

THE GLADNEY CENTER
CONSOLIDATED FINANCIAL STATEMENTS
For the Year Ended August 31, 2002

Report of Independent Accountants

The Board of Directors
The Gladney Center

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and change in net assets, of cash flows, and of expenses by function present fairly, in all material respects, the financial position of the Gladney Center (the "Center") at August 31, 2002, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Center's management; our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Center's 2001 financial statements, and in our report dated November 16, 2001, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.



November 1, 2002

THE GLADNEY CENTER
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
August 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Assets:		
Cash	\$ 850,673	\$ 1,176,135
Accounts receivable	60,797	39,462
Contributions receivable, net	5,986,647	6,243,985
Prepaid expenses	167,321	255,988
Investments	23,406,534	24,587,267
Cash held for long-term investment	-	7,980,433
Property and equipment	17,632,331	6,420,640
Debt issuance costs, net	99,883	107,018
	<u>\$ 48,204,186</u>	<u>\$ 46,810,928</u>
Liabilities and net assets:		
Accounts payable and accrued expenses	\$ 1,839,137	\$ 805,528
Interest rate swap payable	837,592	356,111
Funds held on deposit for programs	76,765	39,237
Deferred revenue	50,677	240,991
Note payable	9,244,761	9,676,955
	<u>12,048,932</u>	<u>11,118,822</u>
Net assets:		
Unrestricted	17,987,825	17,097,042
Temporarily restricted	9,617,151	10,467,174
Permanently restricted	8,550,278	8,127,890
	<u>36,155,254</u>	<u>35,692,106</u>
Total net assets	<u>\$ 48,204,186</u>	<u>\$ 46,810,928</u>
Total liabilities and net assets	<u>\$ 48,204,186</u>	<u>\$ 46,810,928</u>

The accompanying notes are an integral part of the consolidated financial statements.

THE GLADNEY CENTER
CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGE IN NET ASSETS
For the Year Ended August 31, 2002
(with summarized financial information for the year ended August 31, 2002)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2002 Total</u>	<u>2001 Total</u>
Revenues, gains and other support:					
Domestic adoption program	\$ 3,489,144	\$ -	\$ -	\$ 3,489,144	\$ 4,148,138
International adoption program	1,306,939	-	-	1,306,939	1,327,414
Resident insurance settlements	56,917	-	-	56,917	97,004
Post adoption	20,109	-	-	20,109	20,085
Contributions	1,078,335	3,890,296	431,516	5,400,147	10,004,839
Fees	33,994	-	-	33,994	30,339
Investment return (loss)	(451,103)	(523,473)	-	(974,576)	(2,351,426)
Auxiliary special events	239,527	-	-	239,527	466,245
Other	32,517	-	-	32,517	25,450
Net assets released from restrictions	4,225,974	(4,216,846)	(9,128)	-	-
Total revenues, gains and other support	<u>10,032,353</u>	<u>(850,023)</u>	<u>422,388</u>	<u>9,604,718</u>	<u>13,768,088</u>
Expenses:					
Domestic adoption program	2,512,997	-	-	2,512,997	2,264,413
International adoption program	1,484,346	-	-	1,484,346	1,311,879
Post adoption	349,876	-	-	349,876	340,222
Client services	1,474,049	-	-	1,474,049	1,359,480
Administration	2,099,185	-	-	2,099,185	1,698,453
Gladney Fund	1,221,117	-	-	1,221,117	1,164,643
Total expenses	<u>9,141,570</u>	<u>-</u>	<u>-</u>	<u>9,141,570</u>	<u>8,139,090</u>
Change in net assets	<u>890,783</u>	<u>(850,023)</u>	<u>422,388</u>	<u>463,148</u>	<u>5,628,998</u>
Net assets at beginning of year	<u>17,097,042</u>	<u>10,467,174</u>	<u>8,127,890</u>	<u>35,692,106</u>	<u>30,063,108</u>
Net assets at end of year	<u>\$ 17,987,825</u>	<u>\$ 9,617,151</u>	<u>\$ 8,550,278</u>	<u>\$ 36,155,254</u>	<u>\$ 35,692,106</u>

The accompanying notes are an integral part of the consolidated financial statements.

