

WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST

FINANCIAL STATEMENTS

December 31, 1997

THOMAS
HAVEY
LLP

Independent Auditor's Report

THOMAS
HAVEY
LLP

SUCCESSOR TO
LINDQUIST & COMPANY LLP

Independent Auditor's Report

To the Board of Directors of
World Service Office, Inc. and Fellowship
Intellectual Property Trust
Chatsworth, California

We have audited the accompanying consolidated statement of financial position of World Service Office, Inc. and Fellowship Intellectual Property Trust as of December 31, 1997 and 1996, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the management of the World Service Office, Inc. and Fellowship Intellectual Property Trust. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards. 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 our audits provide a reasonable basis for our opinion.

We did not observe the taking of physical inventories at December 31, 1996 (stated at \$392,709), since that date was prior to the time we were initially engaged as auditors for the organizations. We were unable to satisfy ourselves about inventory quantities by means of other auditing procedures.

As more fully described in Note 2b, management elected to not report the functional classification of expenses, such as major programs and supporting activities, which is required by generally accepted accounting principles.

In our opinion, except for the effects of such adjustments, if any, as might have been determined had we been able to observe the physical inventories taken as of December 31, 1996, and for not reporting the functional classifications of expenses which results in an incomplete presentation, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of World Service Office, Inc. and Fellowship Intellectual Property Trust at December 31, 1997 and 1996, and the results of their operations and cash flows for the years then ended, in conformity with generally accepted accounting principles.

Thomas Havey LLP

April 10, 1998

THOMAS
HAVEY
LLP

SUCCESSOR TO
LINDQUIST & COMPANY LLP

September 28, 1998

Mr. Anthony Edmondson
NAWS, Inc.
19737 Nordhoff Place
Chatsworth, CA 91311

Dear Anthony:

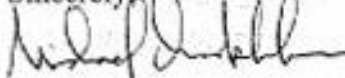
In response to certain questions raised by readers of your financial statements I wanted to elaborate on the qualifications referred to in our audit report.

With respect to the inability to witness the inventory count procedures as of December 31, 1996, we were not engaged until after that date and therefore witnessing the count would have been impossible. This qualification is standard and not unusual when a new auditor is retained due to the timing of retaining the successor auditor. In the future this qualification will not be in the report since we now witness or test count your inventory once your staff has concluded their count procedures.

The omission of functional reporting of expenses as described in the fourth paragraph of our report arose from a recent Financial Accounting Standards Board statement, which requires such disclosures for non-profit organizations. Since World Service Office, Inc. (WSO) never maintained its general ledger to generate this information the qualification was required. Generating this information and avoiding the qualification, solely for purposes of the audit report, would have been, in my opinion, time consuming and not cost beneficial to the organization. It should also be noted that in completing our audit, the WSO and its personnel provided full and complete disclosure of all relevant information for financial reporting purposes. Furthermore, full and complete disclosure was provided to the Internal Revenue Service and the State of California in the WSO's annual tax filings. It is my understanding for NAWS, Inc. we will develop a revised chart of accounts, which will generate a functional expense breakdown. This will then allow us to remove the qualification from the report.

If you have any questions regarding our report, please do not hesitate to call me.

Sincerely,



Michael Quackenbush
Partner

**WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST**
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 1997 and 1996

	ASSETS	
	1997	1996
Current assets:		
Cash	\$ 183,888	\$ 123,182
Accounts receivable (net of allowance for uncollectible accounts of \$12,034 and \$9,101, respectively)	423,880	272,124
Due from affiliated entities (Note 4)	71,139	2,630
Inventory (Note 2c)	405,147	338,882
Prepaid expenses	18,871	25,104
Total current assets	<u>1,102,925</u>	<u>761,922</u>
Property and equipment:		
Furniture and equipment	409,079	387,569
Leasehold improvements	476,172	475,361
Total	885,251	862,930
Less accumulated depreciation and amortization	547,449	417,443
Property and equipment - net	<u>337,802</u>	<u>445,487</u>
Other assets:		
Deposits	19,307	27,474
Trademarks and copyrights (net of accumulated amortization of \$78,740 and \$57,025, respectively) (Note 2c)	107,633	115,054
Total other assets	<u>126,940</u>	<u>142,528</u>
Total assets	<u>\$ 1,567,667</u>	<u>\$ 1,349,937</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 419,478	\$ 339,662
Accrued salaries and withholdings payable	118,838	135,722
Current portion of note payable (Note 5)	30,000	30,000
Due to affiliated entities (Note 4)	-	21,148
Total current liabilities	<u>568,316</u>	<u>526,532</u>
Notes payable	<u>40,000</u>	<u>70,000</u>
Total liabilities	<u>608,316</u>	<u>596,532</u>
Unrestricted net assets	<u>959,351</u>	<u>753,405</u>
Total liabilities and net assets	<u>\$ 1,567,667</u>	<u>\$ 1,349,937</u>

See accompanying notes to consolidated financial statements.

WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended December 31, 1997 and 1996

	1997	1996
Operating revenue:		
Sales of publications and program materials, net of discounts	\$ 4,658,945	\$ 4,207,244
Less cost of sales	<u>1,682,689</u>	<u>1,500,219</u>
Net sales of publications and program materials	<u>2,976,256</u>	<u>2,707,025</u>
Operating expenses:		
Salaries and wages including payroll taxes	1,523,870	1,719,589
Employee health benefits	133,410	162,123
Retirement contribution	41,885	48,163
Contract labor	33,552	11,819
Occupancy	306,175	316,719
Travel	111,361	125,867
Telephone	66,705	46,846
Postage	21,164	30,654
Office expense	66,198	66,589
Depreciation and amortization	146,246	153,551
Professional fees	23,016	34,781
Equipment leases	98,065	98,495
Computer software and supplies	29,472	27,368
Other operating expenses	<u>179,939</u>	<u>175,160</u>
Total operating expenses	<u>2,781,058</u>	<u>3,017,724</u>
Excess (deficiency) of operating revenue over operating expenses	<u>195,198</u>	<u>(310,699)</u>
Nonoperating revenue:		
Interest	714	641
Other	<u>10,034</u>	<u>15,247</u>
Total nonoperating revenue	<u>10,748</u>	<u>15,888</u>
Net increase (decrease)	205,946	(294,811)
Unrestricted net assets:		
Beginning of year	<u>753,405</u>	<u>1,048,216</u>
End of year	<u>\$ 959,351</u>	<u>\$ 753,405</u>

See accompanying notes to consolidated financial statements.

**WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST**

CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31, 1997 AND 1996

	<u>1997</u>	<u>1996</u>
Cash flows from operating activities:		
Net increase (decrease)	\$ 205,946	\$ (294,811)
Adjustment to reconcile net increase (decrease) to net cash provided by operating activities:		
Depreciation and amortization	146,246	153,551
(Increase) decrease in assets:		
Accounts receivable	(151,756)	248,944
Due from affiliated entities	(68,509)	(2,630)
Inventory	(66,265)	36,697
Prepaid expenses	6,233	(8,304)
Deposits	8,167	-
Increase (decrease) in liabilities:		
Accounts payable	79,816	(29,294)
Accrued salaries and withholdings payable	(16,884)	37,633
Due to affiliated entities	(21,148)	(38,782)
Net cash provided by operating activities	<u>121,846</u>	<u>103,004</u>
Cash flows from investing activities:		
Purchase of property and equipment	(22,322)	(25,260)
Payments to secure copyrights and trademarks	(8,818)	(16,409)
Net cash (used in) investing activities	<u>(31,140)</u>	<u>(41,669)</u>
Cash flows from financing activities:		
Reduction of long-term debt	<u>(30,000)</u>	<u>(30,000)</u>
Net increase (decrease) in cash	60,706	31,335
Cash:		
Beginning of year	<u>123,182</u>	<u>91,847</u>
End of year	<u><u>\$ 183,888</u></u>	<u><u>\$ 123,182</u></u>

See accompanying notes to consolidated financial statements.

**WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST**

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - Nature of the Organization:

World Service Office, Inc. (WSO) was incorporated on January 25, 1977 and operates its United States and world center in Chatsworth, California, which provides communications and information for the Fellowship of Narcotics Anonymous (NA). The WSO achieves its purpose by maintaining correspondence with NA groups and service committees, by printing and distributing World Service Conference approved literature, and by maintaining the archives and files of NA.

In 1993, the Fellowship of Narcotics Anonymous established the Fellowship Intellectual Property Trust (the Trust). The Trust was established for the purpose of holding and administering all recovery material and other intellectual properties of the Fellowship of Narcotics Anonymous. The Trust is included in the consolidated financial statements of WSO as a result of common control.

