

**WALDEN ENVIRONMENT, INC.
AND AFFILIATE**

**CONSOLIDATED FINANCIAL STATEMENTS
AND
SUPPLEMENTARY INFORMATION**

Years Ended December 31, 2005 and 2004

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
Years Ended December 31, 2005 and 2004

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Walden Environment, Inc. and Affiliate
San Diego, California

We have audited the accompanying consolidated statements of financial position of Walden Environment, Inc. and Affiliate (nonprofit organizations) as of December 31, 2005 and 2004, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organizations' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Walden Environment, Inc. and Affiliate as of December 31, 2005 and 2004, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 10, 2006, on our consideration of Walden Environment, Inc. and Affiliate's internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were performed for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The information included in Schedules I - IV is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements of Walden Environment, Inc. and Affiliate. The accompanying schedules of expenditures of federal awards and findings and questioned costs are presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and are also not a required part of the basic consolidated financial statements of Walden Environment, Inc. and Affiliate. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Grice, Lund & Tarkington, LLP

Carlsbad, California
February 10, 2006

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 963,876	\$ 705,504
Investments	284,319	310,315
Accounts receivable, net of allowance for doubtful accounts of \$159,845 (2005) and \$136,988 (2004)	1,194,559	1,332,999
Prepaid expenses	<u>63,525</u>	<u>56,827</u>
TOTAL CURRENT ASSETS	2,506,279	2,405,645
PROPERTY AND EQUIPMENT, net	102,249	129,458
DEPOSITS	<u>41,412</u>	<u>45,078</u>
TOTAL ASSETS	<u>\$ 2,649,940</u>	<u>\$ 2,580,181</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current portion of long-term debt	\$ 17,461	\$ 16,488
Overpayments	106,287	144,799
Accounts payable - foster parents	322,091	305,041
Accounts payable - other	116,547	90,667
Accrued compensated absences	134,279	141,379
Accrued expenses - other	251,673	235,762
Line of credit	<u>-</u>	<u>200,000</u>
TOTAL CURRENT LIABILITIES	948,338	1,134,136
LONG-TERM DEBT, net of current portion	<u>51,764</u>	<u>69,223</u>
TOTAL LIABILITIES	1,000,102	1,203,359
NET ASSETS		
Unrestricted	1,203,592	1,052,863
Temporarily restricted	<u>446,246</u>	<u>323,959</u>
TOTAL NET ASSETS	<u>1,649,838</u>	<u>1,376,822</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 2,649,940</u>	<u>\$ 2,580,181</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended December 31, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT AND REVENUE			
Foster care placements	\$ 8,834,224	\$ -	\$ 8,834,224
Mental health service reimbursements	483,483	-	483,483
Grants and contributions	3,686	549,733	553,419
Other	134,160	-	134,160
Investment return	29,492	-	29,492
Net assets released from restrictions, satisfaction of program restrictions	<u>427,446</u>	<u>(427,446)</u>	<u>-</u>
TOTAL SUPPORT AND REVENUE	9,912,491	122,287	10,034,778
EXPENSES			
Program services	8,767,599	-	8,767,599
Supporting services			
General and administrative	872,966	-	872,966
Fundraising	121,197	-	121,197
TOTAL EXPENSES	<u>9,761,762</u>	<u>-</u>	<u>9,761,762</u>
INCREASE IN NET ASSETS	150,729	122,287	273,016
NET ASSETS AT BEGINNING OF YEAR	<u>1,052,863</u>	<u>323,959</u>	<u>1,376,822</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,203,592</u>	<u>\$ 446,246</u>	<u>\$ 1,649,838</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
Year Ended December 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
SUPPORT AND REVENUE			
Foster care placements	\$ 9,156,523	\$ -	\$ 9,156,523
Mental health service reimbursements	832,991	-	832,991
Grants and contributions	36,578	401,371	437,949
Other	108,305	-	108,305
Investment return	35,111	-	35,111
Net assets released from restrictions, satisfaction of program restrictions	<u>115,841</u>	<u>(115,841)</u>	<u>-</u>
TOTAL SUPPORT AND REVENUE	10,285,349	285,530	10,570,879
EXPENSES			
Program services	9,648,234	-	9,648,234
Supporting services			
General and administrative	957,392	-	957,392
Fundraising	116,481	-	116,481
TOTAL EXPENSES	<u>10,722,107</u>	<u>-</u>	<u>10,722,107</u>
INCREASE (DECREASE) IN NET ASSETS	(436,758)	285,530	(151,228)
NET ASSETS AT BEGINNING OF YEAR	<u>1,489,621</u>	<u>38,429</u>	<u>1,528,050</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,052,863</u>	<u>\$ 323,959</u>	<u>\$ 1,376,822</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
Year Ended December 31, 2005