THE GLADNEY CENTER
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended August 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Change in net assets	\$ 463,148	\$ 5,628,998
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net unrealized depreciation on investments	1,635,512	3,351,863
Provision for uncollectible contributions receivable	44,350	108,833
Loss on sale of fixed assets	-	25,126
Depreciation and amortization	295,578	153,930
Loss on interest rate swap	481,481	356,111
Contribution of assets and services	(461,140)	(1,830,330)
Collections of capital campaign contributions	(3,152,062)	(3,025,029)
Collections on contributions restricted for endowment	(258,306)	(610,675)
Dividends and interest restricted for long-term investment	(31,690)	(42,092)
Change in assets and liabilities:		
Accounts receivable	(21,335)	(3,082)
Contributions receivable	212,986	(2,894,105)
Prepaid expenses	88,667	(109,836)
Accounts payable and accrued expenses	1,033,609	(139,866)
Funds held on deposit for programs	37,528	(22,314)
Deferred designated adoption program revenue	(190,314)	195,116
Net cash provided by operating activities	<u>178,012</u>	<u>1,142,648</u>
Cash flows from investing activities:		
Proceeds from sale of investments	11,542,264	4,673,275
Purchase of investments	(11,623,402)	(8,290,948)
Purchase of property and equipment	(11,412,633)	(4,042,222)
Net cash used in investing activities	<u>(11,493,771)</u>	<u>(7,659,895)</u>
Cash flows from financing activities:		
Payments on note payable	(432,194)	(73,045)
Collections of capital campaign contributions	3,152,062	3,025,029
Collections on contributions restricted for endowment	258,306	610,675
Dividends and interest restricted for long-term investment	31,690	42,092
Net change in cash held for long-term investment	<u>7,980,433</u>	<u>3,425,476</u>
Net cash provided by financing activities	<u>10,990,297</u>	<u>7,030,227</u>
Net increase (decrease) in cash	(325,462)	512,980
Cash at beginning of year	<u>1,176,135</u>	<u>663,155</u>
Cash at end of year	<u>\$ 850,673</u>	<u>\$ 1,176,135</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of \$221,589 and \$0, respectively, capitalized	<u>\$ 226,989</u>	<u>\$ 358,970</u>

The accompanying notes are an integral part of the consolidated financial statements.

THE GLADNEY CENTER
CONSOLIDATED STATEMENT OF EXPENSES BY FUNCTION

For the Year Ended August 31, 2002

(with summarized financial information for the year ended August 31, 2001)

	Domestic Adoption Program	International Adoption Program	Post Adoption	Client Services	Administration	Gladney Fund	2002 Total	2001 Total
Salary and wages	\$ 938,952	\$ 585,432	\$ 174,924	\$ 338,371	\$ 873,826	\$ 545,292	\$ 3,456,797	\$ 3,201,149
Employee benefits	149,733	103,749	42,245	79,639	248,157	26,495	650,018	540,924
Medical services	172,536	3,687	226	832	483	-	177,764	196,650
Office expenses	42,302	43,587	11,837	73,784	18,493	256,601	446,604	401,380
Utilities and grounds	122,531	55,058	8,942	53,976	31,336	6,980	278,823	326,887
Leases and rentals	309,812	48,554	15,955	35,525	24,668	-	434,514	360,057
Insurance expense	79,856	42,066	24,865	26,933	24,396	88,103	286,219	224,860
Depreciation and amortization	113,318	29,524	15,457	53,164	84,113	-	295,576	153,929
Other expenses	342,655	489,201	23,358	40,761	257,571	176,314	1,329,860	1,102,050
Professional fees	235,014	59,962	31,323	1,100	30,159	121,332	478,890	514,008
Outreach education	6,288	23,526	744	769,964	24,502	-	825,024	761,085
Loss on interest rate swap	-	-	-	-	481,481	-	481,481	356,111
Total for the year ended August 31, 2002	\$ 2,512,997	\$ 1,484,346	\$ 349,876	\$ 1,474,049	\$ 2,099,185	\$ 1,221,117	\$ 9,141,570	
Total for the year ended August 31, 2001	\$ 2,264,413	\$ 1,311,879	\$ 340,222	\$ 1,359,480	\$ 1,698,453	\$ 1,164,643	\$ 8,139,090	

The accompanying notes are an integral part of the consolidated financial statements.

