

Audited Financial Statements

Mercy Ministries of America, Inc.

December 31, 2004 and 2003

MERCY MINISTRIES OF AMERICA, INC.

Audited Financial Statements

December 31, 2004 and 2003

Table of Contents

	<u>Page Number</u>
Independent Auditors' Report.....	1
Financial Statements:	
Statements of Financial Position.....	2
Statements of Activities.....	3
Statements of Functional Expenses	4
Statements of Cash Flows	5
Notes to Financial Statements.....	6-12

RAYBURN, BATES & FITZGERALD, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

SUITE 300
5200 MARYLAND WAY
BRENTWOOD, TENNESSEE 37027
www.rbfcpa.com

Independent Auditors' Report

To the Board of Trustees
Mercy Ministries of America, Inc.
Nashville, Tennessee

We have audited the accompanying statements of financial position of Mercy Ministries of America, Inc. (a non-profit organization) as of December 31, 2004 and 2003, and the related statements of activities, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of the management of Mercy Ministries of America, Inc. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. 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 financial statements referred to above present fairly, in all material respects, the financial position of Mercy Ministries of America, Inc. at December 31, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Rayburn, Bates & Fitzgerald, P.C.

June 8, 2005

MERCY MINISTRIES OF AMERICA, INC.

Statements of Financial Position

December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents (note 2)	\$ 448,751	-
Accounts receivable	3,638	5,922
Contributions receivable, no allowance necessary	316,551	106,219
Inventory, net of allowance of \$33,047 as of December 31, 2004 (note 3)	88,621	108,538
Prepaid expenses	<u>36,013</u>	<u>43,679</u>
Total current assets	<u>893,574</u>	<u>264,358</u>
Property and equipment, net of accumulated depreciation and amortization (notes 4, 7, 8 and 9)	5,683,035	5,714,490
Other assets	<u>8,265</u>	<u>9,265</u>
	<u>\$6,584,874</u>	<u>5,988,113</u>
Current liabilities:		
Cash overdraft	\$ -	13,904
Accounts payable	75,938	90,644
Accrued expenses (note 6)	54,704	14,581
Line of credit (note 7)	-	545,857
Current portion of notes payable (note 8)	50,836	30,641
Current portion of capital lease obligation (note 9)	<u>-</u>	<u>32,824</u>
Total current liabilities	181,478	728,451
Long-term portion of notes payable (note 8)	<u>292,744</u>	<u>-</u>
	<u>474,222</u>	<u>728,451</u>
Commitments and contingencies (notes 10 and 16)		
Net assets:		
Unrestricted	5,566,591	5,152,322
Temporarily restricted (note 11)	<u>544,061</u>	<u>107,340</u>
Total net assets	<u>6,110,652</u>	<u>5,259,662</u> ✓
	<u>\$6,584,874</u>	<u>5,988,113</u>

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Activities

Years Ended December 31, 2004 and 2003

	2004			2003		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues, gains and other support:						
Received directly - contributions	\$3,901,355	560,665	4,462,020	3,587,375	191,926	3,779,301
Special events, net of expenses of \$4,511 and \$45,246 in 2004 and 2003, respectively	46,697	-	46,697	51,685	-	51,685
Adoption application fees	6,175	-	6,175	7,575	-	7,575
Book sales	21,804	-	21,804	52,453	-	52,453
Teaching tape ministry	7,625	-	7,625	9,819	-	9,819
Royalties	6,378	-	6,378	14,370	-	14,370
Other income	<u>31,745</u>	<u>-</u>	<u>31,745</u>	<u>32,049</u>	<u>-</u>	<u>32,049</u>
Total revenues and gains	4,021,779	560,665	4,582,444 ✓	3,755,326	191,926	3,947,252 ✓
Net assets released from restrictions:						
Satisfaction of program restrictions (note 12)	<u>123,944</u>	<u>(123,944)</u>	<u>-</u>	<u>94,686</u>	<u>(94,686)</u>	<u>-</u>
Total revenue, gains and other support	<u>4,145,723</u>	<u>436,721</u>	<u>4,582,444</u>	<u>3,850,012</u>	<u>97,240</u>	<u>3,947,252</u>
Expenses and losses:						
Counseling and support	2,871,999	-	2,871,999	2,796,203	-	2,796,203
Management and general	803,406	-	803,406	1,025,357	-	1,025,357
Fundraising	<u>56,049</u>	<u>-</u>	<u>56,049</u>	<u>89,514</u>	<u>-</u>	<u>89,514</u>
Total expenses and losses	<u>3,731,454</u>	<u>-</u>	<u>3,731,454</u> ✓	<u>3,911,074</u>	<u>-</u>	<u>3,911,074</u> ✓
Change in net assets	414,269	436,721	850,990	(61,062)	97,240	36,178
Net assets, beginning of year	<u>5,152,322</u>	<u>107,340</u>	<u>5,259,662</u>	<u>5,213,384</u>	<u>10,100</u>	<u>5,223,484</u>
Net assets, end of year	<u>\$5,566,591</u>	<u>544,061</u>	<u>6,110,652</u>	<u>5,152,322</u>	<u>107,340</u>	<u>5,259,662</u>

