

Financial statements of:

FIELDSTONE ALLIANCE, INC.

Year ended June 30, 2006 and the
period from December 27, 2004
(inception) to June 30, 2005

FIELDSTONE ALLIANCE, INC.

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DECEMBER 27, 2004 (INCEPTION) TO JUNE 30, 2005

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INDEPENDENT AUDITOR'S REPORT

Schechter Dokken Kanter
Andrews & Selzer Ltd

Board of Directors
Fieldstone Alliance, Inc.
St. Paul, Minnesota

Suite 1600

We have audited the accompanying statements of financial position of Fieldstone Alliance, Inc. as of June 30, 2006 and 2005, and the related statements of activities and changes in net assets and cash flows for the year ended June 30, 2006 and the period from December 27, 2004 (inception) to June 30, 2005. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

100 Washington Avenue South

Minneapolis, MN

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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

55401-2192

Phone 612-332-5500

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fieldstone Alliance, Inc. as of June 30, 2006 and 2005, and the changes in net assets and cash flows for the year ended June 30, 2006 and the period from December 27, 2004 (inception) to June 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

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August 30, 2006

FIELDSTONE ALLIANCE, INC.STATEMENTS OF FINANCIAL POSITION
JUNE 30

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Cash	\$ 234,527	\$ 282,462
Accounts receivable, net of allowance for doubtful accounts (2006, \$3,317; 2005, \$1,967)	94,933	277,864
Grants receivable	3,502,378	
Inventory	109,887	162,611
Royalty advances	10,221	6,384
Prepaid expenses	<u>23,971</u>	<u>24,675</u>
Total current assets	<u>3,975,917</u>	<u>753,996</u>
Property and equipment, net	<u>58,211</u>	<u>67,502</u>
Other assets:		
Grants receivable, net of current portion	5,400,998	
Deposits	<u>7,646</u>	<u>7,646</u>
Total other assets	<u>5,408,644</u>	<u>7,646</u>
Total assets	<u>\$ 9,442,772</u>	<u>\$ 829,144</u>
Liabilities and net assets:		
Current liabilities:		
Accounts payable:		
Trade	\$ 31,600	\$ 90,771
Employee	1,102	2,713
Accrued expenses	<u>93,652</u>	<u>32,537</u>
Total current liabilities	<u>126,354</u>	<u>126,021</u>
Net assets:		
Unrestricted	354,032	104,208
Temporarily restricted	<u>8,962,386</u>	<u>598,915</u>
Total net assets	<u>9,316,418</u>	<u>703,123</u>
Total liabilities and net assets	<u>\$ 9,442,772</u>	<u>\$ 829,144</u>

See notes to financial statements.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2006 AND THE PERIOD FROM
DECEMBER 27, 2004 (INCEPTION) TO JUNE 30, 2005

FIELDSTONE ALLIANCE, INC.

	<u>2006</u>	<u>2005</u>
Changes in unrestricted net assets:		
Revenues and gains:		
Contributions	\$ 3,450	\$ 1,000
In-kind contributions	2,225	233,112
Book sales, net of discounts	584,431	71,359
Consulting services	385,180	85,244
Shipping revenue	33,906	
Mail list rental income	14,719	
Interest	<u>8,329</u>	<u>569</u>
	1,032,240	391,284
Net assets released from restrictions	<u>730,700</u>	<u>10,539</u>
	<u>1,762,940</u>	<u>401,823</u>
Total unrestricted revenues and gains		
Operating expenses:		
Program services:		
Consulting	696,651	93,626
Publishing	715,178	86,371
Management and general services	81,998	116,748
Fundraising	<u>19,289</u>	<u>870</u>
	<u>1,513,116</u>	<u>297,615</u>
Changes in unrestricted net assets	249,824	104,208
Unrestricted net assets, beginning	<u>104,208</u>	_____
Unrestricted net assets, ending	<u>354,032</u>	<u>104,208</u>
Changes in temporarily restricted net assets:		
Contributions and grants	9,094,171	609,454
Net assets released from restrictions	<u>(730,700)</u>	<u>(10,539)</u>
Changes in temporarily restricted net assets	8,363,471	598,915
Temporarily restricted net assets, beginning	<u>598,915</u>	_____
Temporarily restricted net assets, ending	<u>8,962,386</u>	<u>598,915</u>