	Program Services	Supporting Services		Total
		General and Administrative	Fundraising	
Foster parents	\$ 3,488,173	\$ -	\$ -	\$ 3,488,173
Payroll	2,815,849	472,699	62,011	3,350,559
Payroll taxes and employee benefits	570,860	114,142	9,273	694,275
Office rents and leases	414,235	61,876	-	476,111
Consulting	312,329	8,418	525	321,272
Insurance	185,756	36,882	-	222,638
Mileage reimbursement	147,176	5,728	510	153,414
Regional center respite care	138,221	-	-	138,221
Advertising - foster parents	136,818	-	-	136,818
Activities and special events	72,952	-	34,788	107,740
Telephone	72,695	11,167	1,099	84,961
Foster parent bonuses	60,710	-	-	60,710
Office and computer maintenance and supplies	39,200	11,411	3,753	54,364
Licenses and fees	43,734	98	-	43,832
Utilities	31,899	11,832	-	43,731
Depreciation	31,994	6,435	-	38,429
Bank and payroll charges	203	37,904	-	38,107
Professional fees	4,421	29,812	-	34,233
Equipment rents and leases	29,305	3,771	-	33,076
Postage	20,489	7,085	449	28,023
Conferences, meetings and training	18,522	6,223	596	25,341
Behavior modification rewards	18,544	-	3,166	21,710
Advertising - employment	18,124	2,778	-	20,902
Travel	12,179	7,464	96	19,739
Memberships and dues	2,369	15,239	280	17,888
Training - foster parents	16,634	63	-	16,697
Storage	5,168	8,687	-	13,855
Foster parent well-being	11,607	-	-	11,607
Printing	6,776	2,277	95	9,148
Equipment and building maintenance and supplies	6,713	804	883	8,400
Contract labor	2,062	160	-	2,222
Other	31,882	10,011	3,673	45,566
	<u>\$ 8,767,599</u>	<u>\$ 872,966</u>	<u>\$ 121,197</u>	<u>\$ 9,761,762</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
Year Ended December 31, 2004

