Audited Financial Statements

Mercy Ministries of America, Inc.

December 31, 2005 and 2004

MERCY MINISTRIES OF AMERICA, INC.

Audited Financial Statements

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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, 2005 and 2004, 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, 2005 and 2004, 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 19, 2006

MERCY MINISTRIES OF AMERICA, INC.

Statements of Financial Position

December 31, 2005 and 2004

	2005	2004
Current assets:		
Cash and cash equivalents (note 2)	$ 480,217	448,751
Accounts receivable	-	3,638
Contributions receivable, no allowance necessary	251,038	316,551
Inventory, (note 3)	75,957	88,621
Prepaid expenses	44,346	36,013
Total current assets	851,558	893,574
Property and equipment, net of accumulated depreciation and amortization (notes 4, 7 and 8)	6,559,632	5,683,035
Other assets	765	8,265
	$7,411,955	6,584,874
Current liabilities:		
Accounts payable	$ 65,680	75,938
Accrued expenses (note 6)	35,013	54,704
Current portion of notes payable (note 7)	31,110	50,836
Current portion of capital lease obligation (note 8)	17,982	-
Total current liabilities	149,785	181,478
Long-term portion of notes payable (note 7)	12,239	292,744
	162,024	474,222
Commitments and contingencies (notes 9 and 15)		
Net assets:		
Unrestricted	6,801,119	5,566,591
Temporarily restricted (note 10)	448,812	544,061
Total net assets	7,249,931	6,110,652
	$7,411,955	6,584,874

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Activities

Years Ended December 31, 2005 and 2004

	2005			2004		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues, gains and other support:						
Received directly - contributions	$4,779,756	647,942	5,427,698	3,901,355	560,665	4,462,020
Special events, net of expenses of $1,065 and $4,511 in 2005 and 2004, respectively	85,031	-	85,031	46,697	-	46,697
Adoption application fees	4,850	-	4,850	6,175	-	6,175
Book sales	20,407	-	20,407	21,804	-	21,804
Teaching tape ministry	7,857	-	7,857	7,625	-	7,625
Royalties	24,640	-	24,640	6,378	-	6,378
Girls of Grace event	114,485	-	114,485	-	-	-
Other income	79,879	-	79,879	31,745	-	31,745
Total revenues and gains	5,116,905	647,942	5,764,847	4,021,779	560,665	4,582,444
Net assets released from restrictions:						
Satisfaction of program restrictions (note 11)	743,191	(743,191)	-	123,944	(123,944)	-
Total revenue, gains and other support	5,860,096	(95,249)	5,764,847	4,145,723	436,721	4,582,444
Expenses and losses:						
Counseling and support	3,488,676	-	3,488,676	2,838,952	-	2,838,952
Management and general	1,047,136	-	1,047,136	836,453	-	836,453
Fundraising	89,756	-	89,756	56,049	-	56,049
Total expenses and losses	4,625,568	-	4,625,568	3,731,454	-	3,731,454
Change in net assets	1,234,528	(95,249)	1,139,279	414,269	436,721	850,990
Net assets, beginning of year	5,566,591	544,061	6,110,652	5,152,322	107,340	5,259,662
Net assets, end of year	$6,801,119	448,812	7,249,931	5,566,591	544,061	6,110,652