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Functional Expenses

Years Ended December 31, 2004 and 2003

	2004				2003			
	Program Services	Supporting Services			Program Services	Supporting Services		
	Counseling and Support	Management and General	Fund Raising	Total	Counseling and Support	Management and General	Fund Raising	Total
Salaries	\$1,327,361	228,571	27,572	1,583,504	1,324,189	310,864	30,443	1,665,496
Contract labor	4,973	1,658	-	6,631	3,107	48,141	-	51,248
Payroll taxes	99,644	7,986	2,109	109,739	91,900	21,744	584	114,228
Total salaries and related expenses	1,431,978	238,215	29,681	1,699,874	1,419,196	380,749	31,027	1,830,972
Contributions	415,874	-	-	415,874	354,580	-	-	354,580
Professional fees	5,392	62,147	-	67,539	3,331	34,539	-	37,870
Advertising and public relations	4,805	38,929	-	43,734	6,025	89,923	-	95,948
Automobile	15,857	6,573	-	22,430	20,470	6,638	-	27,108
Books, tapes and videos	8,438	5,903	-	14,341	11,641	25,379	-	37,020
Book costs	-	-	16,129	16,129	-	-	30,012	30,012
Dues and subscriptions	3,225	5,322	-	8,547	3,617	4,405	-	8,022
Educational	2,205	1,520	-	3,725	1,617	898	-	2,515
Travel, conferences, and meetings	48,611	36,722	5,462	90,795	30,345	35,825	4,269	70,439
Room and board	278,297	28,800	-	307,097	270,563	28,800	-	299,363
Insurance	182,660	46,720	-	229,380	164,595	62,142	-	226,737
Medical	3,246	-	-	3,246	1,742	-	-	1,742
Mail out services	47,623	15,874	-	63,497	84,605	28,202	-	112,807
Office	25,250	65,689	-	90,939	26,372	45,714	-	72,086
Postage	31,665	22,819	-	54,484	74,876	52,795	-	127,671
Repairs and maintenance	18,186	1,491	-	19,677	10,984	532	-	11,516
Occupancy	-	8,122	-	8,122	-	9,680	-	9,680
Taxes and licenses	-	-	-	-	22	2,025	-	2,047
Telephone	24,640	19,754	577	44,971	30,572	23,120	842	54,534
Utilities	55,515	15,827	-	71,342	65,352	16,458	-	81,810
Miscellaneous	11,614	43,707	-	55,321	10,812	22,768	6,025	39,605
Newsletter	52,140	48,733	4,200	105,073	31,815	49,855	17,339	99,009
Loss on disposition of investments	-	560	-	560	-	154	-	154
Provision for obsolete inventory	33,047	-	-	33,047	-	-	-	-
Interest	-	32,735	-	32,735	-	48,501	-	48,501
Total expenses and losses before depreciation and amortization	2,700,268	746,162	56,049	3,502,479	2,623,132	969,102	89,514	3,681,748
Depreciation and amortization	171,731	57,244	-	228,975	173,071	56,255	-	229,326
Total expenses and losses	\$2,871,999	\$803,406	\$56,049	\$3,731,454	\$2,796,203	\$1,025,357	\$89,514	\$3,911,074

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Cash Flows

Years Ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Change in net assets	\$ 850,990	36,178
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	228,975	229,326
Provision for inventory obsolescence	33,047	-
Loss on disposition of investments	560	154
Contributions of property, inventory and investments	(79,379)	(6,329)
(Increase) decrease in accounts receivable	2,284	(4,406)
(Increase) decrease in contributions receivable	(210,332)	27,086
Increase in inventory	(13,130)	(71,003)
Decrease in prepaid expenses	53,107	40,965
Increase in intangible assets	-	(3,000)
Decrease in other assets	1,000	-
Increase (decrease) in accounts payable	(14,706)	20,459
Increase in accrued expenses	<u>40,123</u>	<u>2,423</u>
Net cash provided by operating activities	<u>892,539</u>	<u>271,853</u>
Cash flows from investing activities:		
Purchase of property and equipment	(227,259)	(81,116)
Proceeds from sales of investments	<u>78,819</u>	<u>6,175</u>
Net cash used in investing activities	<u>(148,440)</u>	<u>(74,941)</u>
Cash flows from financing activities:		
Repayments of capital lease obligation	(3,085)	(9,438)
Activity for line of credit, net	(545,857)	(282,215)
Proceeds from notes payable	529,365	-
Repayments of notes payable	<u>(261,867)</u>	<u>(40,060)</u>
Net cash used in financing activities	<u>(281,444)</u>	<u>(331,713)</u>
Net increase (decrease) in cash and cash equivalents	462,655	(134,801)
Cash and cash equivalents (overdraft) at beginning of year	<u>(13,904)</u>	<u>120,897</u>
Cash and cash equivalents (overdraft) at end of year	\$ <u>448,751</u>	<u>(13,904)</u>

