21,366,967	$ 2,328,018	$ 444,858	$ 24,139,843

See accompanying notes to consolidated financial statements.

EXCEPTIONAL CHILDREN'S FOUNDATION AND AFFILIATES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
Cash Flows from Operating Activities		
Changes in net assets	$ 605,756	$ (65,078)
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities		
Depreciation and amortization	756,520	759,649
Realized gains on sales of investments	(340,611)	(345,190)
Unrealized (gains) losses on investments	690,730	(1,091,004)
Proceeds from disposition of land and building held for sale	-	644,625
(Increase) decrease in operating assets		
Accounts receivable	582,593	(206,526)
Pledges receivable	(918,500)	-
Inventory	19,763	2,643
Prepaid expenses and other assets	(52,035)	129,902
(Decrease) in operating liabilities		
Accounts payable and accrued expenses	(65,699)	(99,328)
Net Cash Provided by (Used in) Operating Activities	1,278,517	(270,307)
Cash Flows from Investing Activities		
Proceeds from sales of investments	9,238,076	4,735,825
Purchases of investments	(9,017,961)	(5,352,845)
Withdrawals from restricted deposits and funded reserves	276,061	304,680
Payments to and interest earned on restricted deposits and funded reserves	(263,745)	(265,375)
Purchases of fixed assets	(2,321,934)	(507,423)
Net Cash Used in Investing Activities	(2,089,503)	(1,085,138)
Cash Flows from Financing Activities		
Net borrowings on line of credit	200,198	1,193,413
Advances of long-term debt	800,000	2,150,000
Principal payments on long-term debt	(662,545)	(2,621,548)
Net Cash Provided by Financing Activities	337,653	721,865
Net Decrease in Cash and Cash Equivalents	(473,333)	(633,580)
Cash and Cash Equivalents, beginning of year	2,996,909	3,630,489
Cash and Cash Equivalents, end of year	$ 2,523,576	$ 2,996,909

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	2012	2011
Cash Paid during the Year for Interest	$ 403,525	$ 439,537

See accompanying notes to consolidated financial statements.

NOTE 1 - NATURE OF OPERATIONS

Exceptional Children's Foundation ("ECF") and its affiliates, Valverde, Inc. and ERAS Home II (collectively, the "Foundation") are California tax-exempt nonprofit corporations whose mission is to provide the highest quality services for children and adults who are challenged with developmental, learning, and emotional disabilities empowering them to reach their greatest potential. The Foundation provides a wide range of programs and services to infants, youths, adults, and their families each year. People served include individuals with learning disabilities, intellectual disabilities, cerebral palsy, epilepsy, autism, and related conditions. The Foundation has 16 program sites located throughout Los Angeles County.

Foundation programs are as follows:

Kayne ERAS Center

The Kayne ERAS Center of ECF (the "Center") is a large multi-service center serving children and their families each year through its special education programs and services. Based in Culver City, California, the Center provides the highest quality educational programs and therapeutic services to meet the needs of individuals with special learning, emotional and developmental challenges. The Center's state-certified and accredited K-12 nonpublic school provides special education services to students from school districts throughout greater Los Angeles. The Center also includes on-site and home-based mental health as well as diagnostic and therapeutic services.

Programs and services provided by the Center include:

- Therapeutic creative enrichment programs
- Specialized therapy services
- Physical education and recreational services
- Low cost diagnostic screening and comprehensive diagnostic testing
- Specialized full day classroom programs
- Mental health programs

Early Start

The Early Start program provides early intervention services to developmentally delayed children and their families each year in central Los Angeles, the South Bay, and the San Fernando Valley communities of Southern California. Early Start offers center-based and home visit services for infants and toddlers from birth to age three who are developmentally delayed, disabled, or "at risk." The program includes a variety of therapies and carefully structured activities designed to help young children develop language, cognitive and social skills, and gross and fine motor control.

NOTE 1 - NATURE OF OPERATIONS (Continued)

Developmental Activity Centers

Developmental Activity Centers in Culver City and Los Angeles offer many adults with moderate-to-profound mental retardation and other developmental disabilities a stepping-stone to independence. The Culver City program utilizes classroom and natural environments to provide training and support services in the areas of self-care, self-advocacy, community integration, and vocational skills. The Los Angeles program is an innovative simulated community that has won acclaim for creativity as a learning environment.

