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ABILITYWORKS, INC.  
MADISON, MISSISSIPPI  
FINANCIAL REPORT  
JUNE 30, 2007

HARPER, RAINS, KNIGHT & COMPANY, P.A.  
CERTIFIED PUBLIC ACCOUNTANTS  
RIDGELAND, MISSISSIPPI

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HARPER, RAINS, KNIGHT  
& COMPANY

The Board of Directors  
AbilityWorks, Inc.  
Madison, Mississippi

Independent Auditors' Report

We have audited the accompanying basic financial statements of AbilityWorks, Inc., a component unit of the State of Mississippi, as of and for the years ended June 30, 2007 and 2006, as listed in the table of contents. These basic financial statements are the responsibility of AbilityWorks, Inc.'s management. Our responsibility is to express an opinion on these basic 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 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 basic financial statements referred to above present fairly, in all material respects, the financial position of AbilityWorks, Inc., a component unit of the State of Mississippi, as of June 30, 2007 and 2006, and the results of its operations and its 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 September 20, 2007, on our consideration of AbilityWorks, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The Board of Directors  
AbilityWorks, Inc. - Continued

The management's discussion and analysis on page 4 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the accompanying schedules of cost of production, general and administrative expenses, and statistical analysis of operations is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited", on which we express no opinion, has been subjected to the auditing procedures applied in the audits 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.

*Hayes, Rains, Knight & Company, P.A.*

September 20, 2007

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion and analysis of the AbilityWorks, Inc. ("AbilityWorks") financial performance, providing an overview of the activities for the fiscal year ended June 30, 2007.

Since the Management's Discussion and Analysis is designed to focus on the current year's activities, resulting changes and currently known facts, please read it in conjunction with AbilityWorks, Inc.'s basic financial statements.

Highlights

- Total net assets for AbilityWorks at year end were reported at \$7,012,259 which was an increase of \$1,121,253, or 19% from the prior fiscal year.
- Revenues for fiscal year 2007, as stated in Table 2, increased \$389,731, or 5% from fiscal year 2006. The change in Revenue from 2006 to 2007 included an increase in "production revenue" of \$211,991 and increases in "other operating revenue" and "Nonoperating revenue" overall totaling \$177,740.
- Total expenditures increased 2%, or \$240,344 which included a decrease in the "cost of production" of \$198,614 and increases in "general and administrative expenses" and "nonoperating expenses" totaling \$438,958.
- Operating Transfers-in increased \$774,610, or 12%.

Overview of the Financial Statements

Under GASB 34, the applicable accounting standard for governmental financial statements, there are three components to the basic financial statements: 1) the government-wide financial statements, 2) the fund financial statements and 3) the notes to the financial statements.

Government-Wide Statements

AbilityWorks is classified as an Enterprise Fund and therefore utilizes the accrual method as its basis of accounting, which is the same as a private sector business. By utilizing the accrual method of accounting, the presentation of financial information in the Government-Wide Statements and the Fund Financial Statements would contain no differences. However, due to the fact that AbilityWorks is a component unit of the State of Mississippi, Government-Wide Statements are not included herein but will instead be included in the State of Mississippi's basic financial statements. AbilityWorks' financial statements will be presented in the State of Mississippi's Government-Wide Statements under the "Business Type Activities".

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

Fund Financial Statements

The financial statements for AbilityWorks report the financial activity for all seventeen locations making up AbilityWorks. As an Enterprise Fund, these facilities charge customers for services provided, whether to outside customers or to other agencies within the State. The method of accounting used by AbilityWorks is the accrual method of accounting, which is the same used by private sector businesses, in that revenues are recognized when earned and expenses are recognized when incurred. Included in the fund financial statements are the balance sheets, the statements of revenues, expenses, and changes in net assets, and the statements of cash flows using the direct method. No other "required supplementary information" is presented. In addition, supplementary information is presented regarding cost of production, general and administrative expenses and certain statistical information.

Financial Analysis

AbilityWorks' net assets increased \$1,121,253, or 19%, over the course of this fiscal year's operations.