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements

December 31, 2004 and 2003

(1) Nature of Organization and Summary of Significant Accounting Policies

Nature of Organization

Mercy Ministries of America, Inc. (the Ministry) is a nonprofit organization that is designed to assist and meet the needs of any young woman who is facing an unplanned pregnancy.

Individuals are educated regarding the options of single parenting and adoption. Additionally, adoption services are provided along with parental skills training and other instruction necessary for the individual to lead a productive and self-sufficient life. The Ministry also provides similar services for young women between the ages of 16 and 28 with life-controlling problems other than unplanned pregnancy.

Summary of Significant Accounting Policies

Basis of 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*. Under SFAS No. 117, the Ministry is 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) based upon the existence or absence of donor-imposed restrictions.

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 contributions are 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 statement of activities as net assets released from restrictions.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Cash Equivalents

Cash equivalents consist of short-term, highly liquid investments which are readily convertible into cash within ninety (90) days of purchase.

Inventory

Inventory consists of hardback and paperback copies of books written by the founder and president of the Ministry as well as compact discs and cassette tapes recorded by various musicians and clothing. Inventory is valued at the lower of cost or market. Cost is determined by the first-in, first-out method (FIFO).

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(1) Nature of Organization and Summary of Significant Accounting Policies, (Continued)

Summary of Significant Accounting Policies, (Continued)

Property and Equipment

Property and equipment is stated at cost when purchased and fair value if contributed. It is the Ministry's policy to capitalize property and equipment over \$1,000. Lesser amounts are expensed. Equipment, furniture, buildings and automobiles are depreciated over their estimated useful lives which range from three to forty years, using the straight-line method of depreciation.

The cost and accumulated depreciation of property sold or retired is removed from the related asset and accumulated depreciation accounts and any resulting gain or loss is recorded in the period of disposal.

Functional Allocation of Expenses

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

Income Taxes

Income taxes are not provided for in the financial statements, since the Ministry is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code. The Ministry is not classified as a private foundation.

Advertising

Advertising and marketing costs are expensed as incurred.

Use of Estimates

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 amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Donated Materials and Services

Donated materials, property or equipment, when received, are reflected as contributions in the accompanying statements at their estimated fair market values at date of receipt. No amounts have been reflected in the financial statements for donated services of volunteers in as much as no objective basis is available to measure the value of such services. However, a number of volunteers have donated their time to the Ministry's program services and fundraising campaigns.

Reclassification

Certain 2003 amounts have been reclassified to conform to the December 31, 2004 presentation.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(2) Cash and Cash Equivalents

At December 31, 2004 and 2003, the Ministry maintained cash in a local financial institution in excess of federal deposit insurance limits of \$367,643 and \$170,246, respectively.

(3) Inventory

Inventory by major classifications as of December 31, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Finished goods	<u>\$88,621</u>	<u>108,538</u>

(4) Property and Equipment

A summary of property and equipment at December 31, 2004 and 2003 follows:

	<u>2004</u>	<u>2003</u>
Land	\$1,055,281	1,055,281
Buildings	4,643,201	4,643,201
Building improvements	202,808	181,823
Automobiles	218,831	236,798
Office equipment	269,058	220,761
Furniture and fixtures	760,151	752,082
Construction in progress	<u>308,945</u>	<u>197,578</u>
	7,458,275	7,287,524
Less accumulated depreciation and amortization	<u>1,775,240</u>	<u>1,573,034</u>
	<u>\$5,683,035</u>	<u>5,714,490</u>

(5) Investments

Investment return for the years ended December 31, 2004 and 2003 consisted of the following:

	<u>2004</u>	<u>2003</u>
Realized loss	<u>\$(560)</u>	<u>(154)</u>

(6) Promise to Give

Accrued expenses include an unconditional promise to give of \$31,700. The promise is due in 2005.