	Program Services	Supporting Services		Total
		General and Administrative	Fundraising	
Payroll	\$ 3,480,108	\$ 544,669	\$ 76,441	\$ 4,101,218
Foster parents	3,654,527	-	-	3,654,527
Payroll taxes and employee benefits	691,731	110,439	21,335	823,505
Office rents and leases	386,496	58,786	-	445,282
Consulting	271,191	8,866	525	280,582
Mileage reimbursement	175,401	7,179	3,503	186,083
Advertising - foster parents	157,871	-	-	157,871
Regional center respite care	154,814	-	-	154,814
Insurance	127,675	16,080	-	143,755
Telephone	98,284	13,108	687	112,079
Office and computer maintenance and supplies	49,052	13,621	4,855	67,528
Foster parent bonuses	66,000	-	-	66,000
Bank and payroll charges	2,760	49,784	141	52,685
Equipment rents and leases	38,004	6,592	-	44,596
Activities and special events	38,227	-	601	38,828
Professional fees	10,088	28,305	-	38,393
Memberships and dues	2,449	35,014	330	37,793
Depreciation	27,301	5,021	-	32,322
Travel	19,988	7,757	1,748	29,493
Conferences, meetings and training	18,973	8,682	1,311	28,966
Training - foster parents	28,306	6	-	28,312
Postage	18,867	7,844	364	27,075
Utilities	24,979	-	-	24,979
Licenses and fees	22,096	72	-	22,168
Advertising - employment	18,242	3,492	120	21,854
Foster parent well-being	14,985	50	-	15,035
Printing	9,508	4,313	248	14,069
Storage	3,313	10,544	-	13,857
Contract labor	1,656	8,346	-	10,002
Behavior modification rewards	6,928	-	16	6,944
Equipment and building maintenance and supplies	4,474	1,436	642	6,552
Other	23,940	7,386	3,614	34,940
	<u>\$ 9,648,234</u>	<u>\$ 957,392</u>	<u>\$ 116,481</u>	<u>\$ 10,722,107</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase (decrease) in net assets	\$ 273,016	\$ (151,228)
Adjustments to reconcile increase (decrease) in net assets to net cash provided (used) by operating activities:		
Gain on investments	(19,739)	(30,552)
Depreciation	38,429	32,322
(Increase) decrease in operating assets:		
Accounts receivable, net	138,440	50,562
Prepaid expenses	(6,698)	(36,685)
Increase (decrease) in operating liabilities:		
Overpayments	(38,512)	37,084
Accounts payable	42,930	(46,969)
Accrued expenses	8,811	(24,271)
	<u>436,677</u>	<u>(169,737)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(7,120)	(2,876)
Proceeds from sale of investments	52,855	16,179
Purchases of property and equipment	(11,220)	(16,932)
(Increase) decrease in deposits	3,666	(4,473)
	<u>38,181</u>	<u>(8,102)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	-	91,000
Payments on long-term debt	(16,486)	(97,173)
Net increase (decrease) in line of credit	(200,000)	200,000
	<u>(216,486)</u>	<u>193,827</u>
	NET INCREASE IN CASH	15,988
CASH AT BEGINNING OF YEAR	<u>705,504</u>	<u>689,516</u>
	CASH AT END OF YEAR	<u>\$ 963,876</u>
		<u>\$ 705,504</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid	\$ <u>4,498</u>	\$ <u>15,071</u>
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Property acquired through debt financing	\$ <u>-</u>	\$ <u>91,884</u>

See notes to consolidated financial statements.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005 and 2004

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Walden Environment, Inc. (Walden) was formed in 1977 as a nonprofit organization to provide advocacy, out of home placement, and treatment services for children unable to remain in their own homes due to abandonment, abuse, or neglect. Its goal is to help stabilize children, youth and families through community-based prevention and intervention services. Its primary program is a foster family agency which is engaged in the recruitment, certification, and training of foster parents, and the placement of foster children. Walden's funding comes primarily from federal, state, and county welfare programs.

Walden Family Services Foundation, Inc. (Foundation) was incorporated in 2001. The purpose of the Foundation is the solicitation, receipt, and administration of contributions for the benefit of Walden. The Foundation's support is mainly from contributions received from businesses and individuals in Southern California.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Walden Environment, Inc. and its affiliate, Walden Family Services Foundation, Inc. (Organizations). All significant interorganization accounts and transactions have been eliminated.

Basis of Presentation

The Organizations report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The Organizations had no permanently restricted net assets during the years ended December 31, 2005 and 2004.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the consolidated statements of financial position. Gains and losses are included in the change in net assets in the consolidated statements of activities.

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. Accordingly, actual results could differ from those estimates.

Revenue Recognition

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a 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 consolidated statements of activities as net assets released from restrictions.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005 and 2004

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounts Receivable and Overpayments

Accounts receivable consist of program fees due from counties in Southern California that have been earned for foster family children. An allowance for doubtful accounts has been established to adjust the receivables to estimated net realizable value, with a corresponding decrease to program revenue. Based upon a periodic review, accounts are written off against the allowance when they are deemed to be uncollectible. The current provision for uncollectible receivables has been estimated based on a percentage of net accounts receivable that reflects historical uncollectible amounts and current circumstances. Overpayments are fees received from funding sources which Walden has determined are not due at the time of receipt.

