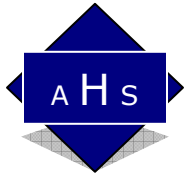


Hope Cottage, Inc.
Audited Financial Statements
December 31, 2011 and 2010

Hope Cottage, Inc.
Audited Financial Statements
December 31, 2011 and 2010

Table of Contents

| | <u>Page</u> |
|--|-------------|
| Independent Auditor's Report | 1 |
| Statements of Financial Position, December 31, 2011 and 2010 | 3 |
| Statement of Activities, For the year ended December 31, 2011 | 5 |
| Statement of Activities, For the year ended December 31, 2010 | 6 |
| Statements of Cash Flows, For the years ended December 31, 2011 and 2010 | 7 |
| Statement of Functional Expenses, For the year ended December 31, 2011 | 9 |
| Statement of Functional Expenses, For the year ended December 31, 2010 | 10 |
| Notes to Financial Statements | 11 |



Independent Auditor's Report

To the Board of Directors
Hope Cottage, Inc.

We have audited the accompanying Statements of Financial Position of Hope Cottage, Inc. and the related Statements of Activities, Cash Flows and Functional Expenses as of and for the years ended December 31, 2011 and 2010. These financial statements are the responsibility of Hope Cottage, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Hope Cottage, Inc.'s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of Hope Cottage, Inc., as of December 31, 2011 and 2010, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Albright, Hill & Sumpter, PC
Certified Public Accountants

Albright, Hill & Sumpter

March 31, 2012

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Hope Cottage, Inc.
 Statements of Financial Position
 December 31, 2011 and 2010

| <u>ASSETS</u> | <u>2011</u> | <u>2010</u> |
|---|---------------------|---------------------|
| Current assets | | |
| Cash and cash equivalents | \$ 65,234 | \$ 100,131 |
| Accounts receivable: | | |
| Trade | 40,606 | 16,523 |
| Grants | 21,861 | 17,344 |
| Due from affiliate | - | 1,599 |
| Investment in endowment trust | 28,129 | 34,860 |
| Prepaid expenses | 2,157 | 6,794 |
| Total current assets | <u>157,987</u> | <u>177,251</u> |
| Restricted assets | | |
| United Way receivable | - | 21,540 |
| Investment in charitable trust | 720,179 | 811,760 |
| Total restricted assets | <u>720,179</u> | <u>833,300</u> |
| Property and equipment (net of accumulated depreciation of \$1,166,966 and \$1,130,129 for 2011 and 2010, respectively) | 2,247,150 | 2,307,995 |
| Other assets: | | |
| Beneficial interest in the net assets of Hope Cottage Foundation | 1,295,983 | 1,333,577 |
| Loan origination fees | 8,013 | 9,469 |
| Website (net of accumulated amortization of \$166,731 and \$132,739 for 2011 and 2010, respectively) | 8,892 | 33,184 |
| Investment in mineral interest | 156,347 | 208,260 |
| Total assets | <u>\$ 4,594,551</u> | <u>\$ 4,903,036</u> |

The accompanying notes are an integral part of these statements.

Hope Cottage, Inc.
 Statements of Financial Position
 December 31, 2011 and 2010

LIABILITIES AND NET ASSETS

| | 2011 | 2010 |
|---|--------------|--------------|
| Current liabilities | | |
| Note payable - current portion | \$ 27,773 | \$ 26,143 |
| Capital lease payable - current portion | 4,646 | 4,061 |
| Accounts payable | 51,541 | 66,716 |
| Accrued liabilities | 19,454 | 11,992 |
| Total current liabilities | 103,414 | 108,912 |
| Long-term liabilities | | |
| Note payable - long-term portion | 1,064,029 | 1,093,865 |
| Capital lease payable - long-term portion | 7,196 | 12,427 |
| Tenant security deposits | 9,306 | 7,806 |
| Total long-term liabilities | 1,080,531 | 1,114,098 |
| Total liabilities | 1,183,945 | 1,223,010 |
| Net assets | | |
| Unrestricted | 2,654,427 | 2,866,213 |
| Temporarily restricted | 756,179 | 813,813 |
| Total net assets | 3,410,606 | 3,680,026 |
| Total liabilities and net assets | \$ 4,594,551 | \$ 4,903,036 |

The accompanying notes are an integral part of these statements.

