MERCY MINISTRIES OF AMERICA, INC.

NASHVILLE, TENNESSEE

DECEMBER 31, 2007 AND 2006

MERCY MINISTRIES OF AMERICA, INC.

NASHVILLE, TENNESSEE

TABLE OF CONTENTS

AUDITED FINANCIAL STATEMENTS

HEARD
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& VESTAL
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April 10, 2008

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

Independent Auditors' Report

We have audited the accompanying statements of financial position of Mercy Ministries of America, Inc. (a nonprofit organization) as of December 31, 2007 and 2006, 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 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 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. as of December 31, 2007 and 2006, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Heard, McElroy & Vestal LLP

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MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2007 AND 2006

ASSETS	2007	2006
Current assets:		
Cash and cash equivalents-Note 2	190,192	572,794
Investments-Note 5	50,968	1,931
Contributions receivable, net of $-0- allowance	161,033	253,923
Inventory-Note 3	180,693	74,185
Prepaid expenses	215,101	75,527
Total current assets	797,987	978,360
Property, plant and equipment: Notes 4, 7 and 9		
Land (undeveloped)	1,515,883	-
Land	1,055,281	1,055,281
Buildings	6,128,089	6,076,427
Equipment	1,883,579	1,816,004
Website development	26,000	-
	10,608,832	8,947,712
Less-accumulated depreciation	(2,696,008)	(2,373,475)
	7,912,824	6,574,237
Investments-long-term:		
Land-undeveloped-Note 5	1,515,883	-
Other assets	6,197	765
Total assets	10,232,891	7,553,362

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

LIABILITIES AND NET ASSETS	2007	2006
Current liabilities:		
Accounts payable	150,025	58,413
Accrued expenses-Note 6	32,309	35,929
Deferred revenue-Note 8	7,200	-
Current portion of notes payable-Note 7	801,894	23,009
Total current liabilities	991,428	117,351
Long-term debt, less portion classified as current-Note 7	1,500,000	-
Total liabilities	2,491,428	117,351
Commitments and contingencies-Notes 9, 10 and 16		
Net assets:		
Unrestricted	7,552,366	6,986,817
Temporarily restricted-Notes 11 and 12	189,097	449,194
Total net assets	7,741,463	7,436,011
Total liabilities and net assets	10,232,891	7,553,362

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007		
	Unrestricted	Temporarily Restricted	Total
Revenues, gains and other support:			
Received directly-contributions	5,077,713	1,528,497	6,606,210
Special events, net of expenses of $-0- and $4,511 in 2007 and 2006, respectively	103,300	-	103,300
Adoption application fees	4,300	-	4,300
Book sales	33,710	-	33,710
Teaching tape ministry	19,218	-	19,218
Royalties-Note 14	933	-	933
Interest income	16,949	-	16,949
Other income	23,541	-	23,541
Total revenues and gains	5,279,664	1,528,497	6,808,161
Net assets released from restriction-Note 12	1,788,594	(1,788,594)	-
Total revenues, gains and other support	7,068,258	(260,097)	6,808,161
Functional expenses:			
Counseling and support	5,332,839	-	5,332,839
Management and general	760,658	-	760,658
Fundraising	409,212	-	409,212
Total functional expenses	6,502,709	-	6,502,709
Change in net assets	565,549	(260,097)	305,452
Net assets-beginning of year	6,986,817	449,194	7,436,011
Net assets-end of year	7,552,366	189,097	7,741,463

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

2006 (Restated)		
Unrestricted	Temporarily Restricted	Total
4,151,487	1,150,375	5,301,862
87,656	-	87,656
3,575	-	3,575
13,244	-	13,244
20,598	-	20,598
2,218	-	2,218
4,208	-	4,208
61,430	-	61,430
4,344,416	1,150,375	5,494,791
1,149,993	(1,149,993)	-
5,494,409	382	5,494,791
4,314,512	-	4,314,512
644,528	-	644,528
349,668	-	349,668
5,308,708	-	5,308,708
185,701	382	186,083
6,801,116	448,812	7,249,928
6,986,817	449,194	7,436,011

