

VITA-LIVING, INC.

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2012 AND 2011

VITA-LIVING, INC.

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DAVID N. MILLER & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Directors
Vita-Living, Inc.
Houston, Texas

Report on the Financial Statements

We have audited the accompanying statements of financial position of Vita-Living, Inc. (the Organization), which comprise the statement of financial position as of December 31, 2012 and 2011, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Vita-Living, Inc. as of December 31, 2012 and 2011, and the results of its activities and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

David N. Miller and Company, LLP

May 20, 2013

VITA-LIVING, INC.
STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2012 AND 2011

| | <u>2012</u> | <u>2011</u> |
|---|--------------------------------|--------------------------------|
| ASSETS | | |
| Cash and equivalents | \$ 800,143 | \$ 961,223 |
| Accounts receivable, net | 577,391 | 759,015 |
| Prepaid expenses, deposits and other assets | 77,934 | 62,637 |
| Advances to clients, net | 11,477 | 16,147 |
| Marketable investments | 182,188 | 751,097 |
| Property and equipment, net | <u>823,929</u> | <u>755,866</u> |
| TOTAL ASSETS | \$ <u>2,473,062</u> | \$ <u>3,305,985</u> |
| LIABILITIES AND NET ASSETS | | |
| LIABILITIES | | |
| Accounts payable | \$ 189,219 | \$ 151,151 |
| Accrued salaries | 343,091 | 417,871 |
| Deferred rent | 3,795 | 6,504 |
| Other accrued liabilities | <u>118,341</u> | <u>20,260</u> |
| | 654,446 | 595,786 |
| NET ASSETS | | |
| Unrestricted | <u>1,818,616</u> | <u>2,710,199</u> |
| TOTAL LIABILITIES AND NET ASSETS | \$ <u>2,473,062</u> | \$ <u>3,305,985</u> |

See notes to financial statements.

VITA-LIVING, INC.
STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| REVENUES | | |
| Medicaid contracted services | \$ 6,170,082 | \$ 6,093,072 |
| Private pay and other income | 462,002 | 442,712 |
| Interest and dividend income | <u>28,510</u> | <u>32,053</u> |
| Total revenues | <u>6,660,594</u> | <u>6,567,837</u> |
| CLIENT CARE AND PROGRAM EXPENSES | 5,580,616 | 5,252,457 |
| OCCUPANCY AND TRANSPORTATION EXPENSES | 1,038,515 | 1,010,522 |
| GENERAL AND ADMINISTRATIVE EXPENSES | <u>886,812</u> | <u>861,354</u> |
| Total expenses | <u>7,505,943</u> | <u>7,124,333</u> |
| DEFICIENCY OF REVENUES UNDER EXPENSES FROM OPERATIONS | <u>(845,349)</u> | <u>(556,496)</u> |
| SUPPORT AND OTHER ITEMS | | |
| Contributions received | 611,374 | 610,121 |
| Contribution to related party | (700,000) | - |
| Gain (loss) from disposition of property and equipment | (2,308) | 8,230 |
| Realized and unrealized gain (loss) from marketable investments | <u>44,700</u> | <u>(14,673)</u> |
| | <u>(46,234)</u> | <u>603,678</u> |
| EXCESS (DEFICIENCY) OF REVENUES AND SUPPORT OVER (UNDER) EXPENSES AND OTHER ITEMS | <u>(891,583)</u> | <u>47,182</u> |
| UNRESTRICTED NET ASSETS | | |
| BEGINNING OF YEAR | <u>2,710,199</u> | <u>2,663,017</u> |
| END OF YEAR | <u>\$ 1,818,616</u> | <u>\$ 2,710,199</u> |

See notes to financial statements.