Hope Cottage, Inc.
Statement of Activities
For the year ended December 31, 2011

| | Unrestricted | Temporarily Restricted | Total |
|---|---------------------|---------------------------|---------------------|
| Support and revenue | | | |
| Contributions and grants | \$ 571,890 | \$ 36,000 | \$ 607,890 |
| Adoption and counseling fees | 496,096 | - | 496,096 |
| Distributions from affiliate | 85,000 | - | 85,000 |
| Investment income | 53,631 | - | 53,631 |
| Mineral interest income - net of expense | 39,088 | - | 39,088 |
| Change in net assets of investment in charitable trust | - | (91,581) | (91,581) |
| Change in value of mineral interest | (51,913) | - | (51,913) |
| Rental income | 122,918 | - | 122,918 |
| Special events and fund raising (net of direct expense) | 10,282 | - | 10,282 |
| Net assets released from restrictions | 2,053 | (2,053) | - |
| Total support and revenue | <u>1,329,045</u> | <u>(57,634)</u> | <u>1,271,411</u> |
| Expenses | | | |
| Program services: | | | |
| Adoption and counseling | 1,047,178 | - | 1,047,178 |
| Supporting services: | | | |
| Management and general | 190,388 | - | 190,388 |
| Fund raising | 90,964 | - | 90,964 |
| Rental property expenses | 174,707 | - | 174,707 |
| Total expenses | <u>1,503,237</u> | <u>-</u> | <u>1,503,237</u> |
| Change in net assets before change in value of beneficial interest | (174,192) | (57,634) | (231,826) |
| Change in value of beneficial interest | <u>(37,594)</u> | <u>-</u> | <u>(37,594)</u> |
| Change in net assets | (211,786) | (57,634) | (269,420) |
| Net assets at beginning of year | 2,866,213 | 813,813 | 3,680,026 |
| Net assets at end of year | <u>\$ 2,654,427</u> | <u>\$ 756,179</u> | <u>\$ 3,410,606</u> |

The accompanying notes are an integral part of this statement.

Hope Cottage, Inc.
Statement of Activities
For the year ended December 31, 2010

| | Unrestricted | Temporarily Restricted | Total |
|---|---------------------|---------------------------|---------------------|
| Support and revenue | | | |
| Contributions and grants | \$ 709,700 | \$ 38,000 | \$ 747,700 |
| Adoption and counseling fees | 357,356 | - | 357,356 |
| Distributions from affiliate | 50,000 | - | 50,000 |
| Investment income | 23,368 | - | 23,368 |
| Mineral interest income - net of expense | 52,065 | - | 52,065 |
| Change in net assets of investment in charitable trust | - | 60,411 | 60,411 |
| Change in value of mineral interest | 42,004 | - | 42,004 |
| Rental income | 78,717 | - | 78,717 |
| Special events and fund raising (net of direct expense) | 17,638 | - | 17,638 |
| Net assets released from restrictions | 107,471 | (107,471) | - |
| Total support and revenue | <u>1,438,319</u> | <u>(9,060)</u> | <u>1,429,259</u> |
| Expenses | | | |
| Program services: | | | |
| Adoption and counseling | 987,414 | - | 987,414 |
| Supporting services: | | | |
| Management and general | 190,387 | - | 190,387 |
| Fund raising | 85,726 | - | 85,726 |
| Rental property expenses | 164,974 | - | 164,974 |
| Total expenses | <u>1,428,501</u> | <u>-</u> | <u>1,428,501</u> |
| Change in net assets before change in value of beneficial interest | 9,818 | (9,060) | 758 |
| Change in value of beneficial interest | <u>139,597</u> | <u>-</u> | <u>139,597</u> |
| Change in net assets | 149,415 | (9,060) | 140,355 |
| Net assets at beginning of year | 2,716,798 | 822,873 | 3,539,671 |
| Net assets at end of year | <u>\$ 2,866,213</u> | <u>\$ 813,813</u> | <u>\$ 3,680,026</u> |

The accompanying notes are an integral part of this statement.