Art Centers

A nationally-recognized Art Center program in Los Angeles and a smaller site in San Pedro, California, encourage, assist and support the maximum personal artistic development for adults with developmental disabilities, ages 18 to more than 60 years. The Art Center program is nationally recognized for its leadership in demonstrating that individuals with developmental disabilities can often produce fine art. In addition to art classes, the program also offers training in independent living skills.

Work Activity

At two Packaging Assembly and Rework ("PAR") Services Work Activity sites in Culver City and Santa Fe Springs, California, adults learn good work habits and appropriate social skills while meeting governmental and private contract requirements for packaging, assembly, and rework. The program provides facility-based vocational training and paid work to improve earning potential and independent functioning of persons with developmental disabilities and to promote transition to community employment settings.

Supported Employment

Adults with developmental disabilities and acquired brain injuries receive community-integrated job placement, on-the-job training, and support services through supported employment. For program participants, this is a much-awaited gateway to greater independence. Under the supervision of an ECF job coach, participants are hired by local businesses to perform a variety of tasks including (but not limited to) clerical, janitorial, grounds maintenance, and food service assignments.

NOTE 1 - NATURE OF OPERATIONS (Continued)

Residential Services

Residential Services provide adults with developmental disabilities the opportunity to live in the community with the level of support each person needs to optimize his or her quality of life. The Foundation operates six different residential facilities, including group homes and independent living centers for individuals located in Los Angeles, Reseda, Whittier, and Culver City, California. Four of the Foundation's residential facilities (the "HUD Projects") are funded by the U.S. Department of Housing and Urban Development ("HUD") to benefit people living with developmental disabilities. Permanent financing for the HUD Projects is provided by HUD under Sections 202 and 811 of the Housing Act of 1959, which regulates the HUD Projects with respect to their rents and operating methods. The HUD Projects also receive HUD Sections 8 and 811 housing assistance and project rental assistance payments. The four HUD Projects are as follows:

Valverde
HUD Project No. 122-EH310-WHH-L8
A 12-bed group home in Los Angeles, California.

Westington
HUD Project No. 122-EH151-WHC-L8
A 13-unit apartment complex in Los Angeles, California.

Whittier Springs
HUD Project No. 122-EH157-WHC-L8
A 13-unit apartment complex in Whittier, California.

ERAS Home II
HUD Project No. 122-HD044-WDD-NP
A 6-bed group home in Culver City, California.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Income Tax Status

The Foundation is comprised of three nonprofit public benefit corporations organized under the laws of California and, as such, are exempt from federal and state income taxes under Internal Revenue Code ("IRC") Section 501(c)(3) and corresponding state provisions.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Tax Status (Continued)

The Foundation's federal income tax and informational returns for tax years ending June 30, 2009, and subsequent remain subject to examination by the Internal Revenue Service. The returns for California, the Foundation's only state tax jurisdiction, remain subject to examination by the California Franchise Tax Board for tax years ending June 30, 2008, and subsequent.

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of ECF, Valverde, Inc., and ERAS Home II. All significant inter-agency transactions and balances have been eliminated in consolidation.

Financial Statement Presentation

The Foundation reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted.

Unrestricted Net Assets, General - Include contributions, fundraising, fees, sales and other forms of revenue that are not restricted by the donor or grantor as well as expenditures related to the general operations of the Foundation.

Unrestricted Net Assets, Board-Designated - Include unrestricted net assets the Foundation's Board of Directors has segregated to be used for capital improvements, purchases, future projects, and operations.

Unrestricted Net Assets, Designated for Land and Buildings - Include unrestricted net assets designated for land and buildings, net of accumulated depreciation and debt secured by the land and building.

Temporarily Restricted Net Assets - Include contributions that are temporarily restricted by the donor or grantor. When the restriction expires, the net assets of this classification are reclassified to unrestricted net assets. Restricted contributions where restrictions are met in the same reporting period are classified as unrestricted.

Permanently Restricted Net Assets - Include contributions that have been restricted by the donor in perpetuity.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from these estimates.