See notes to financial statements.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2006 AND THE PERIOD FROM
DECEMBER 27, 2004 (INCEPTION) TO JUNE 30, 2005

FIELDSTONE ALLIANCE, INC.

	<u>2006</u>	<u>2005</u>
Increase in total net assets	\$ 8,613,295	\$ 703,123
Total net assets, beginning	<u>703,123</u>	<u> </u>
Total net assets, ending	<u>\$ 9,316,418</u>	<u>\$ 703,123</u>

See notes to financial statements.

FIELDSTONE ALLIANCE, INC.STATEMENTS OF CASH FLOWS
YEAR ENDED JUNE 30, 2006 AND THE PERIOD FROM
DECEMBER 27, 2004 (INCEPTION) TO JUNE 30, 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Increase in total net assets	\$ 8,613,295	\$ 703,123
Adjustments to reconcile increase in total net assets to net cash provided by (used in) operating activities:		
Depreciation	18,476	1,876
Increase in:		
Allowance for doubtful accounts	1,350	1,967
Inventory valuation reserve	62,337	
In-kind contributions	(2,225)	(233,112)
Non-cash attorney fees		4,882
(Increase) decrease in assets:		
Accounts receivable	181,581	(279,831)
Grants receivable	(8,903,376)	
Inventory	(9,613)	18,447
Royalty advances	(1,612)	339
Prepaid expenses	704	(24,675)
Deposits		(7,646)
Increase (decrease) in liabilities:		
Accounts payable:		
Trade	(59,171)	90,771
Employee	(1,611)	2,713
Accrued expenses	61,115	32,537
Net cash provided by (used in) operating activities	<u>(38,750)</u>	<u>311,391</u>
Cash flows used in investing activities, purchase of property and equipment	<u>(9,185)</u>	<u>(28,929)</u>
Net (decrease) increase in cash	(47,935)	282,462
Cash, beginning	<u>282,462</u>	
Cash, ending	<u>\$ 234,527</u>	<u>\$ 282,462</u>
Supplemental information:		
In-kind contributions:		
Royalty advance	\$ 2,225	\$ 6,723
Inventory		181,058
Attorney fees		4,882
Property and equipment		40,449
	<u>\$ 2,225</u>	<u>\$ 233,112</u>

See notes to financial statements.

FIELDSTONE ALLIANCE, INC.

1. Nature of business and summary of significant accounting policies:

Nature of business:

Fieldstone Alliance, Inc. (the "Organization") is a Minnesota not-for-profit organization whose mission is to strengthen the performance of the non-profit sector through consulting, training, publishing and research. The Organization was incorporated on December 27, 2004, but did not commence operations until May 2005.

Revenue recognition and net assets:

The Organization recognizes revenues from contributions when promised and upon shipment for book sales. Accounts receivable arising from promises to give are classified as either temporarily restricted or unrestricted depending on the existence and/or nature of any donor restrictions.

Timing differences, which occur between the recognition of temporarily restricted contributions and the incurring of expenses meeting those donor-imposed restrictions, will result in increases or decreases in temporarily restricted net assets and total net assets, that are unrelated to operations.

Pledges for contributions are recorded when promised. All recorded amounts are deemed to be collectible. Accordingly, no allowance is recorded.

Royalty advances:

Advances to publication authors prior to book sales that yield royalties are recorded as an advance and charged to operations as royalties are earned via book sales.