Hope Cottage, Inc.
 Statements of Cash Flows
 For the years ended December 31, 2011 and 2010

| | <u>2011</u> | <u>2010</u> |
|---|------------------|-------------------|
| Cash flows from operating activities | | |
| (Decrease) increase in net assets | \$ (269,420) | \$ 140,355 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 136,353 | 128,894 |
| Change in value of mineral interest | 51,913 | (42,004) |
| Loss on disposal of fixed assets | 1,833 | - |
| Change in value of beneficial interest | 37,594 | (139,597) |
| Change in net assets of investment in charitable trust | 91,581 | (60,411) |
| Change in investment in endowment trust | 6,731 | 7,071 |
| (Increase) decrease in receivables | (7,060) | 63,372 |
| Decrease in due from affiliate | 1,599 | 8,271 |
| Decrease in prepaid expenses | 4,637 | 22,016 |
| (Decrease) increase in accounts payable and accrued expenses | (7,713) | 8,092 |
| Increase in tenant deposits | 1,500 | 3,525 |
| Net cash provided by operating activities | <u>49,548</u> | <u>139,584</u> |
| Cash flows from investing activities | | |
| Cash paid for property and equipment | (51,593) | (58,486) |
| Net cash (used in) investing activities | <u>(51,593)</u> | <u>(58,486)</u> |
| Cash flows from financing activities | | |
| Payments on capital lease | (4,646) | (3,654) |
| Repayments of long-term debt | (28,206) | (24,701) |
| Net cash (used in) financing activities | <u>(32,852)</u> | <u>(28,355)</u> |
| (Decrease) increase in cash and cash equivalents | (34,897) | 52,743 |
| Cash and cash equivalents at beginning of year | 100,131 | 47,388 |
| Cash and cash equivalents at end of year | <u>\$ 65,234</u> | <u>\$ 100,131</u> |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the year for: | | |
| Interest | <u>\$ 67,823</u> | <u>\$ 76,042</u> |
| Income taxes | <u>\$ -</u> | <u>\$ -</u> |

The accompanying notes are an integral part of these statements.

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Hope Cottage, Inc.
Statement of Functional Expenses
For the year ended December 31, 2011

| | Adoption and Counseling | Management and General | Fund Raising | Rental Property Expenses | Total |
|---------------------------|----------------------------|---------------------------|------------------|--------------------------------|---------------------|
| Salaries | \$ 617,504 | \$ 93,797 | \$ 50,651 | \$ 46,327 | \$ 808,279 |
| Payroll taxes | 40,527 | 8,772 | 4,795 | 4,386 | 58,480 |
| Employee benefits | 49,948 | 10,811 | 5,910 | 5,406 | 72,075 |
| Advertising | 5,591 | 1,210 | 661 | 605 | 8,067 |
| Bank charges | 4,497 | 973 | 532 | 487 | 6,489 |
| Client services | 78,628 | - | - | - | 78,628 |
| Conferences | 51,514 | 2,116 | 988 | - | 54,618 |
| Depreciation | 68,177 | 21,816 | 9,545 | 36,815 | 136,353 |
| Dues and subscriptions | 1,097 | 329 | 239 | - | 1,665 |
| Insurance expense | 18,789 | 5,368 | 2,684 | 7,456 | 34,297 |
| Interest expense | 29,256 | 8,772 | 4,179 | 25,616 | 67,823 |
| Miscellaneous | - | 4,775 | - | - | 4,775 |
| Office expense | 10,640 | 8,137 | 1,783 | 920 | 21,480 |
| Postage | 4,077 | 883 | 482 | 441 | 5,883 |
| Printing | 6,192 | 1,012 | 1,071 | - | 8,275 |
| Property and income taxes | - | - | - | 14,429 | 14,429 |
| Repair and maintenance | 22,148 | 7,019 | 2,889 | 14,635 | 46,691 |
| Security expense | 85 | 27 | 12 | 75 | 199 |
| Telephone | 7,677 | 1,662 | 908 | 831 | 11,078 |
| Travel | 12,412 | 189 | 1,065 | - | 13,666 |
| Bad debt expense | - | - | - | - | - |
| Trustee fees | - | 7,152 | - | - | 7,152 |
| Utilities | 18,419 | 5,568 | 2,570 | 16,278 | 42,835 |
| Total | \$ 1,047,178 | \$ 190,388 | \$ 90,964 | \$ 174,707 | \$ 1,503,237 |