THE GLADNEY CENTER

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Background Information:

The Gladney Center (the "Center") was established as a Texas nonprofit 501(c)(3) tax-exempt corporation organized to provide meaningful and ongoing services to the members of the adoption triad: the birth parents, the child, and the adoptive parents. The Center provides residential, medical, counseling, educational, infant and child placement, and post placement services as well as various non-residential services.

The consolidated financial statements of the Center include the financial information of the Gladney Fund (the "Fund") and certain trust entities that benefit the Center. The Fund is a distinct entity established as a 501(c)(3) nonprofit corporation, which has a fiscal year-end of August 31. The Fund was organized to exclusively perform the fundraising activities for the Center. These activities include generating, receiving, and administering funds for the growth, operations, and improvements of the Center. The trust entities were established by the Center as distinct 501(a)(3) entities for maintenance of investments previously held by the Center.

All significant accounts and transactions between the Fund, the Center and the trust entities have been eliminated in consolidation.

2. Summary of Significant Accounting Policies:

Restricted Contributions and Temporarily Restricted Net Assets

The Center reports contributions with donor-imposed restrictions as restricted support; however, donor-imposed restrictions whose restrictions are met in the same fiscal year are reported as unrestricted support. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Contributed Assets and Services

Contributed assets are recorded at fair value on the date of receipt. In the absence of donor restrictions, contributed assets are reported as unrestricted support. Necessary services contributed by persons with specialized skills are reported as unrestricted support at the fair value of those services during the period the service is provided. Services contributed by persons without specialized skills are not recorded due to the difficulty of objectively determining their value.

Contributed services have been included in other support and expense in the amount of \$0 and \$4,708 for the years ended August 31, 2002 and 2001, respectively. The contributed services received by the Center generally consist of contributed printing services related to Auxiliary special events. The Center received contributed architecture services in the amount of \$87,500 and \$662,500 for the construction of the Center's new facility, which was recorded in contributions and support for capital improvements of the Center in the accompanying statement of activities and changes in net assets for the years ended August 31, 2002 and 2001, respectively.

THE GLADNEY CENTER

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

2. Summary of Significant Accounting Policies, continued:

Programs and Services

The Gladney Center provides a comprehensive array of maternity and adoption services at its Fort Worth campus and at additional counseling offices located in Dallas, Houston and Midland, TX; North Carolina; and New York City, NY.

Adoption Programs

Agency Assisted Adoption

The Agency Assisted Adoption Department obtains the best possible adoptive homes for infants entrusted to its care through a diligent education, preparation and home study process. Program policies are based on child placing standards of the State of Texas and the other states where The Gladney Center is licensed, and on the agency's commitment to helping couples build a family through adoption and to providing comprehensive services to birth parents. All services and the policies and procedures flowing from them are flexible in order to meet the needs of the agency's clients.

ABC Adoption Program

ABC stands for Gladney's commitment to African-American and Bi-racial children. The program was created in response to the startling shortage of adoptive parents who are able to provide homes for African-American and Bi-racial children. The Gladney Center is committed to providing permanent and loving families for these children.

International Adoption

Through this program, Gladney helps people achieve their dreams of parenthood by adopting infants and children from around the globe. International adoptions provide loving homes for children who may be lingering in foreign orphanages. Through this broad-based program, the agency facilitates adoptions in three areas of the world, Asia, Latin America and Eastern Europe, often working with two or more countries in each area.