Cash and Cash Equivalents

For financial statement purposes, the Foundation considers all highly-liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments are monitored by the Board of Directors' investment oversight committee and are stated at fair value. Unrealized gains and losses are recognized aggregately. Realized gains and losses are recognized immediately and are computed using the specific identification method.

The Board of Directors has limited the use of investments such that investment principal cannot be used unless approved by a vote of 75% of the Board of Directors in attendance in person or telephonically.

The Foundation reports its investments at fair value among three categories of price inputs available. These categories of inputs are quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3). At June 30, 2012 and 2011, all investments were considered to be Level 1, with the exception of corporate bonds which were deemed to be Level 2 (see Note 3).

Accounts Receivable

Accounts receivable are unsecured and the Foundation is at risk to the extent that such amounts become uncollectible. Management anticipates it will collect 100% of its accounts receivable balance; thus no allowance for doubtful accounts has been established as of June 30, 2012 and 2011.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pledges Receivable

The pledges receivable balance consists of unconditional promises to give monetary assets to the Foundation. Management anticipates it will collect 100% of the pledges receivable balance; thus no allowance for potentially uncollectible pledges has been established as of June 30, 2012 and 2011.

Inventory

Inventory consists of paper products and is stated at cost (first-in, first-out), which approximates fair value.

Fixed Assets

Purchases of fixed assets are recorded at cost. Donated items are recorded at fair value when received. Depreciation and amortization on both purchased and donated items are recorded using the straight-line method over the shorter of the estimated useful life of the related asset or, for leasehold improvements, the term of the lease, as follows:

Buildings and improvements	10 - 40 years
Land improvements	40 years
Furniture and fixtures	3 - 5 years
Equipment (computer, transportation, and other)	5 - 7 years

Normal repairs and maintenance are expensed as incurred, whereas significant charges that materially increase values or extend useful lives are capitalized and depreciated over the estimated useful lives of the related assets.

Impairment of Long-Lived Assets

Management reviews each asset or asset group for impairment whenever events or circumstances indicate the carrying value of an asset or asset group may not be recoverable, but at least annually. No impairment provision was recorded by the Foundation during the years ended June 30, 2012 and 2011.

Endowments

Net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contributions

Contributions consist primarily of donations from foundations, businesses and the general public. Contributions are recorded when committed to the Foundation by the donor.

During the year ending June 30, 2010, the Foundation received a donation of land and building recorded at its estimated fair value of $644,625. This land and building was sold during the year ended June 30, 2011, for the same amount.

Wills and Trusts

In the past, the Foundation has been named as a beneficiary in a substantial number of wills and trusts. These contributions are recorded when estate proceeds become a liability of the estate. Contributions in the form of irrevocable charitable remainder trusts are recognized when the trusts are established and the Foundation is named irrevocably as a beneficiary.

Functional Expenses

The Foundation allocates its expenses on a functional basis among its various programs and support services. Expenses that can be identified with a specific program or support service are allocated directly according to their natural expenditure classification. Other expenses that are common to several functions are allocated accordingly.

Concentration of Risk

Occasionally the Foundation's cash balances exceed FDIC-insured limits. The Foundation has not experienced and does not anticipate any losses related to these balances.

For the year ended June 30, 2012, the Foundation had three major funding sources that comprise 18%, 10% and 10% of its revenue and 21%, 7% and 6%, respectively, of its accounts receivable at June 30, 2012. Management anticipates this funding will continue at present levels.

For the year ended June 30, 2011, the Foundation had one major funding source that comprised 19% of its revenue and 20% of its accounts receivable at June 30, 2011.

Reclassifications

Certain June 30, 2011, balances have been reclassified in order to conform to the June 30, 2012, presentation, with no effect on the June 30, 2011, changes in net assets.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent Events

The Foundation has evaluated events subsequent to June 30, 2012, to assess the need for potential recognition or disclosure in the consolidated financial statements. Such events were evaluated through October 24, 2012, the date the consolidated financial statements were available to be issued. Based upon this evaluation, it was determined no subsequent events occurred that require recognition or additional disclosure in the consolidated financial statements.

