

**MERCY MINISTRIES OF AMERICA, INC.**

**NASHVILLE, TENNESSEE**

**DECEMBER 31, 2006 AND 2005**

MERCY MINISTRIES OF AMERICA, INC.

NASHVILLE, TENNESSEE

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AUDITED FINANCIAL STATEMENTS

April 23, 2007

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

**Independent Auditors' Report**

We have audited the accompanying statement of financial position of Mercy Ministries of America, Inc. (a nonprofit organization) as of December 31, 2006, and the related statements of activities, functional expenses and cash flows for the year 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 audit. The financial statements of Mercy Ministries of America, Inc. as of December 31, 2005, were audited by other auditors whose report dated June 19, 2006, expressed an unqualified opinion on those statements.

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.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of Mercy Ministries of America, Inc. as of December 31, 2006, and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Heard, McElroy & Vestal, LLP*

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2006 AND 2005

<u>A S S E T S</u>	<u>2006</u>	<u>2005</u>
<b><u>Current assets:</u></b>		
Cash and cash equivalents	572,794	480,217
Investments-Note 5	1,931	-
Contributions receivable, net of \$0- allowance	253,923	251,038
Inventory-Note 3	74,185	75,957
Prepaid expenses	<u>75,527</u>	<u>44,346</u>
Total current assets	978,360	851,558
<b><u>Property, plant and equipment</u></b> , net of accumulated depreciation and amortization-Notes 4, 7 and 8	6,574,237	6,559,632
<b><u>Other assets</u></b>	<u>765</u>	<u>765</u>
Total assets	<u>7,553,362</u>	<u>7,411,955</u>
<b><u>LIABILITIES AND NET ASSETS</u></b>		
<b><u>Current liabilities:</u></b>		
Accounts payable	58,413	65,682
Accrued expenses-Note 6	35,929	35,013
Current portion of notes payable-Note 7	23,009	31,110
Current portion of capital lease obligation-Note 8	<u>-</u>	<u>17,982</u>
Total current liabilities	117,351	149,787
<b><u>Long-term debt</u></b> , less portion classified as current-Note 7	<u>-</u>	<u>12,240</u>
Total liabilities	117,351	162,027
<b><u>Commitments and contingencies</u></b> -Notes 9 and 15		
<b><u>Net assets:</u></b>		
Unrestricted	6,986,817	6,801,116
Temporarily restricted-Note 10	<u>449,194</u>	<u>448,812</u>
Total net assets	<u>7,436,011</u>	<u>7,249,928</u>
Total liabilities and net assets	<u>7,553,362</u>	<u>7,411,955</u>

The accompanying notes are an integral part of these financial statements.

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
<b><u>Revenues, gains and other support:</u></b>			
Received directly-contributions	4,151,487	1,150,375	5,301,862
Special events, net of expenses of \$4,511 and \$-0- in 2006 and 2005, respectively	87,656	-	87,656
Adoption application fees	3,575	-	3,575
Book sales	13,244	-	13,244
Teaching tape ministry	20,598	-	20,598
Royalties-Note 13	2,218	-	2,218
Girls of Grace event	-	-	-
Interest income	4,208	-	4,208
Other income	<u>61,430</u>	<u>-</u>	<u>61,430</u>
Total revenues and gains	4,344,416	1,150,375	5,494,791
Net assets released from restriction-Note 11	<u>1,149,993</u>	<u>(1,149,993)</u>	<u>-</u>
Total revenues, gains and other support	5,494,409	382	5,494,791
<b><u>Functional expenses:</u></b>			
Counseling and support	3,812,279	-	3,812,279
Management and general	1,089,481	-	1,089,481
Fundraising	<u>406,948</u>	<u>-</u>	<u>406,948</u>
Total functional expenses	<u>5,308,708</u>	<u>-</u>	<u>5,308,708</u>
<b><u>Change in net assets</u></b>	185,701	382	186,083
<b><u>Net assets-beginning of year</u></b>	<u>6,801,116</u>	<u>448,812</u>	<u>7,249,928</u>
<b><u>Net assets-end of year</u></b>	<u><u>6,986,817</u></u>	<u><u>449,194</u></u>	<u><u>7,436,011</u></u>

The accompanying notes are an integral part of these financial statements.