NOTE 2 - Summary of Significant Accounting Policies:

- a. Basis of accounting - The accompanying consolidated financial statements include the accounts of WSO and the Trust. Significant intercompany balances and transactions are eliminated in consolidation.

The consolidated financial statements are prepared on the accrual basis of accounting. 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 in the financial statements. Actual results could differ from those estimates.

- b. Presentation - Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not-for-Profit Organizations which was adopted during the year ended December 31, 1995. Under SFAS No. 117, WSO and Trust are required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. As of December 31, 1997 and 1996 WSO held no temporarily or permanently restricted net assets.

WORLD SERVICE OFFICE, INC. AND
FELLOWSHIP INTELLECTUAL PROPERTY TRUST

NOTES TO FINANCIAL STATEMENTS

NOTE 2 - Summary of Significant Accounting Policies (Cont'd):

Additionally under SFAS No. 117, WSO is required to provide information about expenses reported by their functional classification, such as major classes of program services and supporting activities. Since the WSO does not use activity based costing an accurate functional classification was unable to be determined.

- c. Inventory - Publications and other items for resale are included in inventories and are carried at the lower of cost or market, with cost determined by the first-in, first-out method.
- d. Property and equipment - Leasehold improvements and furniture and equipment are stated at cost. Major additions are capitalized while replacements, maintenance and repairs, which do not improve or extend the useful life of the asset, are expensed. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which ranges as follows:

Leasehold improvements	5 year
Furniture and equipment	5 - 10 year

- e. Trademarks and copyrights - The cost of acquiring and defending its copyrights and trademarks are capitalized and are being written off over the approximate economic life of the copyright or trademark which is estimated to be ten years.
- f. Translation of foreign branch financial statements - Foreign branch operations are translated throughout the year to United States currency. Gains or losses resulting from translating foreign currency financial statements are recorded in the consolidated statement of activities.
- g. Statement of cash flows - For purposes of the statement of cash flows, cash includes only monies held on deposit at banking institutions and petty cash.

WORLD SERVICE OFFICE, INC. AND
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NOTES TO FINANCIAL STATEMENTS

NOTE 3 - Income Tax Status:

WSO has qualified as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, comparable California Revenue and Taxation Code and, therefore, has made no provision for federal and state income taxes.

In addition, the Internal Revenue Service has determined that the organization is not a private foundation within the meaning of Section 509(a) of the Internal Revenue Code.

NOTE 4 - Affiliated entities:

WSO has two affiliated entities, a tax-exempt organization and an unincorporated association. The financial related activities of these organizations are not included in the accompanying financial statements.

WSO pays certain disbursements and receives deposits on behalf of the two affiliated entities. Amounts are reimbursed among the affiliated entities, as funds become available.

NOTE 5 - Note payable:

WSO obtained a note payable of \$150,000 during the year ended December 31, 1995. Principal payments in the amount of \$2,500 are made monthly through April 2001 in addition to interest payments at a rate of 1.5% plus prime. The note is collateralized by accounts receivable, inventory, equipment, and bank accounts maintained at the lender.

The principal portion of the current outstanding note is scheduled to mature as follows:

1998	\$ 30,000
1999	30,000
2000	<u>10,000</u>
Total	<u>\$ 70,000</u>

Total interest payments on the note was \$8,871 and \$11,684 for the years ended December 31, 1997 and 1996, respectively.

WORLD SERVICE OFFICE, INC. AND
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NOTES TO FINANCIAL STATEMENTS

NOTE 6 - Retirement plan:

The WSO maintains a qualified savings and retirement defined contribution plan which covers all employees. Under the terms of the plan, employees may elect to contribute pre-tax earnings up to the maximum allowable amount. WSO matches up to 5% of the deferred earnings based on the employee's number of years of service. The matching contribution to the plan for the years ended December 31, 1997 and 1996 was \$41,885 and \$48,163, respectively.

NOTE 7 - Operating Leases:

WSO has leased equipment and facilities under various operating leases. In the spring of 1995, the WSO relocated from Van Nuys to a new location in Chatsworth. Minimum lease payments on noncancelable lease commitments subsequent to December 31, 1997 were as follows:

	<u>Amount</u>
1998	\$ 300,506
1999	292,506
2000	205,360
2001	81,652
2002	9,750
Thereafter	<u>20,313</u>
Total	<u>\$ 910,104</u>

Total payments made under operating leases during the years ended December 31, 1997 and 1996 were \$306,174 and \$321,019, respectively.