NOTE 3 - INVESTMENTS

Investments consist of the following:

	2012	2011
Mutual funds	$ 4,594,392	$ 5,780,565
Common stocks	3,906,964	4,819,959
Corporate bonds	1,850,591	321,657
	$ 10,351,947	$ 10,922,181

Activity in the investments during the year was as follows:

	2012	2011
Balance, beginning of year	$ 10,922,181	$ 8,868,967
Purchases of investments	9,017,961	5,352,845
Proceeds from sales of investments	(9,238,076)	(4,735,825)
Realized gains on sales of investments	340,611	345,190
Unrealized gains (losses) on investments	(690,730)	1,091,004
	$ 10,351,947	$ 10,922,181

NOTE 4 - PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	2012	2011
Due in less than one year	$ 318,500	$ -
Due in one to five years	600,000	-
	$ 918,500	$ -

The Foundation has not discounted pledges receivable as management has determined the impact is immaterial to the consolidated financial statements.

NOTE 5 - RESTRICTED DEPOSITS AND FUNDED RESERVES

Restricted deposits and funded reserves are as follows:

	2012	2011
Bond Reserves		
The Foundation is required to make monthly deposits of $20,524 to bond reserve accounts for payments of principal, interest, mortgage insurance and administration of the bonds (see Note 9).	$ 90,286	$ 91,085
Replacement Reserves		
The HUD Projects are required to make monthly deposits to replacement reserves totaling $1,397 per month. In accordance with provisions of the regulatory agreements, the replacement reserves are to be used for the replacement of fixed assets with the prior approval of HUD.	127,276	139,622
Residual Receipts Reserves		
The HUD Projects are required to make annual deposits to the extent of their "surplus cash," as defined by HUD. In accordance with provisions of the regulatory agreements with HUD, the residual receipts reserve is to be used for major expenditures of the HUD Projects with the prior approval of HUD. The HUD Projects have no surplus cash as of June 30, 2012 and 2011.	83,934	83,110
Tenant Security Deposits		
The HUD Projects are required to maintain separate cash accounts for tenants' rental security deposits.	9,451	9,446
	$ 310,947	$ 323,263

NOTE 6 - FIXED ASSETS

Fixed assets consist of the following:

	2012	2011
Buildings and improvements	$ 18,421,296	$ 17,338,267
Land and improvements	7,933,277	7,386,277
Furniture and fixtures	3,354,397	3,329,057
Computer equipment	1,459,718	1,394,554
Transportation equipment	1,113,680	1,067,064
Leasehold improvements	298,422	298,422
Construction-in-progress	776,184	221,399
Other equipment	33,600	33,600
	33,390,574	31,068,640
Accumulated depreciation and amortization	(15,511,745)	(14,763,950)
	$ 17,878,829	$ 16,304,690

The construction-in-progress consists of the purchase and initial permits for the conversion of Engine House #18 into an art center in the West Adams neighborhood of Los Angeles. Management anticipates it will incur additional construction costs totaling approximately $820,000. Construction is anticipated to be completed and the new art center placed into service in January 2013, at which time depreciation will commence.

NOTE 7 - DEFERRED FINANCING COSTS

Deferred financing costs are recorded at cost and are amortized on a straight-line basis over the respective terms of the debt as follows:

	2012	2011
Deferred financing costs	$ 247,879	$ 247,879
Accumulated amortization	(148,324)	(139,599)
	$ 99,555	$ 108,280

NOTE 8 - LINE OF CREDIT

The Foundation has a $2,400,000 revolving line of credit with Merrill Lynch Private Finance, Inc., with monthly payments of interest-only at the 1-month LIBOR (London Interbank Offered Rate - .2432% at June 30, 2012) plus 1.25%. This line is secured by the Foundation's securities, cash and other assets held in a Merrill Lynch Trust Company account and is available for as long as the Foundation maintains its investment portfolio in this account. The line of credit agreement contains various covenants including a requirement to maintain the Foundation's Merrill Lynch Trust Company account at a sufficient value to cover the outstanding balance. At June 30, 2012 and 2011, the Foundation was in compliance with these covenants.