Table 1  
Balance Sheets  
June 30, 2007 and 2006

	<u>Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Current and other assets	<u>\$ 8,729,898</u>	<u>\$ 7,203,417</u>
Total assets	<u>\$ 8,729,898</u>	<u>\$ 7,203,417</u>
Current and other liabilities	<u>\$ 1,717,639</u>	<u>\$ 1,312,411</u>
Total liabilities	<u>\$ 1,717,639</u>	<u>\$ 1,312,411</u>
Net assets:		
Unrestricted	<u>\$ 7,012,259</u>	<u>\$ 5,891,006</u>
Total net assets	<u>\$ 7,012,259</u>	<u>\$ 5,891,006</u>

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- "Current and other assets" increased \$1,526,481 or 21%. Of this amount:
  - "Cash" increased \$1,404,012 while "Investments" increased \$5,624.
  - The increase of \$54,717 in the "Accounts receivables, net" account is related to the increase experienced by the facilities in their production revenue. The AbilityWorks Jackson and Washington County branches have experienced significant growth in 2007 and since branches invoice customers after goods and/or services are delivered an increase in the overall accounts receivable has occurred.
  - The "Unbilled receivables" account, which involved the Medicaid Waiver for payroll processing services, increased \$318,847. The amount represents the payroll generated for those hours earned by personal care attendants prior to June 30<sup>th</sup>, however, the services were not invoiced to the parent agency by the June 30<sup>th</sup> cutoff. The increase in this account is the reflection of the rapid growth that is being experienced in this program.
  - The "Interfund receivables" account, which also is mainly attributable to the payroll processing services for the Medicaid waiver, decreased \$275,292. The majority of this balance relates to the Medicaid waiver, which represents payroll items which have been generated for hourly wages earned by personal care attendants and subsequently invoiced by the parent agency before June 30<sup>th</sup> but were not paid by the parent agency by June 30<sup>th</sup>. AbilityWorks has changed its procedures for billing the parent agency for its payroll processing activity by billing based on the payroll registers as opposed to authorizations. This change in the process has resulted in billings being submitted to the finance office in a more timely manner which in turn ensures the bank account is replenished timely. Therefore, this change in the billing process would have resulted in the decrease to this account at June 30.
  - The "Inventories" and "Prepaid expenses and other" accounts did not significantly change from 2006 to 2007, therefore no explanation is noted.
- "Current liabilities" increased \$405,228. Of this amount:
  - The "accrued expenses" account increased \$579,309. The balance in this account represents the hours earned by the personal care attendants from the period June 16 - 30, 2007 and subsequently paid on July 9, 2007.  
The "accounts payable" account decreased \$174,072. Under our centralized system, all invoices are submitted to the centralized office for processing. With the addition of new staff members in 2007, the process of processing expenses has become more efficient and therefore resulted in less payables at June 30<sup>th</sup>. Additionally, included in "accounts payable" for 2006 was an unemployment insurance expense which was booked as a payable in 2006.

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- The "Interfund Payables" and Deferred Revenue" accounts did not reflect significant changes from 2006 to 2007, therefore no explanation is noted.

Table 2  
Statement of Revenue,  
Expenditures and Changes in Fund Balance  
For the Years Ended June 30, 2007 and 2006

	<u>Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Revenues		
Operating revenues		
Revenue from production, net	\$ 7,793,740	\$ 7,581,749
Other operating income, net	469,955	305,654
Nonoperating revenues		
Investment income	46,871	19,838
Other income	<u>60,491</u>	<u>74,085</u>
Total revenues	8,371,057	7,981,326
Expenditures		
Cost of production	\$ 7,131,934	\$ 7,330,548
General and administrative	7,137,128	6,404,224
Capital asset purchases	<u>226,256</u>	<u>520,202</u>
Total expenditures	14,495,318	14,254,974
Transfers		
Transfers-in	<u>\$ 7,245,514</u>	<u>\$ 6,470,904</u>
Total transfers (net)	\$ 7,245,514	\$ 6,470,904
Increase in net assets		
Net assets - beginning of year	\$ 5,891,006	\$ 5,693,750
Net assets - ending	\$ 7,012,259	\$ 5,891,006