The accompanying notes are an integral part of this statement.

Hope Cottage, Inc.
Statement of Functional Expenses
For the year ended December 31, 2010

| | Adoption and Counseling | Management and General | Fund Raising | Rental Property Expenses | Total |
|---------------------------|----------------------------|---------------------------|------------------|--------------------------------|---------------------|
| Salaries | \$ 583,333 | \$ 88,605 | \$ 47,848 | \$ 43,764 | \$ 763,550 |
| Payroll taxes | 36,370 | 7,872 | 4,304 | 3,936 | 52,482 |
| Employee benefits | 45,347 | 9,815 | 5,366 | 4,908 | 65,436 |
| Advertising | 5,130 | 1,110 | 607 | 555 | 7,402 |
| Bank charges | 5,003 | 1,083 | 592 | 541 | 7,219 |
| Client services | 70,120 | - | - | - | 70,120 |
| Conferences | 53,991 | 2,218 | 1,036 | - | 57,245 |
| Depreciation | 65,013 | 20,061 | 9,266 | 34,554 | 128,894 |
| Dues and subscriptions | 2,040 | 612 | 446 | - | 3,098 |
| Insurance expense | 15,417 | 4,405 | 2,202 | 6,118 | 28,142 |
| Interest expense | 29,781 | 8,929 | 4,254 | 26,075 | 69,039 |
| Miscellaneous | - | 9,207 | - | - | 9,207 |
| Office expense | 8,430 | 6,446 | 1,413 | 729 | 17,018 |
| Postage | 3,892 | 842 | 461 | 421 | 5,616 |
| Printing | 4,549 | 744 | 787 | - | 6,080 |
| Property and income taxes | - | - | - | 15,083 | 15,083 |
| Repair and maintenance | 17,290 | 5,480 | 2,254 | 11,425 | 36,449 |
| Security expense | 190 | 57 | 27 | 168 | 442 |
| Telephone | 7,641 | 1,654 | 904 | 827 | 11,026 |
| Travel | 12,323 | 188 | 1,054 | 3 | 13,568 |
| Bad debt expense | 3,600 | - | 400 | - | 4,000 |
| Trustee fees | - | 15,631 | - | - | 15,631 |
| Utilities | 17,954 | 5,428 | 2,505 | 15,867 | 41,754 |
| Total | \$ 987,414 | \$ 190,387 | \$ 85,726 | \$ 164,974 | \$ 1,428,501 |

The accompanying notes are an integral part of this statement.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In fulfilling its responsibility for the preparation of Hope Cottage, Inc.'s (the Organization) financial statements and disclosures, management selects accounting principles generally accepted in the United States of America and adopts methods for their application. The application of accounting principles requires estimating, matching and timing of revenue and costs in the determination of support and expenditures. It is also necessary for management to determine, measure, allocate and make certain assumptions regarding resources and obligations within the financial process according to these principles. Below are certain significant accounting policies selected by management.

A. Nature of Business

Hope Cottage, Inc. is Dallas' oldest adoption center and is a non-sectarian, non-profit, United Way affiliated organization. The Organization nurtures and builds families through education, counseling and adoption services. The Organization is supported primarily through contributions, including contributions from Hope Cottage Foundation (the Foundation), grants, fees and fund raising activities.

B. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

For reporting purposes, resources are classified into three net asset categories according to the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets – net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors.

Temporarily restricted net assets – net assets 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. Contributions received with donor imposed restrictions that are met in the same year as received are reported as revenue of the unrestricted net asset class.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

Permanently restricted net assets – net assets subject to donor-imposed stipulations that may be maintained in perpetuity by the Organization. As of December 31, 2011 and 2010, there were no permanently restricted net assets.

C. Revenue Recognition

Revenues are reported as an increase in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Temporarily restricted net assets whose restrictions are met in the year the contribution is received are reported as unrestricted net assets. Expirations of temporary restrictions on net assets in a year subsequent to the receipt of the contribution are reported as net assets released from restrictions.

Adoption Fees

Adoption fees are recognized as revenue in two stages during the adoption process. When an initial nonrefundable deposit is made, this deposit is recognized as revenue. Once the adoption is completed, the remaining fee is recognized as revenue.

Contributions

Contributions, including unconditional promises to give, are recorded as the promises are made. All contributions are available for unrestricted use unless specifically restricted by the donor. Unconditional promises to give due in subsequent years are reported at the present value of their estimated net realizable value.

Grants

Revenue from grants which are in effect contributions are recognized as described above.

Revenue from grants which have the characteristics of an exchange transaction is recognized when earned (generally as funds are expended for grant purposes).

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

Contributed Assets and Services

Contributed assets are reflected as contributions in the accompanying statements at their estimated fair value at the date of receipt. Contributed services are reflected in the financial statements at the estimated fair value of the services received if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills that are provided by individuals possessing those skills and would typically need to be purchased if not provided by donation. There were no contributed services for 2011 and 2010.

D. Statements of Cash Flows

Cash and cash equivalents consist of cash on hand and all highly liquid investments purchased with an initial maturity of three months or less.

E. Trade Accounts Receivable

Trade accounts receivable consist of receivables for adoption fees. Management evaluates accounts receivable and writes off accounts when they are deemed uncollectable. The reserve method is used in accounting for bad debts. Management periodically reviews accounts receivable on an account-by-account basis. Management takes into consideration the Organization's past history with the consumer and the size of the account in evaluating the reserve requirements. Accounts are written off when it appears collection efforts will not be successful. As of December 31, 2011 and 2010, no allowance for doubtful accounts was deemed necessary.

Bad debt expense for 2011 and 2010 was \$0 and \$4,000, respectively.

F. Investment in Mineral Interest

Mineral interests are carried at estimated fair value based on industry standards of 48 months of undiscounted income based on the most recent 12 month income history. Unrealized gains and losses are calculated at the estimated current fair value at the end of the year less estimated current fair value at the beginning of the year. Investment income consists of mineral interest royalties net of related expenses.

G. Investment in Endowment Trust

Investment in endowment trust at December 31, 2011 consisted of a trust account (the Endowment Trust) maintained by a bank. These funds are

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

unrestricted. The Endowment Trust is comprised of fixed income and money market funds. Such assets are carried at quoted market prices.

H. Investment in Charitable Trust

The Organization is the sole beneficiary of the L. Storey Stemmons and Grace Stemmons Kepler Charitable Trust (the Charitable Trust) maintained at JP Morgan at December 31, 2011. In accordance with FASB ASC 958, *Not-for-Profit Entities*, a beneficiary shall recognize its rights to the assets held by a recipient organization as an asset unless the recipients are interrelated organizations, the beneficiary shall recognize its interest in the net assets of the recipient organization and adjust that interest for its share of the change in net assets of the recipient organization. The Charitable Trust meets these criteria as the agreement provides that the trust property shall be held, administered and distributed exclusively for the benefit of Hope Cottage, Inc. The Charitable Trust settlement document requires a minimum annual distribution to Our Friends Place (a non-profit organization). A distribution of \$7,521 and \$15,631 was made for 2011 and 2010, respectively.