2005		
<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
4,779,756	647,942	5,427,698
85,031	-	85,031
4,850	-	4,850
20,407	-	20,407
7,857	-	7,857
24,640	-	24,640
114,485	-	114,485
-	-	-
<u>79,879</u>	<u>-</u>	<u>79,879</u>
5,116,905	647,942	5,764,847
<u>743,191</u>	<u>(743,191)</u>	<u>-</u>
5,860,096	(95,249)	5,764,847
3,125,064	-	3,125,064
1,268,751	-	1,268,751
<u>231,756</u>	<u>-</u>	<u>231,756</u>
<u>4,625,571</u>	<u>-</u>	<u>4,625,571</u>
1,234,525	(95,249)	1,139,276
<u>5,566,591</u>	<u>544,061</u>	<u>6,110,652</u>
<u><u>6,801,116</u></u>	<u><u>448,812</u></u>	<u><u>7,249,928</u></u>

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF FUNCTIONAL EXPENSES

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006			
	Program Services	Supporting Services		
	Counseling and Support	Management and General	Fund Raising	Total
Salaries	1,820,790	429,917	163,882	2,414,589
Contract labor	23,355	14,421	-	37,776
Payroll taxes	127,605	30,129	11,485	169,219
Total salaries and related expenses	1,971,750	474,467	175,367	2,621,584
Contributions	583,276	-	-	583,276
Bad debts	-	1,864	-	1,864
Professional fees	7,452	54,652	-	62,104
Marketing and public relations	61,110	-	61,110	122,220
Automobile	22,459	14,972	-	37,431
Books, tapes and videos	43,130	-	10,783	53,913
Dues and subscriptions	16,062	4,589	2,295	22,946
Educational	17,339	1,927	-	19,266
Travel, conferences, and meetings	80,746	40,373	13,458	134,577
Room and board	311,235	155,618	51,873	518,726
Insurance	228,712	98,019	-	326,731
Medical	3,787	-	-	3,787
Mail out services	797	-	7,175	7,972
Office	32,098	32,098	33,071	97,267
Postage	37,615	9,404	47,019	94,038
Repairs and maintenance	15,356	3,839	-	19,195
Occupancy	10,384	10,384	-	20,768
Telephone	33,599	9,600	4,800	47,999
Utilities	78,654	26,218	-	104,872
Miscellaneous	10,743	67,173	-	77,916
Loss on disposition of investments	-	216	-	216
Girls of Grace event	-	-	-	-
Interest	-	2,075	-	2,075
Total expenses before depreciation and amortization	3,566,304	1,007,488	406,951	4,980,743
Depreciation and amortization	245,974	81,991	-	327,965
Total functional expenses	3,812,278	1,089,479	406,951	5,308,708

The accompanying notes are an integral part of these financial statements.



2005

<u>Program Services</u>	<u>Supporting Services</u>		
<u>Counseling and Support</u>	<u>Management and General</u>	<u>Fund Raising</u>	<u>Total</u>
1,181,025	663,722	-	1,844,747
43,571	5,246	-	48,817
<u>87,967</u>	<u>37,972</u>	<u>-</u>	<u>125,939</u>
1,312,563	706,940	-	2,019,503
315,166	-	-	315,166
-	23,469	-	23,469
9,000	66,003	-	75,003
49,760	-	49,761	99,521
20,953	13,969	-	34,922
53,994	-	13,499	67,493
8,382	2,395	1,197	11,974
11,925	1,325	-	13,250
64,288	32,144	10,714	107,146
222,432	111,216	37,072	370,720
203,422	87,181	-	290,603
10,603	-	-	10,603
4,991	-	44,916	49,907
28,474	28,474	29,337	86,285
32,173	8,043	40,217	80,433
13,260	3,315	-	16,575
6,410	6,410	-	12,820
35,307	10,088	5,043	50,438
69,117	23,039	-	92,156
31,254	69,956	-	101,210
-	234	-	234
413,878	-	-	413,878
<u>-</u>	<u>5,313</u>	<u>-</u>	<u>5,313</u>
2,917,352	1,199,514	231,756	4,348,622
<u>207,712</u>	<u>69,237</u>	<u>-</u>	<u>276,949</u>
<u><u>3,125,064</u></u>	<u><u>1,268,751</u></u>	<u><u>231,756</u></u>	<u><u>4,625,571</u></u>