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- AbilityWorks consists of community rehabilitation programs in seventeen separate locations which provide a fee for service to production and manufacturing industries within each workshop's area. Four of the seventeen locations represented approximately 60% of the production revenue recorded in 2007. These facilities were: Jackson, Washington County, Meridian, and Greenwood. These facilities experienced growth in 2007 either through the addition of new contracts or the growth of existing contracts.
- The decrease in the "cost of production" is the result of Facility Managers becoming more efficient in their purchasing practices. As Facility Managers gain additional experience and attend team building trainings with their PEERs, they gain valuable knowledge of ensuring that supplies and services are purchased closer to the time of need as opposed to stocking items. This practice has led to more efficient purchasing which in turn has resulted in a decrease to the "cost of production" account. Additionally, various branches maintain contracts with vendors in which the vendor provides all production supplies, with the exception of labor costs for which the AbilityWorks expense.
- The majority of the "other operating income" account is reported by our AbilityWorks of Jackson branch and is the result of the Medicaid waiver payroll processing services. The increase reported in this revenue account was due to the difference between the amount billed to the parent agency throughout the year for fringe benefits, including Worker's Compensation, and the actual billing billed by the State of Mississippi for annual Worker's Compensation premium.
- The increase in the "general and administrative expenses" account was mainly attributable to the salary category. In 2007, the Mississippi State Legislature passed raises/realignments for all state workers. Therefore, each state employee working at an AbilityWorks branch received a raise or realignment which caused total administrative salaries to increase. Additionally, various vacant positions within the AbilityWorks system were filled in 2007 which also contributed to the increase in the salary figure.
- Capital asset purchases decreased in 2007 as a result of the purchase of production equipment that was experienced in 2006 for the new AbilityWorks of Jackson location as well as the replacement of vehicles within the AbilityWorks fleet that was not required in 2007.
- The Other income account in 2007 reflected the reimbursement by the parent agency for expenses incurred by AbilityWorks related to nonclient positions held at the REACH Center in Tupelo and the Madison office and also includes funds received as a result of the selling of replaced vehicles within the AbilityWorks' fleet.

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- The majority of the transfers-in account is attributable to the parent agency supporting AbilityWorks through funding the Administrative Costs of each of the seventeen facilities. Therefore, an increase in the Transfers-in account would be the result of an increase in the General and administrative account reported by AbilityWorks.

Economic Factors

Since 1995, Mississippi has experienced a steady decrease in the number of jobs in the manufacturing sector. The rate of loss of manufacturing jobs has increased significantly during the last four years. The loss of manufacturing jobs is a direct reflection of the number of manufacturing businesses that closed down their operations in Mississippi. The production income generated by each AbilityWorks' facility is tied to the availability of subcontract work obtained from manufacturing businesses in the local community. Since manufacturing contracts have been declining in recent years, the AbilityWorks' system has been intentionally expanding production income from service sector contracts. These service contracts include janitorial, housekeeping, and ground maintenance.

The AbilityWorks of Harrison County facility is still attempting to rebound from the affects of Hurricane Katrina. Hurricane Katrina destroyed the U.S. Naval Retirement Home, which was the major contract held by this facility. Early estimates on the rebuilding of the Retirement Home could be five plus years. Therefore, due to the loss of this major source of income for this facility, the AbilityWorks and Department of Rehabilitation Services' management are continuing to explore other options for this branch that will generate income as well as ensure clients are provided with a good work environment.

The AbilityWorks, Inc. system anticipates additional Capital Asset purchases in fiscal year 2008 in the following:

- As we continue to evaluate our vehicle fleet, we anticipate the replacement of older less efficient vehicles with newer more efficient ones.
- To ensure the viability of the AbilityWorks, Inc. system we continue to work with local businesses to develop additional contract work. To ensure that we continue to add new contracts throughout the State, we anticipate purchases of new or additional production related equipment, such as clean room equipment, diesel trucks, etc.

ABILITYWORKS, INC.  
FINANCIAL REPORT

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

- To enhance the comprehensive vocational evaluation services and job readiness services, we anticipate the purchase of a new computer based evaluation system and new computers to run this new software.