I. Beneficial Interest

Hope Cottage Foundation was formed for the purpose of raising funds, creating an endowment and supporting its affiliate, Hope Cottage, Inc. The Organization is the sole beneficiary of the Foundation.

The Foundation is supported primarily through contributions and investment income. The Board of Trustees of the Foundation determines the amount, if any, of grant distributions to be made to the Organization. In 2011 and 2010, the Foundation made distributions to the Organization of \$85,000 and \$50,000, respectively.

In accordance with FASB ASC 958, *Not-for-Profit Entities*, if a beneficiary and recipient organization are financially interrelated organizations the beneficiary shall recognize its interest in the assets held by a recipient organization as an asset and adjust that interest for its share of the change in net assets of the recipient organization.

In late 2011, the Board of the Foundation approved dissolution of the Foundation and the payout of all funds to the Organization. Such payout was finalized subsequent to December 31, 2011.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

J. Property, Plant and Equipment

Property, plant and equipment are recorded at cost, if purchased, or estimated fair value at the date of donation. The Organization capitalizes expenditures for plant and equipment in excess of \$500 and with an estimated useful life greater than one year.

Depreciation of plant and equipment is computed on a straight-line basis over estimated useful lives as follows:

| | <u>Estimated Lives</u> |
|--------------------------|------------------------|
| Building and improvement | 7 - 30 years |
| Furniture and equipment | 3 - 10 years |

Management evaluates its long-lived assets for financial impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when the estimated undiscounted cash flows from the assets are less than the carrying value of the assets. Assets to be disposed of are reported at the lower of their carrying amount, or fair value, less costs to sell.

K. Website

The Organization received donated website development and design services during 2006. The website became fully functional in 2007. Amortization expense was \$33,992 and \$33,184 for the years ended December 31, 2011 and 2010, respectively. Amortization expense is included in depreciation expense. The website was fully depreciated as of December 31, 2011.

L. Functional Allocation of Expenses

The costs of providing the various programs and supporting services have been summarized on a functional basis in the Statement of Activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

M. Accounting Estimates and Assumptions

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. Such estimates and assumptions primarily relate to valuation, unsettled transactions, funding continuity and events as of the date of the financial statements. Accordingly,

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

actual results could differ from these estimates and assumptions. The methods used in making accounting estimates are believed by management to be reasonable and have been consistently applied. Significant estimates and assumptions are the valuation of receivables and investments, the allocation of functional expenses and lives used to depreciate fixed assets.

N. Income Taxes

The Organization is recognized by the Internal Revenue Service as tax-exempt under Section 501(c)(3) of the Internal Revenue Code, except to the extent that it has unrelated business income. For the years ended December 31, 2011 and 2010, the Organization had no material unrelated business income. Accordingly, no provision for income taxes has been provided in the accompanying financial statements. The Organization is not recognized as a private foundation.

NOTE 2 – INVESTMENTS

Investments in the endowment and charitable trusts and mineral interests, including temporarily restricted balances, are comprised of the following as of December 31, 2011 and 2010:

| | 2011 | | |
|------------------|------------|---------------------------|-------------------------|
| | Cost | Unrealized Gain (Loss) | Estimated Fair Value |
| Cash | \$ 32,619 | \$ - | \$ 32,619 |
| Other | 272,469 | 438,271 | 710,740 |
| Accrued interest | 4,949 | - | 4,949 |
| Mineral interest | 208,260 | (51,913) | 156,347 |
| | \$ 518,297 | \$ 386,358 | \$ 904,655 |
| | 2010 | | |
| | Cost | Unrealized Gain (Loss) | Estimated Fair Value |
| Cash | \$ 51,665 | \$ - | \$ 51,665 |
| Fixed income | 204,196 | 9,551 | 213,747 |
| Equities | 235,927 | 52,808 | 288,735 |
| Other | 265,379 | 24,823 | 290,202 |
| Accrued interest | 2,271 | - | 2,271 |
| Mineral interest | 4,278 | 203,982 | 208,260 |
| | \$ 763,716 | \$ 291,164 | \$1,054,880 |

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

Financial Accounting Standards Board (FASB) ASC 820, *Fair Value Measurements*, establishes a framework for measuring value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives highest priority to unadjusted quoted fair prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Organization has the ability to access.

