

U.S.A. NATIONAL KARATE-DO FEDERATION, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2005

TABLE OF CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITOR'S REPORT	1
FINANCIAL STATEMENTS	
Statement of Financial Position - modified cash basis	2
Statement of Activities - modified cash basis	3
Statement of Functional Expenses - modified cash basis	4
Statement of Cash Flows - modified cash basis	5
Notes to Financial Statements	6 – 8

Monson & Bass

INC., P.S.

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
U.S.A. National Karate-Do Federation, Inc.
Seattle, Washington

We have audited the accompanying statement of financial position – modified cash basis of U.S.A. National Karate-Do Federation, Inc. (a Washington non-profit corporation) (Organization) as of December 31, 2005, and the related statements of activities, functional expenses, and cash flows – modified cash basis for the year then ended. 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 audit.

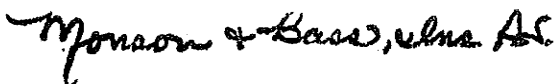
Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audit provides a reasonable basis for our opinion.

Because of inadequacies in the Organization's accounting records, we were unable to form an opinion regarding the amount of contributed services of \$368,000, membership and tournament fees totaling \$457,899, and in-kind expenses of \$368,000.

As described in Note 2, the financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had revenue and expense been susceptible to satisfactory audit tests, the financial statements referred to above present fairly, in all material respects, the financial position of U.S.A. National Karate-Do Federation, Inc. as of December 31, 2005, 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.

The accompanying financial statements have been prepared assuming that the Organization will continue as a going concern. As shown in the financial statements, the Organization incurred a change in net assets of (\$57,298) and has liquid assets of only \$31,823. As described more fully in Note 6 to the financial statements, the Organization is defendant in several lawsuits that, even if it prevailed could result in significant legal fees. The Organization is not aware of alternative sources of support or revenues to meet such demands should they occur. Those conditions raise substantial doubt about the Organization's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.



Monson & Bass Inc., P.S.

February 8, 2007

U.S.A. NATIONAL KARATE-DO FEDERATION, INC
STATEMENT OF FINANCIAL POSITION-MODIFIED CASH BASIS
DECEMBER 31, 2005

ASSETS

Cash		\$ 31,823
Inventory		17,203
Furniture and equipment:		
Office equipment	67,836	
Office furniture & fixtures	7,721	
Athletic equipment	73,202	
	148,759	
Less accumulated depreciation	95,301	53,458
Total assets		\$ 102,484

LIABILITIES AND NET ASSETS

LIABILITIES

Accounts payable		\$ 2,984
Total liabilities		2,984

NET ASSETS

Unrestricted		99,500
Total net assets		99,500
Total liabilities and net assets		\$ 102,484

See accompanying notes to financial statements.

U.S.A. NATIONAL KARATE-DO FEDERATION, INC
STATEMENT OF ACTIVITIES- MODIFIED CASH BASIS
FOR THE YEAR ENDED DECEMBER 31, 2005

SUPPORT AND REVENUE

Public Support:

USOC Grant	\$ 100,000
Contributions	35,370
Contributed services	368,000
Total public support	<u>503,370</u>

Revenue

Membership fees	154,631
Tournament fees	303,268
Marketing royalties	16,000
Gross profit on merchandise sales of \$65,461	10,174
Total revenue	<u>484,073</u>

TOTAL SUPPORT AND REVENUE 987,443

EXPENSES

Program services	1,038,141
Management and general	4,950
Fund raising	1,650
	<u>1,044,741</u>

TOTAL EXPENSES 1,044,741

CHANGE IN UNRESTRICTED NET ASSETS (57,298)

UNRESTRICTED NET ASSETS, beginning of year 156,798

UNRESTRICTED NET ASSETS, end of year \$ 99,500

See accompanying notes to financial statements.