Property and Equipment

Property and equipment are carried at cost or, if donated, at approximate value at the date of the gift. The Organizations capitalize property and equipment with an original cost or value of \$500 or more. Depreciation is computed using the straight-line method over the estimated useful lives of the assets of three to five years.

Unemployment Insurance

The Organizations are self insured under a program for California unemployment insurance. Under this plan, the Organizations are liable for unemployment claims paid by the State to former employees.

Income Taxes

The Organizations are exempt from federal and state income taxes under Internal Revenue Code Section 501(c)(3) and California Revenue and Taxation Code Section 23701d. In addition, the Organizations currently have no unrelated business income. Therefore, no provision for income taxes has been made. The Organizations are not private foundations.

Advertising Costs

Advertising costs are expensed as they are incurred.

Contributed Materials and Services

Contributed materials are recorded at their fair market value where an objective basis is available to measure their value. The fair market value of contributed professional services is reported as support and expense in the period in which the services are performed. Such items are capitalized or charged to operations as appropriate.

NOTE 2. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	2005	2004
Furniture and equipment	\$ 656,194	\$ 644,974
Leasehold improvements	24,545	24,545
Software	18,126	18,126
	698,865	687,645
Less accumulated depreciation	(596,616)	(558,187)
	\$ 102,249	\$ 129,458

WALDEN ENVIRONMENT, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005 and 2004

NOTE 3. OPERATING LEASE COMMITMENTS

The Organizations lease all of their facilities under various operating lease agreements. Total rent expense for the years ended December 31, 2005 and 2004 was \$476,111 and \$445,282, respectively.

Minimum future lease payments at December 31, 2005 are as follows:

<u>Year Ending December 31,</u>	
2006	\$ 297,582
2007	151,005
2008	79,569
2009	36,889
Thereafter	<u>-</u>
	<u>\$ 565,045</u>

The Organizations also lease certain office equipment under various operating lease agreements and month-to-month rentals. Total rent expense for the years ended December 31, 2005 and 2004 was \$33,076 and \$44,596, respectively.

Minimum future lease payments at December 31, 2005 are as follows:

<u>Year Ending December 31,</u>	
2006	\$ 20,591
2007	2,792
2008	2,289
2009	779
2010	195
Thereafter	<u>-</u>
	<u>\$ 26,646</u>

NOTE 4. INVESTMENTS

Investments consist of the following:

	<u>2005</u>	<u>2004</u>
Mutual funds	\$ <u>284,319</u>	\$ <u>310,315</u>

Investment return consists of the following:

	<u>2005</u>	<u>2004</u>
Dividends on money market funds	\$ 5,743	\$ 6,218
Dividends on mutual fund investments	7,120	1,586
Gain on investments	19,739	30,552
Investment management fees	<u>(3,110)</u>	<u>(3,245)</u>
	<u>\$ 29,492</u>	<u>\$ 35,111</u>

WALDEN ENVIRONMENT, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005 and 2004

NOTE 5. LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2005</u>	<u>2004</u>
Union Bank of California, secured by equipment, payable in monthly installments of \$1,749 including interest at 5.75%, matures August 2009	\$ 69,225	\$ 85,711
Less current portion	<u>(17,461)</u>	<u>(16,488)</u>
	<u>\$ 51,764</u>	<u>\$ 69,223</u>

Principal maturities of long-term debt at December 31, 2005 are as follows:

<u>Year ending December 31,</u>	
2006	\$ 17,461
2007	18,492
2008	19,584
2009	13,688
Thereafter	<u>-</u>
	<u>\$ 69,225</u>

NOTE 6. LINE OF CREDIT

Walden has a line of credit of \$350,000 with Union Bank of California. Interest is payable monthly at the prime rate plus 1%. The interest rate at December 31, 2005 was 5.25%. The line of credit agreement expires March 19, 2006.

NOTE 7. FOSTER CARE REVENUE

Walden receives foster care payments for its children from the respective counties. In turn, Walden, under contract with the foster parents, issues monthly payments to the foster families for its children. The net funds utilized by Walden represent approximately 39% of the total foster care revenue for both the years ended December 31, 2005 and 2004.