Financial Contact

AbilityWorks' financial statements are designed to present users with a general overview of the AbilityWorks' finances and to demonstrate its accountability. If you have any questions about the report or need additional information, contact the Deputy Administrator - Finance at the Mississippi Department of Rehabilitation Services, 1281 Highway 51 North, Madison, Mississippi 39110.

ABILITYWORKS, INC.

BALANCE SHEETS  
June 30, 2007 and 2006

ASSETS

	<u>2007</u>	<u>2006</u>
Current assets		
Cash	\$ 5,392,752	\$ 3,988,739
Investments	147,833	142,209
Accounts receivable, net	1,089,990	1,035,274
Unbilled receivables	930,659	611,812
Interfund receivable	958,928	1,234,220
Inventories	193,455	189,572
Prepaid expenses and other	<u>16,281</u>	<u>1,591</u>
 Total assets	 <u>\$ 8,729,898</u>	 <u>\$ 7,203,417</u>

LIABILITIES AND NET ASSETS

Current liabilities		
Accounts payable	\$ 112,644	\$ 286,716
Accrued expenses	1,335,481	756,172
Interfund payables	557	566
Deferred revenue	<u>268,957</u>	<u>268,957</u>
Total current liabilities	1,717,639	1,312,411
 Net assets - unrestricted	 <u>7,012,259</u>	 <u>5,891,006</u>
 Total liabilities and net assets	 <u>\$ 8,729,898</u>	 <u>\$ 7,203,417</u>

The Notes to Financial Statements are an integral part of these statements.

ABILITYWORKS, INC.

STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET ASSETS  
Years Ended June 30, 2007 and 2006

	2007	2006
Revenue		
Revenue from production, net	\$ 7,793,740	\$ 7,581,749
Cost of production	<u>7,131,934</u>	<u>7,330,548</u>
Gross profit	661,806	251,201
Other operating income	469,955	305,654
General and administrative expenses	<u>7,137,128</u>	<u>6,404,224</u>
Operating loss	(6,005,367)	(5,847,369)
Nonoperating revenue (expenses)		
Investment income	46,871	19,838
Other income	60,491	74,085
Capital asset purchases	<u>(226,256)</u>	<u>(520,202)</u>
Total nonoperating expenses	<u>(118,894)</u>	<u>(426,279)</u>
Loss before transfers	(6,124,261)	(6,273,648)
Transfers-in	<u>7,245,514</u>	<u>6,470,904</u>
Increase in net assets	1,121,253	197,256
Net assets, beginning of year	<u>5,891,006</u>	<u>5,693,750</u>
Net assets, end of year	<u>\$ 7,012,259</u>	<u>\$ 5,891,006</u>

The Notes to Financial Statements are an integral part of these statements.

ABILITYWORKS, INC.

STATEMENTS OF CASH FLOWS  
Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Receipts from customers	\$ 7,737,294	\$ 7,910,373
Receipts from DRS for payroll processing	18,631,260	12,338,552
Payments to suppliers	(4,537,441)	(4,355,157)
Payments to employees	(9,619,435)	(9,293,383)
Payments to DRS for payroll processing	<u>(17,928,661)</u>	<u>(12,706,576)</u>
Net cash used by operating activities	<u>(5,716,983)</u>	<u>(6,106,191)</u>
Cash flows from noncapital financing activities:		
Transfers-in	<u>7,245,514</u>	<u>6,470,904</u>
Net cash provided by noncapital financing activities	<u>7,245,514</u>	<u>6,470,904</u>
Cash flows from investing activities:		
Investment and other income	101,738	96,894
Sale and maturity of investments	146,306	141,534
Investment purchases	(146,306)	(144,342)
Capital asset purchases	<u>(226,256)</u>	<u>(520,202)</u>
Net cash used by investing activities	<u>(124,518)</u>	<u>(426,116)</u>
Net increase (decrease) in cash	1,404,013	(61,403)
Cash at beginning of year	<u>3,988,739</u>	<u>4,050,142</u>
Cash at end of year	<u>\$ 5,392,752</u>	<u>\$ 3,988,739</u>

The Notes to Financial Statements are an integral part of these statements.