U.S.A. NATIONAL KARATE-DO FEDERATION, INC
STATEMENT OF FUNCTIONAL EXPENSES - MODIFIED CASH BASIS
FOR THE YEAR DECEMBER 31, 2005

	<u>Total</u>	<u>Program Services</u>	<u>Supporting Services</u>	
			<u>Management and General</u>	<u>Fund Raising</u>
Accounting fees	\$ 3,810	\$ 3,810	\$ -	\$ -
Administrative services	33,000	26,400	4,950	1,650
Bad checks	3,392	3,392	-	-
Bank charges	8,833	8,833	-	-
Contribtuions and awards	90,236	90,236	-	-
Depreciation expense	20,093	20,093	-	-
Dues and membership	1,850	1,850	-	-
Executive director	80,000	80,000	-	-
Insurance	137,339	137,339	-	-
Legal services	69,809	69,809	-	-
Marketing and promotion	60,419	60,419	-	-
Medical services	62,000	62,000	-	-
Miscellaneous expense	3,459	3,459	-	-
Office supplies	39,978	39,978	-	-
Postage	16,175	16,175	-	-
Professional services	97,000	97,000	-	-
Rent and storage	42,971	42,971	-	-
Repairs and maintenance	4,247	4,247	-	-
Taxes and licenses	11,296	11,296	-	-
Telephone	27,060	27,060	-	-
Tournament costs	200,850	200,850	-	-
Travel	3,393	3,393	-	-
Wages - support staff	27,531	27,531	-	-
	<u>\$ 1,044,741</u>	<u>\$ 1,038,141</u>	<u>\$ 4,950</u>	<u>\$ 1,650</u>

See accompanying notes to financial statements.

**U.S.A. NATIONAL KARATE-DO FEDERATION, INC.
STATEMENT OF CASH FLOWS - MODIFIED CASH BASIS
FOR THE YEAR ENDED DECEMBER 31, 2005**

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net assets	\$ (57,298)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:	
Depreciation	20,093
Changes in operating assets and liabilities	
Decrease in accounts receivable	30,561
Decrease in inventory	14,525
Decrease in prepaid expenses and deposit	39,515
Decrease in accounts payable	(5,975)
Decrease in checking account overdraft	(6,759)
Net cash provided by operating activities	<u>34,662</u>
 CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of furniture and equipment	<u>(2,839)</u>
Net cash used in investing activities	<u>(2,839)</u>
 Net increase in cash	 31,823
 CASH, beginning of year	 <u>-</u>
CASH, end of year	<u>\$ 31,823</u>

See accompanying notes to financial statements.

U.S.A. NATIONAL KARATE-DO FEDERATION, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – NATURE OF ORGANIZATION

The U.S.A. National Karate-Do Federation, Inc. (the Organization) was formed June 29, 1994 to promote and encourage the sport of karate. The Organization coordinates recreational and competitive amateur karate activities in the United States and other countries. During 1996, the Organization became the national governing body of the sport and is a member of the U.S.A. National Olympic Committee.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The Organization uses the modified cash basis of accounting to prepare its financial statements. Under this method of accounting, certain revenue and the related assets are recognized when received rather than when earned and certain expenses are recognized when paid rather than when the obligation is incurred.

Financial Statement Presentation – The Organization presents its financial statements using Statement of Financial Accounting Standards (SFAS) No. 117 “Financial Statements of Not-for-Profit Organizations.” Under SFAS No. 117, the Organization is required to report information regarding its financial position and activities according to classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. There are no temporarily or permanently restricted net assets.

Advertising – The Organization expenses advertising costs as incurred. Marketing and promotion expense was \$60,419 for the year ending December 31, 2005.

Inventory – Inventory is comprised of resale merchandise and is stated at the lower of cost (determined by the first-in, first-out method) or market.

Property and Equipment – Land, building and equipment purchased by the Organization are recorded at cost. The Organization follows the practice of capitalizing all donated fixed assets at fair market value. Depreciation is provided on the straight-line method based on the estimated useful lives of three to ten years.

Contributed Services – Contributions of services that require specialized skills, provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at their fair value, based on management’s estimates, in the period received. Some volunteer services have not been reported in the financial statements because they did not meet the criteria for recognition under SFAS No. 116, “Accounting for Contributions Received and Contributions Made”.

Federal Income Tax – The Organization is exempt from Federal income taxation under Internal Revenue Code Section 501(c)(3), except for unrelated business income tax. The Organization had no unrelated business income for the year ended December 31, 2005, and therefore was not subject to federal income tax.

Use of Estimates – Management uses estimates and assumptions in preparing financial statements in accordance with the modified cash basis of accounting. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were assumed in preparing the financial statements.

**U.S.A. NATIONAL KARATE-DO FEDERATION, INC.
NOTES TO FINANCIAL STATEMENTS**

NOTE 3 – RELATED PARTY TRANSACTIONS

The Organization received donated secretarial services from a corporation owned by the former president of the Federation. The president has donated significant time to the Organization, and the Organization has recognized revenue and expenses from contributed services of the Executive Director.