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
<b><u>Cash flows from operating activities:</u></b>		
Change in net assets	186,083	1,139,276
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	327,965	276,949
Provision for inventory obsolescence	(11,150)	(6,305)
Bad debts expense	-	23,469
(Gain) loss on disposition of investments and vehicles	(188)	234
Contributions of property, inventory and investments	(22,491)	(741,477)
(Increase) in accounts receivable	-	(19,831)
(Increase) decrease in contributions receivable	(2,885)	65,513
Decrease in inventory	12,922	18,969
(Increase) decrease in prepaid expenses	(31,181)	29,276
Decrease in other assets	-	7,500
(Decrease) in accounts payable	(7,269)	(10,258)
Increase (decrease) in accrued expenses	<u>916</u>	<u>(19,691)</u>
Net cash provided by operating activities	452,722	763,624
<b><u>Cash flows from investing activities:</u></b>		
Purchase of property and equipment	(336,958)	(398,780)
Proceeds from sales of investments and vehicles	<u>15,136</u>	<u>15,380</u>
Net cash (used) by investing activities	(321,822)	(383,400)
<b><u>Cash flows from financing activities:</u></b>		
Repayments of capital lease obligation	(17,982)	(10,918)
Repayments of notes payable	<u>(20,341)</u>	<u>(337,840)</u>
Net cash (used) by financing activities	<u>(38,323)</u>	<u>(348,758)</u>
<u>Net increase in cash and cash equivalents</u>	92,577	31,466
<u>Cash and cash equivalents-beginning of year</u>	<u>480,217</u>	<u>448,751</u>
<u>Cash and cash equivalents-end of year</u>	<u><u>572,794</u></u>	<u><u>480,217</u></u>

The accompanying notes are an integral part of these financial statements.

MERCY MINISTRIES OF AMERICA, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

**1. Organization and Significant Accounting Policies**

**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, ages 13 through 28, who is facing life-controlling problems such as drug and alcohol abuse, addictions, depression, eating disorders, and unplanned pregnancy. In cases of unplanned pregnancy, individuals are educated regarding the options of single parenting or 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 provides a free residential treatment program designed to address the whole person: spiritual, physical and emotional.

**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.

## 1. Organization and Significant Accounting Policies (Continued)

### *Inventory*

Inventory consists of hardback and paperback copies of books written by the founder and president of the Ministry, 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).

### *Property and Equipment*

Property and equipment are 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 five 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 benefitted.

### *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. Advertising costs were \$-0- and \$314 for the years ended December 31, 2006 and 2005.

### *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 the date of receipt. No amounts have been reflected in the financial statements for donated services of volunteers since 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 2005 amounts have been reclassified to conform to the December 31, 2006 presentation.

## 2. Cash and Cash Equivalents

At December 31, 2006 and 2005, the Ministry maintained cash in a local financial institution in excess of federal deposit insurance limits of \$311,492 and \$394,005, respectively.

3. **Inventory**

Inventory by major classifications as of December 31, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Finished goods	89,777	102,699
Allowance for obsolete inventory	<u>(15,592)</u>	<u>(26,742)</u>
	<u>74,185</u>	<u>75,957</u>

4. **Property and Equipment**

A summary of property and equipment at December 31, 2006 and 2005 follows:

	<u>2006</u>	<u>2005</u>
Land	1,055,281	1,055,281
Buildings	5,649,034	5,649,034
Building improvements	427,393	206,305
Automobiles	277,251	271,361
Office equipment	437,553	398,558
Furniture and fixtures	<u>1,101,200</u>	<u>1,031,282</u>
	8,947,712	8,611,821
<u>Less-accumulated depreciation</u>	<u>2,373,475</u>	<u>2,052,189</u>
	<u>6,574,237</u>	<u>6,559,632</u>

5. **Investments**

Investment return for the years ended December 31, 2006 and 2005 consisted of the following:

	<u>2006</u>	<u>2005</u>
Realized loss	<u>216</u>	<u>234</u>

6. **Promise to Give**

Accrued expenses include an unconditional promise to give of \$11,900 at December 31, 2006 and 2005, respectively. The promise to give is intended for scholarships to a program similar to that of the Ministry.