NOTE 9 - LONG-TERM DEBT

Long-term debt is as follows:

	2012	2011
Note payable to California United Bank, secured by the Kayne ERAS Center's land and building, with monthly principal and interest installments of $40,774. Interest is fixed at a rate of 5.125% through June 2016, at which time all outstanding principal and interest are due.	$ 1,761,962	$ 2,150,000
California Health Facilities Financing Authority ("CHFFA") Insured Revenue Bonds, 1995 Series A, secured by a deed of trust on the ECF headquarters' land and building, payable in monthly installments of $20,885, sufficient to pay semi-annual payments of bond interest (6.1%) and annual bond principal payments. Bond principal payments increase over time up to $225,000 per year, with the final payment due May 2020.	1,213,967	1,349,800
Note payable to California United Bank, secured by a second lien on the Kayne ERAS Center's land and building, with monthly principal and interest installments of $4,830. Interest is fixed at a rate of 5.250% through September 2021, at which time all outstanding principal and interest are due.	787,441	-

NOTE 9 - LONG-TERM DEBT (Continued)

	2012	2011
Note payable to HUD, secured by a first deed of trust on the Valverde 12-bed group home for the developmentally disabled, with living quarters for the site manager, payable in monthly installments of $4,501, including interest at 9.25%, through June 2026.	$ 423,192	$ 438,464
Note payable to HUD, secured by a first deed of trust on the Westington 13-unit apartment complex for the developmentally disabled, payable in monthly installments of $5,716, including interest at 9.25%, through March 2024.	490,356	512,463
Note payable to HUD, secured by a first deed of trust on the Whittier Springs 13-unit apartment complex for the developmentally disabled, payable in monthly installments of $5,988, including interest at 9.25%, through May 2024.	517,695	540,501
Capital advance from HUD, secured by a first deed of trust on the ERAS Home II 6-bed group home for the developmentally disabled, noninterest-bearing, with no payment due as long as the Foundation continues to provide housing to the developmentally disabled through September 2037.	404,900	404,900
Severance agreement payable to a former executive, unsecured, payable in monthly installments of $7,500, net of a discount rate of 5.68%, through March 2012, when it was completely paid off.	-	65,930
	5,599,513	5,462,058
Current portion	(633,393)	(649,986)
	$ 4,966,120	$ 4,812,072

NOTE 9 - LONG-TERM DEBT (Continued)

Future scheduled maturities of long-term debt are as follows:

Year Ending June 30,	
2013	$ 633,393
2014	672,210
2015	712,833
2016	753,609
2017	303,900
Thereafter	2,523,568
	$ 5,599,513

The monthly installment payments for the three notes payable to HUD (described above) are withheld by HUD from the monthly Section 8 vouchers payable by HUD to the Foundation (see Note 13).

NOTE 10 - EMPLOYEE BENEFIT PLANS

The Foundation offers IRC Sections 403(b) and 401(k) individual defined contribution plans for all eligible employees. The 401(k) plan is open to all employees except substitutes and temporary employees. Participants may make salary deferrals to their individual accounts up to the maximum allowable deferral amounts for defined contribution plans. The Foundation may make discretionary contributions to the 401(k) plan for eligible employees. No discretionary contributions were accrued for the years ended June 30, 2012 and 2011.

The 403(b) plan is a non-ERISA plan designed for highly-compensated employees. Participants may make annual contributions up to the maximum allowable deferral amount for defined contribution plans.

NOTE 11 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets and releases as of and for the year ended June 30, 2012, are as follows:

	Released from Restrictions	Balance, June 30, 2012
Annenberg Foundation	$ -	$ 1,000,000
Kayne Family Mortgage Pledge	-	900,000
PAR Services	109,219	265,009
Early Start Program	45,070	166,000
Emma Jane Meyers	50,000	135,490
Barman House	85,000	113,333
Weingart Foundation	100,000	100,000
Dale Fukamaki Memorial Fund	-	26,259
Unappropriated Earnings on Permanent Endowment (see Note 12)	8,625	27,107
Looking Beyond & Simantaub	22,063	13,271
Marci Glen Study Fund	-	12,601
Herschensohn	-	12,367
ERAS Home II Special Purpose Fund	-	8,146
Nethercut PSVE Fund	-	8,139
Skirball Foundation	7,500	7,500
Carrie Estelle Doheny Foundation	-	7,000
The Siragusa Foundation	2,045	5,455
John W. Carson Foundation	5,000	5,000
Archerd Fund - Rosenblum House #2	-	3,377
Scholarship Fund	33	1,653
CEO's Employee Development Fund	-	850
Paula Sapon Scholarship	1,040	835
Ruth Farber Scholarship	520	425
ERAS Home I Promissory Note	20,000	-
Dwight Stuart Youth Foundation	5,000	-
Barbara Cull Fund	3,400	-
Tikum Olam Early Start	200	-
	$ 464,715	$ 2,819,817