NOTE 8. MENTAL HEALTH SERVICES

Walden provides mental health services and receives reimbursements per contract for its children from the respective counties.

NOTE 9. DEFERRED COMPENSATION PLAN

The Organizations sponsor an IRS 401(k) deferred compensation plan. Employees can elect to contribute up to the maximum amount allowed by federal law, as defined in the Plan. Each employee self-directs the investment of his or her assets. The Organizations make matching contributions to the Plan. The matching contribution is 25% of each employee's contribution to a maximum of \$750 per year. Total expense was \$ 21,924 and \$18,417 for the years ended December 31, 2005 and 2004, respectively.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005 and 2004

NOTE 10. RESTRICTIONS ON NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2005</u>	<u>2004</u>
Employee skills	\$ 25,146	\$ 17,657
Auxiliary	26,120	4,850
Management information systems	4,047	4,047
Multi-dimensional treatment foster care	162,106	37,000
Independent futures	72,696	128,176
Transitions	90,516	88,305
Special projects	<u>65,615</u>	<u>43,924</u>
	<u>\$ 446,246</u>	<u>\$ 323,959</u>

NOTE 11. CONCENTRATION OF CREDIT RISK

The Organizations have deposits in financial institutions in excess of the amount insured by the Federal Depository Insurance Corporation. The Organizations manage the risk by using only high quality financial institutions.

NOTE 12. RECLASSIFICATIONS

Certain items in the 2004 financial statements have been reclassified to conform to current year classifications. Such reclassifications had no effect on previously reported changes in net assets.

NOTE 13. FUNCTIONAL ALLOCATION OF EXPENSES

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

SUPPLEMENTARY INFORMATION



GRICE, LUND AND TARKINGTON LLP
CERTIFIED PUBLIC ACCOUNTANTS

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Walden Environment, Inc. and Affiliate
San Diego, California

We have audited the consolidated financial statements of Walden Environment, Inc. and Affiliate (nonprofit organizations) as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated February 10, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered Walden Environment, Inc. and Affiliate's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Walden Environment, Inc. and Affiliate's consolidated financial statements are free of material misstatement, we performed tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, board of directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grice, Lund & Tarkington, LLP

Carlsbad, California
February 10, 2006

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GRICE, LUND AND TARKINGTON LLP
CERTIFIED PUBLIC ACCOUNTANTS

REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Directors
Walden Environment, Inc. and Affiliate
San Diego, California

Compliance

We have audited the compliance of Walden Environment, Inc. and Affiliate (nonprofit organizations) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of their major federal programs for the year ended December 31, 2005. Walden Environment Inc. and Affiliate's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Walden Environment, Inc. and Affiliate's management. Our responsibility is to express an opinion on Walden Environment Inc. and Affiliate's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Walden Environment, Inc. and Affiliate's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Walden Environment, Inc. and Affiliate's compliance with those requirements.

In our opinion, Walden Environment Inc. and Affiliate complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2005.

Internal Control Over Compliance

The management of Walden Environment, Inc. and Affiliate is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Walden Environment, Inc. and Affiliate's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

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REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

(Continued)

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, board of directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Spice, Lund & Taskington, LLP

Carlsbad, California
February 10, 2006

WALDEN ENVIRONMENT, INC. AND AFFILIATE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 Year Ended December 31, 2005

Federal/Pass-Through Grantor and Program Title	Federal CFDA Number	Agency or Pass-Through Grantor No.	Expenditures
<u>U.S. Department of Health and Human Services</u>			
Foster Care Title IV-E	93.658	n/a	\$ 4,042,491
Medical Assistance Program (Medicaid Title XIX)	93.778	n/a	<u>241,400</u>
Total expenditures of federal awards			<u>\$ 4,283,891</u>

Note

This schedule of expenditures of federal awards includes the federal grant activity of Walden Environment, Inc. and Affiliate and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 Year Ended December 31, 2005