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF FUNCTIONAL EXPENSES

FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007			
	Program Services	Supporting Services		
	Counseling and Support	Management and General	Fund Raising	Total
Salaries	2,506,363	353,966	204,427	3,064,756
Contract labor	30,981	4,333	-	35,314
Payroll taxes	168,513	23,799	13,745	206,057
Total salaries and related expenses	2,705,857	382,098	218,172	3,306,127
Tithe	631,497	-	-	631,497
Room and board	551,046	-	-	551,046
Travel, conferences and meetings	215,827	16,736	16,737	249,300
Marketing and public relations	83,987	-	77,178	161,165
Professional fees	20,438	71,723	-	92,161
Automobile	45,667	-	1,338	47,005
Books, tapes and videos	65,538	-	13,997	79,535
Dues and subscriptions	13,722	1,773	591	16,086
Educational	13,352	776	-	14,128
Insurance	308,379	126,372	-	434,751
Office	123,389	17,426	10,064	150,879
Computer communication	30,534	7,341	3,671	41,546
Postage	56,428	8,608	25,825	90,861
Repairs and maintenance	41,308	2,298	-	43,606
Occupancy	8,554	950	-	9,504
Telephone	57,314	3,886	1,943	63,143
Utilities	105,948	11,679	3,988	121,615
Mail out services	3,209	-	13,889	17,098
Miscellaneous	7,358	12,001	1,698	21,057
Contribution processing charges	-	33,420	-	33,420
Interest	-	4,645	-	4,645
Total expenses before depreciation and amortization	5,089,352	701,732	389,091	6,180,175
Depreciation and amortization	243,487	58,926	20,121	322,534
Total functional expenses	5,332,839	760,658	409,212	6,502,709

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

2006 (Restated)			
Program Services	Supporting Services		
Counseling and Support	Management and General	Fund Raising	Total
2,058,030	290,650	167,860	2,516,540
23,355	14,421	-	37,776
138,409	19,547	11,289	169,245
2,219,794	324,618	179,149	2,723,561
583,276	-	-	583,276
420,560	-	-	420,560
120,624	6,976	6,976	134,576
62,660	-	59,779	122,440
14,586	47,518	-	62,104
36,512	-	919	37,431
45,915	-	7,998	53,913
19,583	2,522	841	22,946
17,299	1,966	-	19,265
285,057	41,674	-	326,732
79,366	11,209	6,473	97,047
20,283	13,867	4,735	38,885
57,981	9,014	27,042	94,037
19,195	-	-	19,195
18,691	2,077	-	20,767
43,716	2,855	1,428	47,999
92,459	9,253	3,160	104,872
2,719	-	5,253	7,972
6,651	10,382	-	17,033
-	24,057	-	24,057
-	2,075	-	2,075
4,166,927	510,063	303,753	4,980,743
147,585	134,465	45,915	327,965
4,314,512	644,528	349,668	5,308,708

MERCY MINISTRIES OF AMERICA, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Cash flows from operating activities:		
Change in net assets	305,452	186,083
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	322,534	327,965
Provision for inventory obsolescence	222	(11,150)
(Gain) on disposition of investments	-	(188)
Contributions of property, inventory and investments	(221,878)	(22,491)
(Increase) decrease in contributions receivable	92,890	(2,885)
(Increase) decrease in inventory	(106,731)	12,922
(Increase) in prepaid expenses	(139,574)	(31,181)
(Increase) in other assets	(5,432)	-
Increase (decrease) in accounts payable	91,612	(7,269)
Increase (decrease) in accrued expenses	(3,620)	916
Increase in deferred revenue	7,200	-
Net cash provided by operating activities	342,675	452,722
Cash flows from investing activities:		
Purchase of property and equipment	(3,177,003)	(336,958)
Proceeds from sales of investments and vehicles	172,841	15,136
Net cash (used) by investing activities	(3,004,162)	(321,822)
Cash flows from financing activities:		
Repayments of capital lease obligation	-	(17,982)
Proceeds from issuance of notes payable	2,355,257	-
Repayments of notes payable	(76,372)	(20,341)
Net cash provided (used) by financing activities	2,278,885	(38,323)
Net increase (decrease) in cash and cash equivalents	(382,602)	92,577
Cash and cash equivalents-beginning of year	572,794	480,217
Cash and cash equivalents-end of year	190,192	572,794