Level 2 – Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices of identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.
- If the asset or liability has a specified contractual term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The assets or liabilities fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value:

Mineral Interest: 12 months revenue X 4.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

Fixed Income: Quoted market prices.

Equity Securities: Quoted market prices.

The methods described above may produce fair value estimates that may not be indicative of net realized value or reflective of future fair values. Furthermore, although the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Organization's investments at estimated fair value as of December 31, 2011:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|----------------------------|-------------------|----------------|-------------------|-------------------|
| Mineral interest | \$ - | \$ - | \$ 156,347 | \$ 156,347 |
| Cash | 37,568 | - | - | 37,568 |
| JP Morgan balanced fund | 710,740 | - | - | 710,740 |
| | <u>\$ 748,308</u> | <u>\$ -</u> | <u>\$ 156,347</u> | <u>\$ 904,655</u> |

The following is a reconciliation of the beginning and ending balances of mineral interests measured at fair value using significant unobservable inputs (Level 3).

| | |
|--------------------|-------------------|
| Balance 12/31/2010 | \$ 208,260 |
| Unrealized loss | <u>(51,913)</u> |
| Balance 12/31/2011 | <u>\$ 156,347</u> |

NOTE 3 – RESTRICTED ASSETS

Temporarily restricted assets at December 31, 2011 and 2010 were available for the following purposes:

| | <u>2011</u> | <u>2010</u> |
|--------------------------|------------------|-----------------|
| Foster adoption services | \$ 36,000 | \$ - |
| Capital improvements | - | 2,053 |
| | <u>\$ 36,000</u> | <u>\$ 2,053</u> |

In addition, temporarily restricted assets at December 31, 2011 and 2010 include the Organization's investments in the Charitable Trust.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

The assets of which are held for the benefit of the Organization and are available for the following purposes:

| | 2011 | 2010 |
|---|------------|------------|
| Tuition, tutoring and other education needs | \$ 720,179 | \$ 811,760 |

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following at December 31, 2011 and 2010:

| | 2011 | 2010 |
|-------------------------------------|--------------|--------------|
| Land | \$ 771,410 | \$ 771,410 |
| Building and improvements (pledged) | 2,479,382 | 2,446,542 |
| Furniture and equipment | 92,429 | 119,836 |
| Computer hardware and software | 70,895 | 100,336 |
| | 3,414,116 | 3,438,124 |
| Accumulated depreciation | (1,166,966) | (1,130,129) |
| Total | \$ 2,247,150 | \$ 2,307,995 |

Depreciation expense was \$100,905 and \$94,254 for the years ended December 31, 2011 and 2010, respectively. Amortization expense of \$33,992 and \$33,184 for website development cost and \$1,456 and \$1,456 for loan origination fees is included in depreciation expense for the years ended December 31, 2011 and 2010.

NOTE 5 – ACCRUED LIABILITIES

Accrued liabilities consisted of the following at December 31, 2011 and 2010:

| | 2011 | 2010 |
|----------|-----------|-----------|
| Vacation | \$ 9,653 | \$ 6,782 |
| Other | 9,801 | 5,210 |
| Total | \$ 19,454 | \$ 11,992 |

NOTE 6 – LONG-TERM DEBT

In May 2007, the Organization signed a real estate note payable to Symetra in the amount of \$1,200,000 secured by a deed of trust and an assignment of leases and rents. Interest was 6.065% at December 31, 2011 and 2010. Monthly payments of \$7,780, including principal and interest, commenced on July 1, 2007 for 119 consecutive months with all unpaid principal and interest due June 1, 2017. No full or partial prepayment of principal is permitted during the first five years of the loan. The balance of the mortgage payable was \$1,091,802 as of December 31, 2011.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

Maturities of long-term debt are as follows:

| | | |
|------------|----|---------------------|
| 2012 | \$ | 27,773 |
| 2013 | | 29,505 |
| 2014 | | 31,345 |
| 2015 | | 33,300 |
| 2016 | | 35,377 |
| Thereafter | | 934,502 |
| Total | | <u>\$ 1,091,802</u> |

NOTE 7 – CAPITAL LEASES

During 2010, the Organization entered into a capital lease for two (2) copiers. This lease expires in 2014. The Organization has the option to purchase this copier for \$1 at the end of the lease term.