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified
 Internal control over financial reporting:
 Material weakness(es) identified? yes no
 Reportable condition(s) identified
 not considered to be material weaknesses? yes none reported
 Noncompliance material to the financial statements noted? yes no

Federal Awards

Internal control over major program:
 Material weakness(es) identified? yes no
 Reportable condition(s) identified
 not considered to be material weaknesses? yes none reported

Type of auditors' report issued on compliance
 for major programs Unqualified

Any audit findings disclosed that are required
 to be reported in accordance with OMB
 Circular A-133, Section.510(a)? yes no

Identification of major program:

CFDA Number

93.658

Name of Federal Program or Cluster

Foster Care Title IV-E

Dollar threshold used to distinguish
 between Type A and Type B programs: \$300,000

Auditee qualified as a low-risk auditee
 under OMB Circular A-133, Section 530? yes no

SECTION II - FINANCIAL STATEMENT FINDINGS

None

SECTION III - FEDERAL AWARD FINDINGS

None

WALDEN ENVIRONMENT, INC. AND AFFILIATE
SCHEDULE I - CONSOLIDATING STATEMENT OF FINANCIAL POSITION
December 31, 2005

	<u>Walden</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Total</u>
ASSETS				
CURRENT ASSETS				
Cash	\$ 454,621	\$ 509,255	\$ -	\$ 963,876
Investments	150,582	133,737	-	284,319
Accounts receivable, net of allowance for doubtful accounts of \$159,845	1,192,559	2,000	-	1,194,559
Prepaid expenses	63,525	-	-	63,525
Due from Foundation	102,358	-	(102,358)	-
TOTAL CURRENT ASSETS	1,963,645	644,992	(102,358)	2,506,279
PROPERTY AND EQUIPMENT, net	102,249	-	-	102,249
DEPOSITS	41,412	-	-	41,412
TOTAL ASSETS	<u>\$ 2,107,306</u>	<u>\$ 644,992</u>	<u>\$ (102,358)</u>	<u>\$ 2,649,940</u>
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Current portion of long-term debt	\$ 17,461	\$ -	\$ -	\$ 17,461
Overpayments	106,287	-	-	106,287
Accounts payable - foster parents	322,091	-	-	322,091
Accounts payable - other	116,547	-	-	116,547
Accrued compensated absences	134,279	-	-	134,279
Accrued expenses - other	251,673	-	-	251,673
Due to Walden	-	102,358	(102,358)	-
TOTAL CURRENT LIABILITIES	948,338	102,358	(102,358)	948,338
LONG-TERM DEBT, net of current portion	51,764	-	-	51,764
TOTAL LIABILITIES	1,000,102	102,358	(102,358)	1,000,102
NET ASSETS				
Unrestricted	1,107,204	96,388	-	1,203,592
Temporarily restricted	-	446,246	-	446,246
TOTAL NET ASSETS	<u>1,107,204</u>	<u>542,634</u>	<u>-</u>	<u>1,649,838</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 2,107,306</u>	<u>\$ 644,992</u>	<u>\$ (102,358)</u>	<u>\$ 2,649,940</u>

See independent auditors' report.