Special Needs

The Special Needs program seeks to find loving families for those children who are more difficult to place due to their particular circumstances. Special needs can refer to children who are older as well as those with medical or developmental difficulties. Gladney works closely with state foster care systems to locate permanent, loving homes for these children.

Cash

The Center considers cash to include cash on hand and cash on deposit in banks. The Center regularly maintains cash on deposit at financial institutions in amounts in excess of FDIC coverage.

Cash Held for Long-term Investment

The Center included approximately \$5.0 million in cash from issuance of notes payable and approximately \$3.0 million in cash received from the sale of its facility in the accompanying statements of financial position at August 31, 2001. These amounts had been designated by the Center for construction of its new facility, and therefore, are not included in cash available for operations.

Investments

Investments are presented at fair value, using quoted market prices. Realized gains and losses and unrealized appreciation (depreciation) are aggregated and included as investment return in the consolidated statements of activities and cash flows.

THE GLADNEY CENTER
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

2. Summary of Significant Accounting Policies, continued:

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Improvements which substantially enhance the utilization of or increase the useful life of property are capitalized at cost. Depreciation is recognized using the straight-line method over the expected useful lives of the assets. Expected useful lives range from 3 to 10 years. Cost of assets disposed of and related accumulated depreciation are eliminated, and the resulting gain or loss reflected in the period of disposal.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates used by the Center include collectibility of contributions receivable and depreciation.

Comparative Prior Year Information

The consolidated statements of activities and functional expenses for the year ended August 31, 2001 include certain comparative financial information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Center's consolidated financial statements for the year ended August 31, 2001, from which the summarized information was derived.

Reclassification

Certain comparative prior year information has been reclassified to conform to the current year presentation. These reclassifications had no effect on total assets, total net assets, or change in net assets as previously presented.

3. Contributions Receivable:

The Fund recognizes unconditional promises to give as support in the period the promise is made and reports them as contributions on the statement of activities. Contributions receivable, net of discounts of \$426,959, are expected to be collected as follows:

2003	\$ 2,094,144
2004	1,215,568
2005	973,114
2006	740,700
2007	<u>1,167,326</u>
Total	<u>\$ 6,190,852</u>

As of August 31, 2002 and 2001, the Fund had an allowance for uncollectible contributions receivable of \$204,205 and \$175,548, respectively.

THE GLADNEY CENTER
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

4. Investments and Investment Return:

The composition of investments as of August 31, 2002 and 2001 are reflected in the following table:

	<u>2002</u>	<u>2001</u>
Equity securities	\$ 10,944,804	\$ 9,923,735
Debt securities and other obligations	10,812,545	12,380,512
Money market mutual funds	1,649,185	2,283,020
	<u>\$ 23,406,534</u>	<u>\$ 24,587,267</u>

The components of investment return (loss) for the years ended August 31, 2002 and 2001 are reflected in the following table:

	<u>2002</u>	<u>2001</u>
Dividends and interest	\$ 660,936	\$ 1,000,437
Net unrealized depreciation on investments	(1,635,512)	(3,351,863)
	<u>\$ (974,576)</u>	<u>\$ (2,351,426)</u>

5. Property and Equipment:

A summary of property and equipment at August 31, 2002 and 2001 are as follows:

	<u>2002</u>	<u>2001</u>
Land	\$ 1,335,252	\$ 1,335,252
Building	15,252,788	
Construction progress	-	4,733,326
Furniture and fixtures	1,821,823	875,614
Automobiles	134,499	126,309
	<u>18,544,362</u>	<u>7,070,501</u>
Less accumulated depreciation	(912,031)	(649,861)
Property and equipment, net	<u>\$ 17,632,331</u>	<u>\$ 6,420,640</u>

6. Liability Under Split Interest Agreements:

The Center has included in accounts payable and accrued expenses a discounted liability of approximately \$88,168 and \$114,000 as of August 31, 2002 and 2001, respectively, for amounts due to donor-specified beneficiaries. This discounted liability represents remaining annual payments due through October 28, 2006. The liability arose under a split interest agreement wherein the Center received a cash gift of approximately \$300,000 during the fiscal year ended August 31, 1998.