7. **Notes Payable**

The Ministry's notes payable consist of the following at December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Note payable to a finance company for insurance, payable in monthly installments of \$3,441, including interest at a rate of 8.75%, maturing July 2007.	23,009	23,516
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 was secured by a vehicle. This note was paid off in February 2006.	<u>-</u>	<u>19,834</u>
	23,009	43,350

7. **Notes Payable (Continued)**

	<u>2006</u>	<u>2005</u>
Less-current portion	<u>(23,009)</u>	<u>(31,110)</u>
Long-term portion	<u>-</u>	<u>12,240</u>

The Ministry has access to a line of credit in the amount of \$250,000, which will expire on August 15, 2007.

8. **Capital Lease Obligation**

The Ministry leased equipment with a book value of \$22,080 net of accumulated depreciation of \$6,720.

The Ministry had the option to dispose of the lease by paying the face amount within nine months of the lease's inception after which, the Ministry retained title to the leased equipment. The Ministry satisfied its lease obligation in June 2006 and received title to the equipment.

9. **Operating Lease Commitment**

The Ministry leased office equipment and apartments under operating lease agreements. Total lease payments for these leases were \$24,367 and \$15,490 in 2006 and 2005, respectively. The Ministry's leases on the apartments terminated and were not renewed.

Future minimum lease commitments are as follows:

<u>Year Ending</u> <u>December 31,</u>	
2007	5,676
2008	<u>3,784</u>
	<u>9,460</u>

10. **Temporarily Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Transitional care	47,498	-
Enhancements for education/classroom	2,905	2,905
Third floor addition	47,213	-
Christmas gifts	23,604	-
Care for girls in the Northwest area	35,255	35,255
St. Louis facility and operations	140,189	364,430
Nashville facility	5,279	-
Houston facility	5,900	5,900
Monroe facility	31,930	-
Northern California facility	97,281	30,322
Oklahoma facility	10,000	10,000
Kitchen fund	390	-
Monroe graduates	<u>1,750</u>	<u>-</u>
	<u>449,194</u>	<u>448,812</u>

**11. 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, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Purpose restrictions accomplished:		
Transitional care	5,886	-
Adoption expenses	-	1,500
Classroom enhancements	-	35,105
Care for Middle Tennessee residents	-	7,333
St. Louis facility	652,590	606,124
Northern California facility	25,612	677
Care for Texas residents	-	5,000
Monroe facility	-	4,458
Nashville facility	-	20,000
Christmas gifts	30,343	62,994
Monroe graduates	250	-
Third floor addition	<u>435,312</u>	<u>-</u>
Total restrictions released	<u><u>1,149,993</u></u>	<u><u>743,191</u></u>

**12. Supplemental Cash Flow Disclosures**

Operating activities reflect interest paid in the amounts of \$1,111 and \$5,313 for the years ending December 31, 2006 and 2005, respectively.

The Ministry received noncash contributions of equity securities totaling \$16,516 and \$15,614 during 2006 and 2005, respectively.

During 2006 and 2005, the Ministry received and distributed donated materials totaling \$69,323 and \$52,379, respectively.

During 2005, the Ministry prepaid expenses in the amount of \$37,609 by incurring a note payable.

During 2005, the Ministry received noncash contribution of construction related to the renovation of the St. Louis facility in the amount of \$692,063

The Ministry acquired equipment under a capital lease obligation during 2005, in the amount of \$28,800.

During 2006 and 2005, the Ministry received donated equipment and vehicles in the amount of \$5,975 and \$33,800.

**13. Royalty Income**

The Ministry receives royalties on a recorded compilation titled "The Mercy Project" for which no formal agreement exists with the publisher. During the years 2006 and 2005, \$869 and \$552 were received by the Ministry for this project.

The Ministry has also entered into a royalty agreement with a publishing company relating to an audio book entitled "Word Becomes Flesh." This agreement provides for royalty payments to the Ministry based on 5% of net sales. The Ministry received royalty income of \$1,349 and \$23,863 during the years 2006 and 2005.

**14. Related Party Transactions**

Members of the Board of Trustees regularly contribute to the Ministry. For the years ended December 31, 2006 and 2005, contributions from related parties totaled \$85,710 and \$105,831, respectively.

The Ministry shares its program format, name and trademark, as well as assistance with similar ministries located in foreign countries. The Ministry receives no income from foreign affiliates and incurs no expense beyond that of providing assistance with the design of the affiliates' programs.

**15. Commitments and Contingencies**

The St. Louis, Missouri home was completed in September 2005. Another nonprofit entity contributed \$788,907 in funds to renovate the location.

There are stipulations the other nonprofit entity has placed on its commitment:

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