## NOTES TO FINANCIAL STATEMENTS

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of AbilityWorks, Inc., (hereafter referred to as "AbilityWorks"), a component unit of the State of Mississippi, have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board ("GASB"). The more significant of AbilityWorks' accounting policies follow.

#### Organization and Nature of Operations

AbilityWorks is a non-profit corporation owned and operated by the State of Mississippi, Department of Rehabilitation Services, Office of Vocational Rehabilitation ("the Division"). AbilityWorks was incorporated on July 18, 1969 with the granting of a charter by the State of Mississippi. Legal authority for AbilityWorks is granted under Section 37-33-101 of the Mississippi Code of 1972. AbilityWorks' purpose is to operate a statewide system of community rehabilitation programs through which handicapped citizens receive work experience to prepare them for employment outside the workshop setting.

Currently, seventeen (17) AbilityWorks facilities are located in communities throughout the State. These facilities provide work settings with realistic job stations where vocational evaluation, work adjustment, counseling, guidance and other services are provided. The Division funds some of the general and administrative expenses, such as staff payroll, rent, utilities, etc. Also, the Division transfers funds to the facilities on a monthly basis for additional expenses incurred as a result of expanded client services, such as maintenance to clients and incentive allowances.

#### Basis of Presentation

AbilityWorks presents its financial statements using the financial reporting standards set forth in Statement No. 34 "Basic Financial Statements and Management Discussion and Analysis for State and Local Governments". As a component of the State of Mississippi AbilityWorks reports as a business-type enterprise fund.

#### Basis of Accounting

The accounts of AbilityWorks are reported using the accrual basis of accounting and the economic resources measurement focus. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred. Revenue from production and payroll processing income are stated net of provision for bad debt expense (benefit) of \$(82,638) in 2007 and \$14,195 in 2006.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Inventories

Finished goods inventories are stated at the lower of manufacturing cost (first-in, first-out) or market (net realizable value). Purchased raw materials and supplies are stated at the lower of cost (first-in, first-out) or replacement market.

Revenue Recognition

Production revenue is recognized when the goods are shipped or the services performed.

Deferred Revenue

Deferred revenue represents production loss reimbursements made prior to July 1, 2002, to AbilityWorks from the Division in excess of the net loss actually incurred by AbilityWorks, determined on a monthly basis. Effective July 1, 2002, the Division suspended its policy of reimbursing AbilityWorks for production losses. Previously, the excess reimbursement was to be charged against future production losses in upcoming fiscal years.

Interfund/Intrafund Transactions

Interfund represents transactions with a fund outside of AbilityWorks, while intrafund represents transactions within AbilityWorks. Interfund/intrafund transactions are reflected as either loans, services provided, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon combination. Services provided are treated as revenues and expenditures/expenses.

Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related expense as a reimbursement. All other interfund/intrafund transactions are treated as transfers. Intrafund balances have been eliminated and are not reflected in the basic financial statements.

Capital Asset Purchases

Property and equipment purchased directly by the facilities are also the property of the State of Mississippi. These acquisition costs are classified as a nonoperating expense.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Income Taxes

AbilityWorks is exempt from federal and state income taxes.

Investments

Investments in mutual funds were carried at fair value determined by quoted market price. Mutual fund investments were sold during 2006. Unrealized gains and losses are included in the increase in net assets. Certificates of deposit are carried at cost.

Other

AbilityWorks provides transportation and maintenance funds to clients of the Department of Rehabilitation Services based on the orders of client counselors. The clients are not necessarily those employed by AbilityWorks. The amounts provided, \$43,783 in 2007 and \$37,008 in 2006, have been fully reimbursed by the state. The funds provided do not represent income or expenses of AbilityWorks and have not been recorded in the financial statements.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash includes all checking and savings accounts. AbilityWorks has no cash equivalents.

Employee Benefits

Employees of AbilityWorks, who are eligible for employee benefits, are considered employees of and are provided employee benefits through the State of Mississippi. Sufficient details are not provided to AbilityWorks to separately disclose any retirement plan expenses and postemployment benefits. Employee benefit expenses are allocated to AbilityWorks through state paid expenditure transactions and are reported within the general and administrative expenses and cost of production schedules. Disclosures regarding employee benefits are maintained and communicated within the State of Mississippi financial reports.