VITA-LIVING, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

INCREASE (DECREASE) IN CASH AND EQUIVALENTS

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash received from clients and third-party payers | \$ 6,813,708 | \$ 6,443,350 |
| Cash received from contributors | 611,374 | 610,121 |
| Cash paid to employees and suppliers | (7,346,971) | (6,968,931) |
| Cash donation | (28,560) | - |
| Interest and dividend income | <u>28,510</u> | <u>32,053</u> |
| Net cash provided by operating activities | <u>78,061</u> | <u>116,593</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from sale of property and equipment | - | 8,230 |
| Purchase of property and equipment | (181,310) | (74,192) |
| Proceeds from sale of marketable investments | 95,000 | 48,864 |
| Purchase of marketable investments | <u>(152,831)</u> | <u>(250,547)</u> |
| Net cash used by investing activities | <u>(239,141)</u> | <u>(267,645)</u> |
| NET DECREASE IN CASH | (161,080) | (151,052) |
| CASH AND EQUIVALENTS | | |
| BEGINNING OF YEAR | <u>961,223</u> | <u>1,112,275</u> |
| END OF YEAR | <u>\$ 800,143</u> | <u>\$ 961,223</u> |

See notes to financial statements.

VITA-LIVING, INC.

STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

INCREASE (DECREASE) IN CASH AND EQUIVALENTS

| | <u>2012</u> | <u>2011</u> |
|--|------------------|-------------------|
| Reconciliation of excess (deficiency) of revenues and support over (under) expenses and other items to net cash provided by operating activities | | |
| Excess (deficiency) of revenues and support over (under) expenses and other items | \$ (891,583) | \$ 47,182 |
| Adjustments | | |
| Depreciation and amortization | 110,939 | 110,049 |
| Contribution of marketable investments | 671,440 | - |
| Unrealized (gain) loss on marketable investments | (1,786) | 15,436 |
| Realized gain on marketable investments | (42,914) | (763) |
| (Gain) loss on disposition of property and equipment | 2,308 | (8,230) |
| (Increase) decrease in | | |
| Accounts receivable | 181,624 | (92,434) |
| Prepaid expenses, deposits and other assets | (15,297) | (7,225) |
| Advances to clients, net | 4,670 | 2,733 |
| Increase (decrease) in | | |
| Accrued salaries | (74,780) | 32,390 |
| Accounts payable and other accrued liabilities | 136,149 | 18,549 |
| Deferred rent | <u>(2,709)</u> | <u>(1,094)</u> |
| Net cash provided by operating activities | \$ <u>78,061</u> | \$ <u>116,593</u> |

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS

ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Vita-Living, Inc. (VLI) was incorporated in August 1982 as a non-profit corporation. VLI provides lifelong services and supports for children and adults with developmental disabilities while promoting personal growth toward a satisfying, safe, and meaningful life in the community.

Financial Statements

VLI presents its financial statements in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958 regarding accounting for Financial Statements of Not-for-Profit Organizations. Under ASC 958, VLI is required to report information on its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Support

VLI also follows the recommendations of ASC 958 regarding Accounting for Contributions Received and Contributions Made. Under ASC 958, contributions received are recorded as unrestricted, temporarily restricted or permanently restricted depending on the existence and nature of any donor restrictions.

Accounts Receivable and Advances

Accounts receivable are subject to certain Texas Department of Aging and Disability Services (DADS) rules and regulations relating to Level of Need (LON) review. These rules permit DADS a 364-day retroactive review of LON determinations with recoupment of payments determined to be in excess of need. VLI is paid set fees through the Texas Health and Human Service Commission based on Medicaid allowances for care and services provided to clients. Management has established an allowance for doubtful accounts for certain accounts and advances whose collectibility is uncertain.

Property and Equipment

Property and equipment are stated at cost or donated value. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the assets.

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Marketable Investments

VLI presents its investments in accordance with ASC 958 regarding Accounting for Certain Investments Held by Non Profit Organizations. Under ASC 958 investments in marketable securities are required to be carried at fair value. Any unrealized gains and losses from these investments are reported in the statements of activities.