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

1. Organization and Significant Accounting Policies

Organization

Mercy Ministries of America, Inc. (the Ministry) is a nonprofit organization whose purpose is to transform lives of young women, ages 13 through 28, 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 and are provided adoption services, parental skills training, and other instruction to lead a productive and self-sufficient life. Residential facilities provide a home for the young women free of charge where counseling addresses the whole person: spiritual, physical and emotional. The Ministry reaches worldwide, providing resources and speaking engagements to minister the life-transforming power of God's unconditional love.

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 the founder and president of the Ministry and 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 $2,000. 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 various program services and supporting activities of the Ministry have been summarized on a functional basis in accordance with the *Statement of Financial Accounting Standard* (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Accordingly, certain expenses have been allocated among programming, fundraising, and general and management expenses.

Program expenses consist of the activities that promote the Ministry's vision, including the operation of the residential program, counseling services, Christian education, publication and media that spread the Ministry's mission; and other activities that fulfill the purpose for which the Ministry exists.

Fundraising expenses derive from those activities to promote contributions, gifts, grants, etc., including conducting fundraising campaigns and events, maintaining donor information, distributing fundraising materials, and conducting other activities involved with facilitating contributions.

Management and general expenses include oversight, business management, and finance activities. These expenses are not identifiable with program or fundraising activities, but are indispensable to the conduct of those activities and to the organization's existence.

In accordance with the American Institute of Certified Public Accountants' Statement of Position 98-2, "*Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund-Raising*" (SOP 98-2), the Ministry's policy is to report all joint costs, as defined by SOP 98-2, not specifically attributable to particular components of the activities, as allocated among program, general and management, and fundraising expenses.

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.

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.

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

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 2006 amounts have been reclassified to conform to the December 31, 2007 presentation.

2. **Cash and Cash Equivalents**

At December 31, 2007 and 2006, the Ministry maintained cash in a local financial institution in excess of federal deposit insurance limits of $60,677 and $311,492, respectively.

3. **Inventory**

Inventory by major classifications as of December 31, 2007 and 2006 is as follows:

	2007	2006
Finished goods	196,507	89,777
Allowance for obsolete inventory	(15,814)	(15,592)
	180,693	74,185

4. **Property and Equipment**

A summary of property and equipment net of related accumulated depreciation by location at December 31, 2007 and 2006 follows:

	2007	2006
Monroe, LA home	193,963	183,481
Nashville, TN home	1,257,885	1,262,065
St. Louis, MO home	3,027,098	3,124,116
Florida home	1,515,883	-
Corporate Office-Nashville, TN	1,917,995	2,004,575
	7,912,824	6,574,237

The Ministry purchased approximately 11.75 acres of undeveloped property in Florida in 2007. It is the intention of the Ministry to use approximately half of the acreage as the site of a new home for girls. This portion of the property is included in property and equipment.

5. **Investments**

Investment return for the years ended December 31, 2007 and 2006 consisted of the following:

	2007	2006
Realized gain (loss)	661	(216)

The Ministry purchased approximately 11.75 acres of undeveloped property in Florida in 2007. It is the intention of the Ministry to sell approximately half of the acreage and use the remainder as the site of a home for girls. The portion of the property expected to be sold at a future date is included in long-term investments.