(2) CONCENTRATIONS OF CREDIT AND OTHER RISKS

Financial instruments that potentially subject AbilityWorks to concentrations of credit risk consist of cash and cash equivalents, accounts receivable and loss of financial assistance from the State of Mississippi. AbilityWorks receives substantial support in the form of financial assistance from the State of Mississippi, the loss of which could have a material effect on continuation of operations. Accounts receivable are due from customers in numerous industries within the State of Mississippi. Each facility monitors the credit worthiness of its customers to limit credit risk.

(2) CONCENTRATIONS OF CREDIT AND OTHER RISKS - Continued

AbilityWorks maintains cash balances at various financial institutions. Accounts at each institution are insured up to \$100,000 by the Federal Deposit Insurance Corporation ("FDIC"). Amounts in excess of \$100,000 are collateralized by certain assets pledged by the financial institution's trust department in AbilityWorks' name. In addition, AbilityWorks has minimized credit risk by depositing cash and cash equivalents in banks with a high credit standing. AbilityWorks has not experienced any losses of such funds and management believes exposure to significant credit risk on cash and cash equivalents is minimal.

(3) INVESTMENTS

Investments at June 30, 2007, consist of a certificate of deposit totaling \$147,833 and maturing in February 2008. Investments at June 30, 2006, consist of a certificate of deposit totaling \$142,209 and matured in February 2007. The following schedule summarizes the return on investments and cash balances for the years ended June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Interest income	\$ 46,871	\$ 20,675
Dividend income	-	3,894
Net realized/unrealized (losses) gains	<u>-</u>	<u>(4,731)</u>
Investment income	<u>\$ 46,871</u>	<u>\$ 19,838</u>

(4) ACCOUNTS RECEIVABLE

A summary of accounts receivable follows:

	<u>2007</u>	<u>2006</u>
Trade receivable	\$ 1,115,172	\$ 1,055,257
Less allowance for doubtful accounts	<u>(25,182)</u>	<u>(19,983)</u>
Accounts receivable, net	<u>\$ 1,089,990</u>	<u>\$ 1,035,274</u>

(5) UNBILLED RECEIVABLES

Unbilled receivables are the total amount for payroll processing services rendered but not yet invoiced, related to Medicaid waiver. Unbilled receivables totaled \$930,659 in 2007 and \$611,812 in 2006.

(6) INTERFUND RECEIVABLES/PAYABLES

Interfund receivables/payables consist of the following:

	<u>2007</u>	<u>2006</u>
Interfund receivables:		
Mississippi Department of Rehabilitation	<u>\$ 958,928</u>	<u>\$ 1,234,220</u>

	<u>2007</u>	<u>2006</u>
Interfund payables:		
Office of Vocational Rehabilitation	<u>\$ 557</u>	<u>\$ 566</u>

(7) INVENTORIES

A summary of inventories follows:

	<u>2007</u>	<u>2006</u>
Finished goods	<u>\$ 70,556</u>	<u>\$ 75,633</u>
Raw materials and supplies	<u>122,899</u>	<u>113,939</u>
Total inventories	<u>\$ 193,455</u>	<u>\$ 189,572</u>

(8) OTHER OPERATING INCOME, NET

A summary of other operating income, net follows:

	<u>2007</u>	<u>2006</u>
Payroll processing income, net	<u>\$ 18,673,087</u>	<u>\$ 13,112,517</u>
Payroll processing expense	<u>(18,203,132)</u>	<u>(12,806,863)</u>
Other operating income, net	<u>\$ 469,955</u>	<u>\$ 305,654</u>

(9) RELATED PARTY TRANSACTIONS

Transfers-in of \$7,245,514 in 2007 and \$6,470,904 in 2006 represent general and administrative expenses paid on behalf of the AbilityWorks facilities by the State of Mississippi Department of Rehabilitation Services.

(10) FACILITIES

Production facilities utilized by seven AbilityWorks locations are provided without rent by the counties in which the facilities are located. The other ten facilities reported rent expense of \$384,321 in 2007 and \$376,044 in 2006 under cancellable operating leases.