Fair Value Measurements

The financial statements reflect the adoption of ASC 820 regarding Fair Value Measurements. ASC 820 establishes a single authoritative definition of fair value, sets a framework for measuring fair value and requires additional disclosures about fair value measurement. In accordance with ASC 820, VLI classifies its investments into Level 1, which refers to securities traded in an active market; Level 2, which refers to securities not traded on an active market but for which observable market inputs are readily available or Level 1 securities where there is a contractual restriction; and Level 3, which refers to securities not traded in an active market and for which no significant observable market inputs are available. At December 31, 2012 and 2011, all of VLI's investments are considered Level 1.

Federal Income Taxes

VLI is a non-profit, tax exempt organization as described in Section 501(c)(3) of the Internal Revenue Code. Therefore, no provision for federal income tax has been included in the financial statements.

Cash Flows

For purposes of the statement of cash flows, VLI considers cash and equivalents to be the Company's cash accounts plus its money market accounts with original maturities of three months or less.

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to the prior year information to conform to the current year presentation.

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

CASH AND CASH EQUIVALENTS

Cash and equivalents at December 31, 2012 and 2011 are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|---------------------------------------|-------------------|-------------------|
| Cash in banks | \$ 594,555 | \$ 817,247 |
| Cash in money market investment funds | 198,861 | 137,249 |
| Cash on hand | <u>6,727</u> | <u>6,727</u> |
| | <u>\$ 800,143</u> | <u>\$ 961,223</u> |

Cash in banks at December 31, 2011 includes a \$75,000 time deposit with an original maturity of three months or less. The time deposit bears interest at 0.10%.

VLI maintains a cash balance at a Texas bank which exceeds the Federally insured limits. VLI has not experienced any losses from maintaining cash accounts in excess of this limit. At December 31, 2012, VLI's balances at this bank exceed the insured limit by approximately \$330,000.

ACCOUNTS RECEIVABLE

Accounts receivable includes income earned for services provided as of December 31, 2012 and 2011 and are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|--------------------------------------|-------------------|-------------------|
| DADS | | |
| HCS program | \$ 397,246 | \$ 508,980 |
| ICFMR program | 90,812 | 95,491 |
| CLASS program | 69,162 | 124,384 |
| Private pay and other | <u>32,787</u> | <u>38,752</u> |
| | 590,007 | 767,607 |
| Allowance for uncollectible accounts | <u>(12,616)</u> | <u>(8,592)</u> |
| | <u>\$ 577,391</u> | <u>\$ 759,015</u> |

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

ADVANCES TO CLIENTS

Advances to clients at December 31, 2012 and 2011 are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|--------------------------------------|------------------|------------------|
| Advances | \$ 13,861 | \$ 18,313 |
| Allowance for uncollectible advances | <u>(2,384)</u> | <u>(2,166)</u> |
| | <u>\$ 11,477</u> | <u>\$ 16,147</u> |

MARKETABLE INVESTMENTS

Marketable investments are carried at fair market value (FMV) at December 31, 2012 and 2011 and are summarized as follows:

| | <u>2012</u> | | <u>2011</u> | |
|------------------------------|-------------------|-------------------|-------------------|-------------------|
| | <u>Cost</u> | <u>FMV</u> | <u>Cost</u> | <u>FMV</u> |
| Fixed Income | | | | |
| Investment Funds: | | | | |
| Vanguard Short-term | | | | |
| Investment Grade Fund #539 | \$ <u>25,188</u> | \$ <u>25,387</u> | \$ <u>200,363</u> | \$ <u>198,406</u> |
| Total | <u>25,188</u> | <u>25,387</u> | <u>200,363</u> | <u>198,406</u> |
| Corporate bonds: | | | | |
| 4.875% maturing 2012 | - | - | 97,370 | 96,000 |
| 4.875% maturing 2014 | 98,750 | 104,240 | 98,750 | 104,307 |
| 2.00% to 5.65% maturing 2015 | - | - | 150,178 | 162,984 |
| 2.65% maturing 2017 | 50,240 | 52,561 | - | - |
| 6.15% maturing 2018 | - | - | 100,221 | 103,209 |
| 5.49% maturing 2019 | <u>-</u> | <u>-</u> | <u>97,990</u> | <u>86,191</u> |
| Total | <u>148,990</u> | <u>156,801</u> | <u>544,509</u> | <u>552,691</u> |
| Total fixed income | <u>\$ 174,178</u> | <u>\$ 182,188</u> | <u>\$ 744,872</u> | <u>\$ 751,097</u> |