NOTE 11 - TEMPORARILY RESTRICTED NET ASSETS (Continued)

Temporarily restricted net assets and releases as of and for the year ended June 30, 2011, are as follows:

	Released from Restrictions	Balance, June 30, 2011
Par Services	$ 100,000	$ 374,228
Barman House	85,000	198,333
Emma Jane Meyers	-	185,490
Unappropriated Earnings on Permanent Endowment (see Note 12)	141,504	25,813
Looking Beyond	7,946	22,334
Dale Fukamaki Memorial Fund	10,000	21,224
ERAS Home I Promissory Note	20,000	20,000
Marci Glen Study Fund	-	12,601
Herschensohn	-	12,367
ERAS Home II Special Purpose Fund	-	8,146
Nethercut PSVE Fund	-	8,139
Dwight Stuart Youth Foundation	-	5,000
Barbara Cull Fund	-	3,400
Archerd Fund - Rosenblum House #2	-	3,377
Paula Sapon Scholarship	-	1,875
Scholarship Fund	-	1,686
Early Start Program	23,940	1,070
Ruth Farber Scholarship	1,700	945
Tikum Olam Early Start	-	200
Ahmanson Foundation	75,000	-
Weingart Foundation	45,175	-
Green Foundation	35,000	-
Annenberg Foundation DAC Roof	27,830	-
Lon V. Smith Foundation	10,000	-
Fund Development	5,017	-
	$ 588,112	$ 906,228

NOTE 12 - ENDOWMENTS

The Foundation's endowments includes both permanently donor-restricted funds and funds designated by the Board of Directors to function as endowments.

Interpretation of Relevant Law

The Board of Directors of the Foundation has interpreted the California Uniform Prudent Management of Institutional Funds Act ("Cal UPMIFA") as requiring the preservation of the fair value of donor-restricted endowment funds, absent further instructions. Any remaining portion of the donor-restricted endowment fund not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by Cal UPMIFA.

In accordance with Cal UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund

(2) The purposes of the Foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

(5) The expected total return from income and the appreciation of investments

(6) Other resources of the Foundation

(7) The investment policies of the Foundation

Return Objectives and Risk Parameters

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds classified as permanently restricted net assets as well as board-designated funds. Under this policy, as reviewed and monitored by the Investment Committee and approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that do not underperform the price and yield results of a blended benchmark of broad based equity and fixed income indices. Actual returns in any given year may vary from this amount.

NOTE 12 - ENDOWMENTS (Continued)

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Foundation uses the total return methodology in which investment returns are achieved through either capital appreciation (realized and unrealized) or current yield (interest and dividends). The Foundation has a diversified asset allocation policy that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How Investment Objectives Relate to Spending Policy

The Foundation has a policy of appropriating for distribution each year a stated amount of its board-designated endowment on the first day of each fiscal year. From its donor-restricted endowment, the Foundation may spend a discretionary portion of its annual current earnings, not to exceed 5% of the average endowment balance, in any given year. In establishing this policy, the Foundation considers the long-term expected return on its endowment. The Foundation understands the current spending policy may reduce its board-designated endowment to the extent spending exceeds earnings in any period. The Foundation is required to maintain the initial principal balance ($1,000,000) of the donor-restricted endowment assets.