(11) COMMITMENTS AND CONTINGENCIES

AbilityWorks is involved in various legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on AbilityWorks financial position, results of operations or liquidity.

ABILITYWORKS, INC.

SCHEDULES OF COST OF PRODUCTION

Years Ended June 30, 2007 and 2006

	2007	2006
Bank charges	\$ 1,147	\$ 5,685
Commissions	87,059	83,800
Employee benefits	580,378	663,711
Equipment rent and maintenance	168,306	161,507
Facility repairs and maintenance	71,485	112,850
Freight	259	568
General shop and tools	70,286	208,214
Marketing	44,048	51,606
Miscellaneous	84,834	112,532
Opportunity wages production	1,632,834	1,668,772
Other administrative expenses	42,162	7,251
Professional fees	341,973	257,418
Rent	384,321	376,044
Salaries, non-client employees	1,885,301	1,897,040
Supplies	1,538,120	1,574,518
Uniforms	7,340	6,286
Vehicle expense	192,081	142,746
	<u>          </u>	<u>          </u>
Total cost of production	\$ <u>7,131,934</u>	\$ <u>7,330,548</u>

See Independent Auditors' Report.

ABILITYWORKS, INC.

SCHEDULES OF GENERAL AND ADMINISTRATIVE EXPENSES

Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Client transportation	\$ 504,853	\$ 425,305
Commodities	41,703	42,444
Contractual services	771,557	776,274
Equipment	-	5,452
Salaries and related expenses	5,753,070	5,100,615
Subsidy - opportunity wages	58,000	49,720
Travel	<u>7,945</u>	<u>4,414</u>
 Total general and administrative expenses	 <u>\$ 7,137,128</u>	 <u>\$ 6,404,224</u>

See Independent Auditors' Report.

ABILITYWORKS, INC.

SCHEDULE OF STATISTICAL ANALYSIS OF OPERATIONS  
Year Ended June 30, 2007  
(Unaudited)

	Total per the Statement of Revenues, Expenses and Changes in Net Assets	Total Cost of Operations For Year in Relation to		
		Clients Served	Client Days	Clients Closed/Rehabilitated
Cost of production	\$ 7,131,934	\$ 3,090	\$ 95	\$ 11,375
General and administrative expenses	7,137,128	3,092	95	11,383
Total operating cost	14,269,062	6,182	190	22,758
Less revenue and other operating income	7,793,740	3,377	104	12,430
Total operating cost, net of revenue and other operating revenue	6,475,322	2,805	86	10,328
Less nonoperating (revenue) expense	118,894	52	2	190
Total operating cost after nonoperating (revenue) expense	\$ 6,594,216	\$ 2,857	\$ 88	\$ 10,518
Totals for the year ended June 30, 2007:				
Clients served	2,308			
Client days	75,219			
Clients closed/rehabilitated	627			
Average daily attendance	308			
Average length of stay per client in days	Client days Clients served	33		

\* Total operating cost after nonoperating expense does not include payroll processing income and payroll processing expenses. These items are not related to clients served and employed data and are appropriately not included in the above analysis.

See Independent Auditors' Report.



## HARPER, RAINS, KNIGHT & COMPANY

The Board of Directors  
AbilityWorks, Inc.  
Madison, Mississippi

### 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

We have audited the basic financial statements of AbilityWorks, Inc., a component unit of the State of Mississippi, as of and for the year ended June 30, 2007, and have issued our report thereon dated September 20, 2007. We conducted our audit 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 audit, we considered AbilityWorks, Inc., a component unit of the State of Mississippi, internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of AbilityWorks, Inc., a component unit of the State of Mississippi, internal control over financial reporting.

A control deficiency exists when the design or operation of one or more of the internal control structure elements does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

The Board of Directors  
AbilityWorks, Inc. - Continued

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether AbilityWorks, Inc., a component unit of State of Mississippi, basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of management, others within the Organization and Board of Directors of AbilityWorks, Inc. and is not intended to be and should not be used by anyone other than these specified parties.

*Harper, Rains, Knight & Company, P.A.*

September 20, 2007