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

MARKETABLE INVESTMENTS - CONTINUED

Revenues from these investments provide an income stream for annual operations. Realized and unrealized income from marketable investments are reported in the statement of activities.

Investment return from the marketable investments is summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|--|------------------|------------------|
| Interest and dividend income | \$ 28,482 | \$ 31,978 |
| Realized and unrealized gains and losses | <u>44,700</u> | <u>(14,673)</u> |
| | <u>\$ 73,182</u> | <u>\$ 17,305</u> |

PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2012 and 2011 are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|-------------------|
| Land | \$ 122,126 | \$ 122,126 |
| Buildings and improvements | 993,932 | 951,373 |
| Equipment | <u>669,792</u> | <u>642,175</u> |
| | 1,785,850 | 1,715,674 |
| Less accumulated depreciation and amortization | <u>(961,921)</u> | <u>(959,808)</u> |
| Net property and equipment | <u>\$ 823,929</u> | <u>\$ 755,866</u> |

Depreciation expense for 2012 and 2011 amounted to \$110,939 and \$110,049, respectively.

CONCENTRATIONS AND RISKS

Concentration of credit risk - A substantial portion of VLI's income is derived from its contract with DADS. Consequently, VLI's credit risk is dependent upon the future economic activities of DADS. The Organization does not obtain collateral for its receivables.

Concentration of performance risk - The ability of the issuers of certain financial instruments held by VLI to meet their obligation may be affected by economic developments, including those particular to a specific industry or region.

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

COMMITMENTS

VLI is committed to several renewable annual operating leases, which provide facilities for client residences, activities and storage. VLI is also committed to other operating leases for office space and office equipment. The office lease has a base rental escalation clause for maintenance, utilities, insurance and taxes. Certain equipment leases, after the minimum term or extension, renew on a month to month basis unless the lessor is notified at least 30 days prior to the expiration of the minimum term or extension.

Future minimum lease payments consist of the following:

| | |
|------|-------------------|
| 2013 | \$ 205,099 |
| 2014 | 151,790 |
| 2015 | 79,336 |
| 2016 | 14,404 |
| 2017 | <u>7,736</u> |
| | <u>\$ 458,365</u> |

Lease expense for 2012 and 2011 amounted to \$271,679 and \$252,342, respectively.

RELATED PARTY TRANSACTIONS

VLI's board of directors created the Vita-Living Foundation (VLF) in 1996. VLF is a non-profit organization that works to ensure the long-term financial security of VLI. One of VLF's board of directors is also a VLI director.

VLI has executed certain operating leases with VLF. Leasing expense under these lease agreements for 2012 and 2011 amounted to \$90,000 and \$79,200, respectively. Future minimum lease payments have been included with the commitments previously reported.

VLF has elected to make annual contributions to VLI of at least five percent of the FMV of VLF's marketable investments. VLF's contribution for the years ended December 31, 2012 and 2011 amounted to \$61,540 and \$65,057, respectively. Additionally, during the years ended December 31, 2012 and 2011, VLF contributed \$90,000 and \$79,200, respectively, to VLI for operating expenses.

During 2012, VLI contributed marketable securities with a fair market value of \$671,440 and cash of \$28,560 to VLF for a total contribution of \$700,000.

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

RETIREMENT PLAN

VLI has a 403 (b) plan for its employees. All employees who have attained the age of twenty-one are eligible to participate in the plan. VLI did not contribute any amounts to this plan during 2012 and 2011.