Inventory:

Inventory is stated at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) basis. The Organization maintains a valuation reserve as a reduction to inventory based on management's estimate to lower the carry value to an estimated fair value below cost.

Property and equipment:

The Organization capitalizes expenditures of property and equipment greater than \$1,000 and records purchased items at cost and donated items at their estimated value on date of receipt. Equipment is being depreciated using straight-line and accelerated methods over the estimated useful lives of the related assets.

Leasehold improvements are depreciated over the shorter of the estimated useful lives of the assets or the lease term.

Net assets:

Net assets are classified as temporarily restricted if they are restricted as to use by either time or purpose.

Net assets that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire, that is when a time restriction expires or the restricted purpose is accomplished, within the same reporting period in which the revenue is recognized.

Income taxes:

The Organization is exempt, as a public charity, from income taxes under section 501(c)(3) of the Internal Revenue Code and related state statutes.

Use of estimates:

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

Concentrations:

The Organization maintains its cash at a financial institution in Minnesota. At times the bank balance exceeds limits insured by Federal agencies. The Organization has not experienced any loss associated with this practice and believes it is not exposed to any significant credit risk on cash.

FIELDSTONE ALLIANCE, INC.

1. Nature of business and summary of significant accounting policies (continued):

Concentrations (continued):

Grants receivable at June 30, 2006 and temporarily restricted contributions and grants for the year ended June 30, 2006 include a grant totaling \$8,828,376 resulting from an award from one grantor. The grant amounts to 87% of total unrestricted revenues and gains and change in temporarily restricted net assets for year ended June 30, 2006.

Accounts receivable:

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual account balances that are still outstanding. After management has used exhaustive collection efforts, accounts receivable balances are written off through a charge to the valuation allowance.

2. Grants receivable:

The Organization received a grant on May 22, 2006 in the amount of \$9,302,433, from the W.K. Kellogg Foundation, to be received in three annual installments on September 1 of each year for 2006 to 2008. The Organization also received a grant, on July 15, 2005, in the amount of \$150,000, from the Bush Foundation, to be received in equal installments of \$75,000 on August 31, 2005 and 2006. The unconditional promises are included in the financial statements as grants receivable and revenue of the appropriate net asset category. The discount rate used on pledges was 5.15% in 2006.

Unconditional promises to give at June 30, 2006 are as follows:

	2006
Grants receivable:	
Current	\$3,502,378
Non-current	<u>5,875,055</u>
	9,377,433
Less discounts to net present value	<u>474,057</u>
	<u>\$8,903,376</u>

3. Inventory:

	2006	2005
Publications	\$ 122,661	\$ 131,954
Costs associated with publications in progress	49,563	30,657
Inventory valuation reserve	<u>(62,337)</u>	<u> </u>
	<u>\$ 109,887</u>	<u>\$ 162,611</u>

4. Property and equipment, net:

	2006	2005
Furniture and equipment	\$ 76,022	\$ 66,837
Leasehold improvements	<u>2,541</u>	<u>2,541</u>
	78,563	69,378
Less accumulated depreciation	<u>20,352</u>	<u>1,876</u>
	<u>\$ 58,211</u>	<u>\$ 67,502</u>

FIELDSTONE ALLIANCE, INC.

5. Notes payable:

On December 29, 2005, the Organization entered into a revolving credit arrangement with an unrelated organization that bears interest at 10%. The note is secured by equipment, inventory and receivables. The credit has a maximum borrowing limit of \$100,000 and expires on December 31, 2006. There was no outstanding balance at June 30, 2006.

6. Commitments:

The Organization has a lease agreement that commenced June 1, 2005, for office space through September 30, 2010, and the Organization is also responsible for its pro rata share of operating expenses. The lease has escalating monthly payments and includes one month of free rent in each of the first three years of the lease and as a result has recorded deferred rent for the effect of straight-line rent versus actual rent payment.