Endowment Net Asset Composition by Type of Fund

	June 30, 2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 27,107	$ 1,000,000	$ 1,027,107
Board-designated endowment funds	8,708,585	-	-	8,708,585
	$ 8,708,585	$ 27,107	$ 1,000,000	$ 9,735,692

NOTE 12 - ENDOWMENTS (Continued)

Endowment Net Asset Composition by Type of Fund (Continued)

	June 30, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 25,813	$ 1,000,000	$ 1,025,813
Board-designated endowment funds	8,910,765	-	-	8,910,765
	$ 8,910,765	$ 25,813	$ 1,000,000	$ 9,936,578

Changes in Endowment Net Assets

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance, July 1, 2010	$ 7,970,539	$ 14,711	$ 1,000,000	$ 8,985,250
Investment return				
Investment income	297,019	548	37,265	334,832
Investment fees	(45,302)	(84)	(5,684)	(51,070)
Net realized and unrealized gains	947,005	1,748	118,813	1,067,566
Reclassification of investment earnings	-	150,394	(150,394)	-
Amounts expended during the year for operational and program expenses	(258,496)	(141,504)	-	(400,000)
Balance, June 30, 2011	8,910,765	25,813	1,000,000	9,936,578
Investment return				
Investment income	363,436	1,053	40,786	405,275
Investment fees	(44,685)	(129)	(5,015)	(49,829)
Net realized and unrealized losses	(232,601)	(673)	(26,103)	(259,377)
Reclassification of investment earnings	-	9,668	(9,668)	-
Amounts expended during the year for operational and program expenses	(288,330)	(8,625)	-	(296,955)
Balance, June 30, 2012	$ 8,708,585	$ 27,107	$ 1,000,000	$ 9,735,692

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Foundation leases facilities and equipment under several long-term operating lease agreements. Future required minimum lease payments are as follows:

Year Ending June 30,	
2013	$ 209,267
2014	30,676
2015	3,036
2016	3,036
2017	3,036
Thereafter	1,518
	$ 250,569

Rent expense, comprised of facilities, equipment, buses and uniforms totaled $502,456 and $545,621 for the years ended June 30, 2012 and 2011, respectively.

HUD Section 8 Housing Assistance Payments Contracts, Section 811 Project Rental Assistance Contract

Each of the HUD Projects has entered into either a Section 8 Housing Assistance Payments ("HAP") Contract or a Section 811 Project Rental Assistance Contract ("PRAC"). The amount earned under the three HAP contracts totaled $437,425 and $410,251 for the years ended June 30, 2012 and 2011, respectively. The amount earned under the PRAC contract totaled $12,330 and $6,750 for the years June 30, 2012 and 2011, respectively.

These contracts provide for a maximum annual rent supplement payment by HUD to the HUD Projects. This maximum annual rent supplement payment is subject to adjustment if there is any change in contract rent, number of contract units or family income of the tenant.

Congress has determined not to renew HAP contracts on a long-term basis. Future renewals of terminating HAP contracts will generally be for a period of one to five years and will tend to be at or below comparable market rate rents in the HUD Projects' areas. It cannot be determined what ultimate effect this may have on the HUD Projects' future rental revenue and operations.

NOTE 13 - COMMITMENTS AND CONTINGENCIES (Continued)

Barman House

Effective July 2005, the City of Culver City, California, transferred ownership of Barman House to the Foundation, subject to its continued operation as an intermediate care facility/developmentally disabled habilitative through October 2013. The Foundation recognized Barman House as a temporarily restricted contribution in the amount of $850,000 at the time of the contribution, and will release the restriction on a pro-rata basis through October 2013. If the Foundation ceases to operate Barman House as an intermediate care facility/developmentally disabled habilitative prior to October 2013, ownership will revert to the City of Culver City.

Contingent Promissory Note

The Foundation has a conditional noninterest-bearing promissory note payable to the State of California Department of Housing and Community Development ("CA HCD"), secured by the real estate of ERAS Home I. The terms of the note agreement require the Foundation to provide housing to the developmentally disabled. For as long as the Foundation complies with the provisions of its regulatory agreement with CA HCD, the remaining principal ($0 and $20,000 as of June 30, 2012 and 2011, respectively) shall be amortized at the rate of $20,000 annually until reduced to $0 in the year 2012, at which time the mortgage lien will be released with no payments of principal or interest required. Management is currently working with CA HCD to effect this release. Since management complied with all aspects of the regulatory agreement, this conditional noninterest-bearing promissory note was recorded as temporarily restricted net assets and was not recorded as a liability.