FINANCIAL INSTRUMENTS

The estimated fair value of VLI's financial instruments are as follows:

Cash - VLI considers the estimated fair value of cash and cash equivalents to equal the carrying amount recognized in the statements of financial position.

Marketable investments - VLI considers the estimated fair value of marketable investments to be the carrying amount recognized in the statements of financial position.

INCOME TAX UNCERTAINTIES

VLI has reviewed its filing positions on its current income tax return, as well as all open tax years. VLI adopted the policy of recognizing interest and penalties, if any, related to unrecognized tax positions as income tax expense. VLI did not have any unrecognized tax positions or benefits from tax positions that do not meet the more likely than not criterion. Accordingly, there was no effect on the VLI's financial condition or results of operations for the year ended December 31, 2012. The Federal tax returns of VLI for 2012, 2011 and 2010 are subject to examination by the Internal Revenue Service.

GENERAL BUSINESS ENVIRONMENT

Since 2008 and continuing into 2013, the financial markets experienced considerable stress and credit continues to tighten for some businesses and households. In addition, the State of Texas is experiencing tight budget constraints. This prevailing economic uncertainty, along with the credit crises, the contraction in housing, and higher unemployment, have marked a decline in donations for local causes. If the current crisis continues for an extended period of time, or worsens, VLI may experience insufficient liquidity to meet its operational needs in the future.

VITA-LIVING, INC.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 3, 2013, which is the date the financial statements were available to be issued. Based on the evaluation, no adjustments to the accompanying financial statements were required.

In January 2013, VLI transferred ownership of certain owned residential properties to VLF. VLF is now responsible for the properties and VLI leases the properties for its residential operations. The properties had a net book value of \$513,000 and a fair market value of \$1,063,000.

SUPPLEMENTARY INFORMATION

DAVID N. MILLER & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON SCHEDULE OF EXPENSES

Board of Directors
Vita-Living, Inc.
Houston, Texas

Our report on our audits of the basic financial statements of Vita-Living, Inc. for December 31, 2012 and 2011 appears on page 3-4. These audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The attached schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

David N. Miller and Company, LLP

May 20, 2013

VITA-LIVING, INC.
SCHEDULE OF EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| CLIENT CARE AND PROGRAM EXPENSES | | |
| Wages | \$ 3,659,945 | \$ 3,444,788 |
| Fringe benefits | 696,378 | 654,127 |
| Consultants | 535,366 | 487,586 |
| Food | 166,122 | 157,570 |
| Client training | 465,153 | 462,491 |
| Medical and dental expenses | 45,828 | 34,590 |
| Activities | <u>11,824</u> | <u>11,305</u> |
| Total client care and program expenses | <u>\$ 5,580,616</u> | <u>\$ 5,252,457</u> |
| OCCUPANCY AND TRANSPORTATION EXPENSES | | |
| Leases | \$ 271,679 | 252,342 |
| Transportation | 174,470 | 164,037 |
| Utilities | 174,085 | 175,449 |
| Maintenance and repairs | 172,312 | 181,803 |
| Depreciation and amortization | 110,939 | 110,049 |
| Insurance | 92,773 | 84,617 |
| Housekeeping | 41,272 | 41,185 |
| Taxes, real estate and other | <u>985</u> | <u>1,040</u> |
| Total occupancy and transportation expenses | <u>\$ 1,038,515</u> | <u>\$ 1,010,522</u> |
| GENERAL AND ADMINISTRATIVE EXPENSES | | |
| Wages | \$ 538,553 | \$ 543,754 |
| Professional fees | 109,152 | 113,599 |
| Fringe benefits | 93,072 | 103,340 |
| Miscellaneous | 82,592 | 42,894 |
| Office and postage | 32,581 | 27,467 |
| Employee training | 9,397 | 8,871 |
| Insurance | 6,715 | 5,521 |
| Dues and licenses | <u>14,750</u> | <u>15,908</u> |
| Total general and administrative expenses | <u>\$ 886,812</u> | <u>\$ 861,354</u> |