(7) Line of Credit

The Ministry has a revolving line of credit with a local financial institution. The line of credit has available funds of \$200,000. The credit line bears interest at the bank's index rate plus 1.25%, and is secured by a mortgage on the corporate office. The line of credit expires February 9, 2005. The line of credit was extended for an additional year to February 9, 2006. The collateral was released at that time.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(8) Notes Payable

The Ministry's notes payable consist of the following at December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Note payable to a finance company, payable in monthly installments of \$2,555, including interest at a rate of 5.25%, maturing July 2005. This note is unsecured.	\$ 17,577	14,266
Note payable to an insurance company, payable in monthly installments of \$2,480, no interest, maturing August 2004. This note was unsecured.	-	16,375
Note payable to financial institution, payable in monthly installments of \$4,656 beginning March 2005, including interest at a rate of 7.5%, maturing February 2020. This note is secured by a mortgage on the corporate office and Nashville home.	299,000	-
Note payable to finance company, payable in monthly installments of \$711 beginning July 2004, including interest at a rate of 5.75%, maturing June 2008. This note is secured by a vehicle.	<u>27,003</u>	<u>-</u>
	343,580	30,641
Current portion	<u>(50,836)</u>	<u>(30,641)</u>
Long-term portion	<u>\$292,744</u>	<u>\$ -</u>

Future scheduled maturities of notes payable are as follows:

Year ending <u>December 31,</u>	
2005	\$ 50,836
2006	44,240
2007	47,534
2008	46,755
2009	45,861
Thereafter	<u>108,354</u>
	<u>\$343,580</u>

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(9) Capital Lease Obligation

The Ministry leased an automobile with a lease term through April 2004. The obligation under the capital lease has been recorded in the accompanying financial statements at the present value of future minimum lease payments, discounted at a rate of 8.50%. In 2003, the total capitalized cost of \$56,507 is included in property and equipment and is being depreciated over the lease term of 36 months. The book value of the vehicle at the end of the lease term was \$29,739. The vehicle was purchased in 2004 with a note payable to a finance company.

(10) Operating Lease Commitment

The Ministry leases office equipment and an apartment in St. Louis under operating lease agreements. Total lease payments for these leases were \$13,798 and \$1,892 in 2004 and 2003, respectively.

Future minimum lease commitments are as follows:

<u>Year ending</u> <u>December 31,</u>	
2005	\$12,076
2006	5,676
2007	5,676
2008	<u>3,784</u>
	<u>\$27,212</u>

(11) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Enhancements for education/classroom	\$ 38,010	-
Care for Middle Tennessee residents	7,333	-
Christmas gifts	22,574	-
Care for girls in the Northwest area	35,255	-
St. Louis facility	424,989	92,140
Houston facility	5,900	5,200
Oklahoma facility	<u>10,000</u>	<u>10,000</u>
	<u>\$544,061</u>	<u>107,340</u>

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(12) Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by donors during the year ended December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Purpose restrictions accomplished:		
Contribution for gift to president	\$ -	20,000
Adoption expenses	10,924	-
Classroom enhancements	11,745	-
Care for Middle Tennessee residents	667	-
Banquet funded St. Louis renovations	-	12,429
St. Louis facility	76,686	62,257
Christmas gifts	<u>23,922</u>	<u>-</u>
Total restrictions released	<u>\$123,944</u>	<u>94,686</u>

(13) Supplemental Cash Flow Disclosures

Operating activities reflect interest paid in the amounts of \$32,735 and \$48,501 for the years ending December 31, 2004 and 2003, respectively.

The Ministry received non-cash contributions of equity securities totaling \$79,379 and \$6,329 during 2004 and 2003, respectively.

During 2004 and 2003, the Ministry received and distributed donated materials totaling \$35,453 and \$50,205, respectively.

During 2004 and 2003, the Ministry prepaid expenses in the amount of \$45,441 and \$47,443, respectively, by incurring a note payable.

(14) Royalty Income

The Ministry has entered into a royalty and license agreement with a recording company relating to a sound recording entitled "The Mercy Project" for manufacture and distribution. This agreement provides that the Ministry will receive royalty income equal to 20% of net sales of the sound recording. The agreement expires September 2005.

(15) Related Party Transactions

Members of the Board of Trustees regularly contribute to the Ministry. For the year ended December 31, 2004 and 2003, contributions from related parties totaled \$102,913 and \$64,934, respectively.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2004 and 2003

(16) Commitments and Contingencies

A home is currently being constructed in St. Louis, Missouri. Another non-profit entity has committed up to \$1,000,000 in funds to renovate this location. Funds expended for the construction totaled \$111,367 in 2004.

There are some stipulations the other non-profit entity has placed on its commitment:

- (1) The current President of the Ministry shall remain in this position.
- (2) The Ministry shall remain a Christian-based residential facility for troubled girls and unwed mothers.