6. **Promise to Give**

Accrued expenses include an unconditional promise to give of $11,900 at December 31, 2007 and 2006, 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, 2007 and 2006:

	2007	2006
Note payable to a finance company for insurance, payable in monthly installments of $9,131, including interest at a rate of 11.5%, maturing April 2008.	26,894	23,009
Note payable Suntrust Bank for Florida property; accrued interest only paid monthly equal to 30-day LIBOR, plus 120 basis points per anum. On Sept. 18, 2008, principal is due in the amount of $775,000. The remaining balance of $1,500,000 is due Sept. 18, 2009.	2,275,000	-
	2,301,894	23,009
Less-current portion	(801,894)	(23,009)
Long-term portion	1,500,000	-

The Ministry has access to a line of credit in the amount of $250,000, which will expire on August 15, 2008.

8. **Deferred Revenue**

The Ministry received advanced payment of $7,200 in 2007 for books that will be available in 2008.

9. **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.

10. **Operating Lease Commitment**

The Ministry leased office equipment and apartments under operating lease agreements. Total lease payments for these leases were $5,676 and $24,367 in 2007 and 2006, respectively. The Ministry's leases on the apartments terminated in 2006 and were not renewed.

Future minimum lease commitments are as follows:

Year Ending December 31,	
2008	5,738
2009	5,738
2010	5,738
2011	5,738
2012	2,869
	25,821

11. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31, 2007 and 2006:

	2007	2006
Transitional care	6,580	47,498
Enhancements for education/classroom	1,068	2,905
Third floor addition	-	47,213
Christmas gifts	-	23,604
Care for girls in the Northwest area	-	35,255
St. Louis facility and operations	-	140,189
Nashville facility	-	5,279
Houston facility	5,900	5,900
Monroe facility	-	31,930
Northern California facility	134,359	97,281
Oklahoma facility	-	10,000
Monroe building project	130	-
Kitchen fund	-	390
Monroe graduates	1,500	1,750
Research for former residents	6,500	-
Bibles	167	-
Florida property	32,893	-
	189,097	449,194

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, 2007 and 2006:

	2007	2006
Purpose restrictions accomplished:		
Transitional care	66,637	5,886
Adoption expenses	400	-
Classroom enhancements	1,838	-
Care for girls in the Northwest	35,255	-
St. Louis facility	462,060	652,590
Northern California facility	17,860	25,612
Monroe facility	78,569	-
Nashville facility	28,170	-
Christmas gifts	238,268	30,343
Monroe graduates	250	250
Third floor addition	66,682	435,312
Kitchen fund	390	-
Florida Land 07	751,082	-
25th anniversary	1,000	-
Bibles	133	-
Website development	40,000	-
Total restrictions released	1,788,594	1,149,993

13. Supplemental Cash Flow Disclosures

Operating activities reflect interest paid in the amounts of $4,645 and $2,075 for the years ending December 31, 2007 and 2006, respectively. Capitalized interest totaled $41,732 for the year ended December 31, 2007.

The Ministry received noncash contributions of equity securities totaling $221,878 and $16,516 during 2007 and 2006, respectively.

During 2007 and 2006, the Ministry received and distributed donated materials totaling $95,500 and $69,323, respectively.

During 2007 and 2006, the Ministry received donated equipment and vehicles in the amount of $27,100 and $5,975, respectively.

14. 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 2007 and 2006, $135 and $869 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 $798 and $1,349 during the years 2007 and 2006.

15. Related Party Transactions

Members of the Board of Trustees regularly contribute to the Ministry. For the years ended December 31, 2007 and 2006, contributions from related parties totaled $356,923 and $85,710, respectively.

In 2007, the Ministry funded in part the global development of Mercy Ministries. In addition, the Ministry received contributions in the amount of $148,812 for global development and expended approximately $400,377 toward international efforts. As a result, in January 2008, Mercy Ministries International, Inc. has been created as its own 501(c)(3).

16. 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 Ministry shall remain a Christian-based residential facility for troubled girls and unwed mothers.

(2) The current President of the Ministry shall remain in that position.

17. Restated

The 2006 functional expenses were restated to conform to the 2007 allocation. Total expenses did not change for 2006.