Rent expense, including operating expenses was \$87,615 and \$6,795 for the year ended June 30, 2006 and the period ended June 30, 2005, respectively. Future minimum rental payments over the life of the lease are as follows:

<u>Year ending June 30</u>	<u>Amount</u>
2007	\$ 48,546
2008	50,569
2009	53,266
2010	13,485

7. Net assets released from restrictions:

Net assets released from donor restrictions by incurring expenses satisfying their restricted purpose or by occurrence of other events specified by the donor are as follows:

	<u>2006</u>	<u>2005</u>
Bush Foundation	\$ 75,000	
John S. & James L. Knight Foundation	95,228	\$ 3,949
McKnight Foundation	42,151	3,590
W.K. Kellogg Foundation - Nexus Project	71,824	3,000
David & Lucile Packard Foundation	<u>446,497</u>	
	<u>\$ 730,700</u>	<u>\$ 10,539</u>

FIELDSTONE ALLIANCE, INC.

8. Temporarily restricted net assets: _____

Temporarily restricted net assets are available for the following purposes:

<u>Grant</u>	<u>Purpose</u>	<u>2006</u>	<u>2005</u>
W.K. Kellogg Foundation	Project Management, Learning Lab, and Marketplace	\$ 8,828,376	
Bush Foundation	Transition costs	75,000	
John S. & James L. Knight Foundation	Develop economic growth plan for Aberdeen, South Dakota	51,830	31,263
McKnight Foundation	Publication of "Creative Community Builder"	4,500	46,651
W.K. Kellogg Foundation	Nexus project	2,680	74,504
David & Lucile Packard Foundation	Transition costs		<u>446,497</u>
		<u>\$ 8,962,386</u>	<u>\$ 598,915</u>

INDEPENDENT AUDITOR'S REPORT ON
ACCOMPANYING INFORMATION

Schechter Dokken Kanter
Andrews & Selzer Ltd

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Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The statements of operating expenses for the periods ended June 30, 2006 and 2005 on page 11, 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 audit 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.

*Schechter Dokken Kanter
Andrews & Selzer Ltd*

August 30, 2006

FIELDSTONE ALLIANCE, INC.STATEMENTS OF OPERATING EXPENSES
YEAR ENDED JUNE 30, 2006 AND THE PERIOD FROM
DECEMBER 27, 2004 (INCEPTION) TO JUNE 30, 2005

	<u>2006</u>	<u>2005</u>
Salaries	\$ 642,372	\$ 99,481
Payroll taxes	49,909	9,699
Employee benefits	69,709	5,759
Insurance	15,859	2,013
Staff development and employee recognition	1,407	146
Dues and subscriptions	1,741	97
Licenses and fees	259	756
Software support and maintenance	12,788	2,711
Meeting expense	5,347	797
Board	1,419	
Travel	40,289	9,949
Accounting services	5,900	
Legal services	12,682	10,115
Professional services, external	172,546	99,948
Professional services, interprogram	195	
Royalties	29,268	2,297
Sales commissions	1,671	179
Casual labor	7,341	551
IS services	8,979	
Honorariums	18,000	
Advertising and marketing	2,687	170
Printing	29,575	4,745
Copier	5,580	
Postage	55,112	4,922
Supplies	22,074	3,314
National conference packet	150	
Conference exhibit fees	3,745	
Book award entry fees	270	
Promo books	3,063	
Cost of good sold	87,097	20,072
Equipment purchases, rentals, repairs and maintenance	1,304	1,055
Occupancy	87,615	6,795
Telephone and internet fees	13,579	6,081
Payroll fees	2,366	387
Bank and credit card fees	8,815	538
Inventory shrinkage	1,627	1,192
Bad debt expense	9,933	1,970
Inventory valuation	62,337	
Miscellaneous expense	30	
Depreciation expense	<u>18,476</u>	<u>1,876</u>
Total operating expenses	<u>\$ 1,513,116</u>	<u>\$ 297,615</u>