NOTE 4 – OPERATING LEASE COMMITMENT

On October 24, 2005, the Organization entered into a 36-month operating lease for office space. The lease expires on October 31, 2008.

Minimum annual rent payments are as follows:

Year	Amount
2006	\$ 33,000
2007	33,700
2008	31,000
	\$ 97,700

Rental payments for 2005 were \$40,263 and included both storage expense paid on a month to month basis and office space including parking.

NOTE 5 – CONTRIBUTED SERVICES

The following represents the breakdown by category of contributed services at December 31, 2005:

<u>Program Services</u>	
Legal Services	\$ 46,000
Medical Services	62,000
Professional Services	97,000
Executive Director	80,000
Marketing and Promotion	50,000
Administrative Services	26,400
	361,400
 <u>Management and General</u>	
Administrative Services	4,950
 <u>Fund Raising</u>	
Administrative Services	1,650
	1,650
 Total contributed Services	 \$ 368,000

**U.S.A. NATIONAL KARATE-DO FEDERATION, INC.
NOTES TO FINANCIAL STATEMENTS**

NOTE 6 – CONTINGENCIES

The Organization including certain former and current officers and directors are defendants in several lawsuits that have arisen in the normal course of the Organization's operations. One suit seeks the dissolution of the Organization and has alleged defalcations against the officers and directors. In all cases the Organization is vigorously contesting allegations and believes the claims are without merit.

The Organization has claims against its insurer in one case. The insurer has agreed to defend the case but not necessarily provide coverage. One director/defendant has counterclaimed in another suit.

The outcomes of the aforementioned claims and counterclaims are uncertain and cannot be reasonably estimated. Legal fees may be significant to the Organization even if it prevails.

NOTE 7 – SUBSEQUENT EVENTS

Subsequent to year end the Organization was notified that it was no longer eligible for USOC grants. During 2005 the Organization received \$116,000 in grants and shared costs from the USOC.

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To the Board of Directors
U.S.A. Karate-Do Federation, Inc.
81 Old Main Plaza
Saint Albans, WV 25177

In planning and performing our audit of the financial statements of U.S.A Karate-Do Federation, Inc. (the Organization) for the year ended December 31, 2005 we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

PERSONNEL CONSIDERATIONS – During the audit we observed that the books and records of the Organization were not sufficient to support in-kind contributions, related in-kind expenses, and support the completeness and classification of certain transactions.

- **RECOMMENDATION** – As the transition is made to the Saint Albans office we believe the Organization needs to hire a bookkeeper that is familiar with the accounting required by not-for-profit organizations. In addition, your bookkeeper or accountant should institute policies and procedures for recording cash and credit card transactions, and in-kind transactions. On a regular basis, say quarterly, your outside CPA should receive internally prepared financial statements that can be reviewed to identify potential audit issues. Likewise, the organization should recruit a board member that has sufficient financial background. This board member should be familiar with the reporting requirements of the Internal Revenue Service (such as for payroll and acknowledgement of contributions) so that compliance status can be monitored.

ACCOUNTING SOFTWARE – During the year Quicken was used to account for the Organization's transactions. Quicken is a software designed for recording a personal checkbook and is not sufficient for the needs of the Organization.

- RECOMMENDATION -- There are a number of products on the market that would be relatively inexpensive yet sufficient for the Organization's needs. QuickBooks or Peachtree products are two examples of low end software that should work. It has been our experience that there are more bookkeepers that are familiar with QuickBooks, so that should be a consideration in your software selection process.

USOC MANAGEMENT LETTER --The USOC internal auditor's management letter contains excellent recommendations that require the attention of the Board of Directors. The Board should establish a committee responsible for the oversight of the implementation of recommendations. A copy of that letter is enclosed for your reference.

CONFLICT OF INTEREST POLICIES -- The 2005 Form 990, Schedule A asks if the Organization has a conflict of interest policy. The addition of this question is an indication of the significance conflict of interest issues to those who watch not-for-profit organizations.

- RECOMMENDATION -- The Organization should review its conflict of interest policies and restate them if necessary. Policies should clearly indicate those covered by the policies and when relationships should be disclosed. At a minimum, the policy should require that Board Members excuse themselves from voting on matters that are considered a conflict of interest.

We would be pleased to discuss these matters at your convenience.

Monson & Bass, Inc. PC

Monson & Bass, Inc., P.S.

February 8, 2007