Future remaining payments pursuant to this capital lease are as follows:

| | | |
|----------------------------------|----|---------------|
| Total Lease Payments | | |
| <u>Years Ending December 31,</u> | | |
| 2012 | \$ | 4,646 |
| 2013 | | 4,646 |
| 2014 | | <u>2,670</u> |
| Total gross remaining payments | | 11,962 |
| Amount representing interest | | <u>(120)</u> |
| Total | \$ | <u>11,842</u> |

NOTE 8 – COMMITMENTS, CONTINGENCIES AND CREDIT RISK

Litigation

The Organization, at times, may become involved in various lawsuits in the normal course of business. Management cannot predict the outcome or estimate the amount of loss that may result. Accordingly, no provision or any contingent liabilities has been made in the financial statements.

Grants

The Organization receives funds or reimbursements from government agencies which are subject to specific compliance requirements, review and audit by grantor agencies. Such audits could result in request for reimbursements by the grantor

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

agency for expenses disallowed under the terms and conditions specified in the grant agreements. In the opinion of management, the net effect of any disallowance or adjustments resulting from these activities would not be material to the Organization's financial statements.

Cash and Cash Equivalents

The Organization maintains cash balances at several financial institutions in Dallas, Texas which, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

NOTE 9 – RETIREMENT PLAN

The Organization adopted a 403(b) defined contribution retirement plan effective November 1992. All employees are eligible to participate in the plan and begin vesting in the Organization's contributions when they complete one year of service. Participants vest 20% per year until they are fully vested in all of the Organization's contributions upon 5 years of service.

The Organization's basic and discretionary contributions are determined annually. The Organization's contribution was \$0 for the years ended December 31, 2011 and 2010.

The Organization terminated the 403(b) plan effective December 31, 2011. Current plan participants became fully vested as a result of the termination.

NOTE 10 – RENTAL INCOME

The Organization leases a portion of its building to various tenants for a monthly rental fee. These agreements are classified as operating leases.

The future minimum lease payments due from the tenants is as follows:

| | |
|-------|-------------------|
| 2012 | \$ 95,661 |
| 2013 | 82,643 |
| 2014 | 73,344 |
| 2015 | 32,436 |
| Total | <u>\$ 284,084</u> |

Rental income was \$122,918 and \$78,717 in 2011 and 2010, respectively.

Hope Cottage, Inc.
Notes to Financial Statements
December 31, 2011 and 2010

NOTE 11 – FINANCIAL CONDITION

The Organization depends heavily on donations and grants for its revenue. The ability of the donors and grantors to continue giving amounts comparable with prior years may be dependent upon (among other things) current and future overall economic conditions and mission acceptance.

NOTE 12 – DISCLOSURES ABOUT UNCERTAINTY IN INCOME TAXES UNDER FASB ASC 740

The Organization files an annual information tax return. With few exceptions, the Organization is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2008.

The Organization has adopted the provisions of FASB ASC 740, *Accounting for Uncertainty in Income Taxes*. As of December 31, 2011 and 2010, there were no unrecognized tax benefits.

The Organization recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in administrative expense. There were no such interest and penalties for 2011 and 2010.

NOTE 13 – SUBSEQUENT EVENTS

Management has reviewed events occurring subsequent to December 31, 2011 through the issue date of the financial statements, March 31, 2012. Based on this review, other than the event mentioned in Note 1 - Section I, no events have occurred requiring disclosure.