WALDEN ENVIRONMENT, INC. AND AFFILIATE**SCHEDULE II - CONSOLIDATING STATEMENT OF FINANCIAL POSITION**

December 31, 2004

	<u>Walden</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Total</u>
ASSETS				
CURRENT ASSETS				
Cash	\$ 293,915	\$ 411,589	\$ -	\$ 705,504
Investments	185,716	124,599	-	310,315
Accounts receivable, net of allowance for doubtful accounts of \$136,988	1,332,999	-	-	1,332,999
Prepaid expenses	56,827	-	-	56,827
Due from Foundation	128,545	-	(128,545)	-
TOTAL CURRENT ASSETS	1,998,002	536,188	(128,545)	2,405,645
PROPERTY AND EQUIPMENT, net	129,458	-	-	129,458
DEPOSITS	45,078	-	-	45,078
TOTAL ASSETS	\$ 2,172,538	\$ 536,188	\$ (128,545)	\$ 2,580,181
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Current portion of long-term debt	\$ 16,488	\$ -	\$ -	\$ 16,488
Overpayments	144,799	-	-	144,799
Accounts payable - foster parents	305,041	-	-	305,041
Accounts payable - other	90,667	-	-	90,667
Accrued compensated absences	141,379	-	-	141,379
Accrued expenses - other	235,762	-	-	235,762
Line of credit	200,000	-	-	200,000
Due to Walden	-	128,545	(128,545)	-
TOTAL CURRENT LIABILITIES	1,134,136	128,545	(128,545)	1,134,136
LONG-TERM DEBT, net of current portion	69,223	-	-	69,223
TOTAL LIABILITIES	1,203,359	128,545	(128,545)	1,203,359
NET ASSETS				
Unrestricted	969,179	83,684	-	1,052,863
Temporarily restricted	-	323,959	-	323,959
TOTAL NET ASSETS	969,179	407,643	-	1,376,822
TOTAL LIABILITIES AND NET ASSETS	\$ 2,172,538	\$ 536,188	\$ (128,545)	\$ 2,580,181

See independent auditors' report.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
SCHEDULE III - CONSOLIDATING STATEMENT OF ACTIVITIES
Year Ended December 31, 2005

	<u>Walden</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Total</u>
SUPPORT AND REVENUE				
Foster care placements	\$ 8,834,224	\$ -	\$ -	\$ 8,834,224
Mental health service reimbursements	483,483	-	-	483,483
Grants and contributions	427,446	553,419	(427,446)	553,419
Other	134,160	-	-	134,160
Investment return	20,474	9,018	-	29,492
	<u>9,899,787</u>	<u>562,437</u>	<u>(427,446)</u>	<u>10,034,778</u>
TOTAL SUPPORT AND REVENUE				
EXPENSES				
Program services	8,767,599	-	-	8,767,599
Supporting services				
General and administrative	872,966	-	-	872,966
Fundraising	121,197	-	-	121,197
Contributions made	-	427,446	(427,446)	-
	<u>9,761,762</u>	<u>427,446</u>	<u>(427,446)</u>	<u>9,761,762</u>
TOTAL EXPENSES				
	138,025	134,991	-	273,016
INCREASE IN NET ASSETS				
NET ASSETS AT BEGINNING OF YEAR	<u>969,179</u>	<u>407,643</u>	<u>-</u>	<u>1,376,822</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,107,204</u>	<u>\$ 542,634</u>	<u>\$ -</u>	<u>\$ 1,649,838</u>

See independent auditors' report.

WALDEN ENVIRONMENT, INC. AND AFFILIATE
SCHEDULE IV - CONSOLIDATING STATEMENT OF ACTIVITIES
Year Ended December 31, 2004

	<u>Walden</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Total</u>
SUPPORT AND REVENUE				
Foster care placements	\$ 9,156,523	\$ -	\$ -	\$ 9,156,523
Mental health service reimbursements	832,991	-	-	832,991
Grants and contributions	133,189	420,601	(115,841)	437,949
Other	108,305	-	-	108,305
Investment return	24,268	10,843	-	35,111
	<u>10,255,276</u>	<u>431,444</u>	<u>(115,841)</u>	<u>10,570,879</u>
EXPENSES				
Program services	9,648,234	-	-	9,648,234
Supporting services				
General and administrative	957,392	-	-	957,392
Fundraising	116,481	-	-	116,481
Contributions made	-	115,841	(115,841)	-
TOTAL EXPENSES	<u>10,722,107</u>	<u>115,841</u>	<u>(115,841)</u>	<u>10,722,107</u>
INCREASE (DECREASE) IN NET ASSETS				
	(466,831)	315,603	-	(151,228)
NET ASSETS AT BEGINNING OF YEAR	<u>1,436,010</u>	<u>92,040</u>	<u>-</u>	<u>1,528,050</u>
NET ASSETS AT END OF YEAR	<u>\$ 969,179</u>	<u>\$ 407,643</u>	<u>\$ -</u>	<u>\$ 1,376,822</u>

See independent auditors' report.