7. Notes Payable:

The Center borrowed \$9,750,000 from a bank in August 2000, incurring \$114,153 of issuance costs. The note agreement requires the Center to maintain certain financial covenants, including but not limited to, liquidity and debt service coverage ratios. At August 31, 2002, the Company was in compliance with all covenants. Payment terms require interest only semi-annual payments through June 2002, then semi-annual principal and interest payments through June 1, 2016, maturity date. The note bears interest at either 75% of the 30, 60, or 90 day LIBOR rate or 51% of the prime rate the method chosen at the Center's discretion (1.4% at August 31, 2001).

THE GLADNEY CENTER
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

7. Notes Payable, continued:

Effective May 14, 2001, the Center entered into an interest rate swap agreement with an initial notional principal amount of \$9,750,000 and an expiration date of June 1, 2016. Pursuant to the agreement, the Center pays a fixed rate of 4.54% and receives a floating interest rate during the duration of the swap agreement. The effective interest rate of the swap is currently 3.1%. The change in fair value of the agreement since inception and the related fair value of the derivative instrument have been presented as a separate line item in the accompanying consolidated statement of expenses by function and the consolidated statement of financial position, respectively, as of and for the period ended August 31, 2002.

The note and the interest rate swap are collateralized by the contributions receivable for the Capital Campaign Project and the facilities to be constructed.

The minimum required principal loan payments over the next five years are as follows:

2003	\$ 456,346
2004	481,849
2005	508,777
2006	537,210
2007	567,231
Thereafter	<u>6,693,348</u>
	<u>\$ 9,244,761</u>

8. Temporarily Restricted Net Assets and Net Assets Released from Restrictions:

As of August 31 temporarily restricted net assets were available for the following purposes:

	<u>2002</u>	<u>2001</u>
Gladney Fund	\$ 9,450,361	\$ 10,201,900
Domestic programs	121,311	219,439
International programs	<u>45,479</u>	<u>45,835</u>
	<u>\$ 9,617,151</u>	<u>\$ 10,467,174</u>

During the year ended August 31, net assets were released from donor restrictions by making expenditures satisfying the following restricted purposes:

	<u>2002</u>	<u>2001</u>
Gladney Fund	\$ 4,081,751	\$ 408,600
Domestic programs	108,388	109,597
International programs	35,835	7,232
Capital programs	<u>-</u>	<u>29,710</u>
	<u>\$ 4,225,974</u>	<u>\$ 555,139</u>

THE GLADNEY CENTER
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Continued

9. Permanently Restricted Net Assets:

As of August 31 permanently restricted net assets were restricted to investments in perpetuity, the income from which is expendable to support the following:

	<u>2002</u>	<u>2001</u>
International Adoption Program	\$ 103,506	\$ 102,758
Greer Garson Educational Opportunities	545,000	545,000
ABC Adoption Program	1,021,700	621,700
Transitional care	370,753	370,753
Campus and capital improvement	535,000	535,000
Post adoption	306,445	306,407
Career Development	268,818	268,818
Any activities of the Fund	<u>5,399,056</u>	<u>5,377,454</u>
	<u>\$ 8,550,278</u>	<u>\$ 8,127,890</u>

10. Auxiliary Special Events:

The Fund has 17 auxiliary groups located throughout the United States that sponsor fund raising special events. These groups of volunteers raised a total of \$1,159,739 and \$850,536 with related expenses of \$920,212 and \$384,291 for the years ended August 31, 2002 and 2001, respectively.

11. Retirement Plan:

The Center maintains a 403(b) defined contribution retirement plan for the benefit of its full-time employees who have attained 21 years of age and two years of service. The Center matches 50% of the employee's pretax compensation-deferral contributions to the plan until their sixth year of service and, thereafter, matches 100% of the employee's contribution. The expense recognized by the Center totaled \$247,702 and \$186,198 for the years ended August 31, 2002 and 2001, respectively.