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Functional Expenses

Years Ended December 31, 2005 and 2004

	2005				2004			
	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	$1,446,444	347,493	50,810	1,844,747	1,327,361	228,571	27,572	1,583,504
Contract labor	43,571	5,246	-	48,817	4,973	1,658	-	6,631
Payroll taxes	99,710	23,566	2,664	125,940	99,644	7,986	2,109	109,739
Total salaries and related expenses	1,589,725	376,305	53,474	2,019,504	1,431,978	238,215	29,681	1,699,874
Contributions	305,848	-	-	305,848	415,874	-	-	415,874
Bad debts	-	23,469	-	23,469	-	-	-	-
Professional fees	8,683	66,320	-	75,003	5,392	62,147	-	67,539
Advertising and public relations	1,526	31,338	-	32,864	4,805	38,929	-	43,734
Automobile	24,239	10,684	-	34,923	15,857	6,573	-	22,430
Books, tapes and videos	14,139	40,489	12,865	67,493	8,438	38,950	16,129	63,517
Dues and subscriptions	5,967	6,007	-	11,974	3,225	5,322	-	8,547
Educational	11,677	1,574	-	13,251	2,205	1,520	-	3,725
Travel, conferences, and meetings	64,266	37,174	5,706	107,146	48,611	36,722	5,462	90,795
Room and board	341,220	29,500	-	370,720	278,297	28,800	-	307,097
Insurance	199,070	91,534	-	290,604	182,660	46,720	-	229,380
Medical	10,603	-	-	10,603	3,246	-	-	3,246
Mail out services	34,356	8,211	7,340	49,907	47,623	15,874	-	63,497
Office	27,145	59,141	-	86,286	25,250	65,689	-	90,939
Postage	40,479	39,954	-	80,433	31,665	22,819	-	54,484
Repairs and maintenance	14,271	2,304	-	16,575	18,186	1,491	-	19,677
Occupancy	-	12,820	-	12,820	-	8,122	-	8,122
Telephone	32,645	17,324	469	50,438	24,640	19,754	577	44,971
Utilities	70,602	21,554	-	92,156	55,515	15,827	-	71,342
Miscellaneous	39,575	70,946	-	110,521	11,614	43,707	-	55,321
Newsletter	31,050	25,704	9,902	66,656	52,140	48,733	4,200	105,073
Loss on disposition of investments	-	234	-	234	-	560	-	560
Girls of Grace event	413,878	-	-	413,878	-	-	-	-
Interest	-	5,313	-	5,313	-	32,735	-	32,735
Total expenses and losses before depreciation and amortization	3,280,964	977,899	89,756	4,348,619	2,667,221	779,209	56,049	3,502,479
Depreciation and amortization	207,712	69,237	-	276,949	171,731	57,244	-	228,975
Total expenses and losses	$3,488,676	1,047,136	89,756	4,625,568	2,838,952	836,453	56,049	3,731,454

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Statements of Cash Flows

Years Ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Change in net assets	$1,139,279	850,990
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	276,949	228,975
Provision for inventory obsolescence	(6,305)	33,047
Bad debts expense	23,469	-
Loss on disposition of investments	234	560
Contributions of property, inventory and investments	(741,477)	(176,223)
(Increase) decrease in accounts receivable	(19,831)	2,284
(Increase) decrease in contributions receivable	65,513	(210,332)
(Increase) decrease in inventory	18,969	(13,130)
Decrease in prepaid expenses	29,276	53,107
Decrease in other assets	7,500	1,000
Decrease in accounts payable	(10,258)	(14,706)
Increase (decrease) in accrued expenses	(19,691)	40,123
Net cash provided by operating activities	763,627	795,695
Cash flows from investing activities:		
Purchase of property and equipment	(398,783)	(130,415)
Proceeds from sales of investments	15,380	78,819
Net cash used in investing activities	(383,403)	(51,596)
Cash flows from financing activities:		
Repayments of capital lease obligation	(10,918)	(3,085)
Activity for line of credit, net	-	(545,857)
Proceeds from notes payable	-	529,365
Repayments of notes payable	(337,840)	(261,867)
Net cash used in financing activities	(348,758)	(281,444)
Net increase in cash and cash equivalents	31,466	462,655
Cash and cash equivalents (overdraft) at beginning of year	448,751	(13,904)
Cash and cash equivalents at end of year	$ 480,217	448,751

See accompanying notes to financial statements.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements

December 31, 2005 and 2004

(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, 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.

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, 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, 2005 and 2004

(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 the 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 2004 amounts have been reclassified to conform to the December 31, 2005 presentation.

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2005 and 2004

(2) Cash and Cash Equivalents

At December 31, 2005 and 2004, the Ministry maintained cash in a local financial institution in excess of federal deposit insurance limits of $394,005 and $367,643, respectively.

(3) Inventory

Inventory by major classifications as of December 31, 2005 and 2004 is as follows:

	2005	2004
Finished goods	$ 102,699	121,668
Allowance for obsolete inventory	(26,742)	(33,047)
	$ 75,957	88,621

(4) Property and Equipment

A summary of property and equipment at December 31, 2005 and 2004 follows:

	2005	2004
Land	$1,055,281	1,055,281
Buildings	5,649,034	4,643,201
Building improvements	206,305	202,808
Automobiles	271,361	218,831
Office equipment	398,558	269,058
Furniture and fixtures	1,031,282	760,151
Construction in progress	-	308,945
	8,611,821	7,458,275
Less accumulated depreciation and amortization	2,052,189	1,775,240
	$6,559,632	5,683,035

(5) Investments

Investment return for the years ended December 31, 2005 and 2004 consisted of the following:

	2005	2004
Realized loss	$ 234	560

(6) Promise to Give

Accrued expenses include an unconditional promise to give of $11,900 and $31,700 at December 31, 2005 and 2004 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, 2005 and 2004:

	2005	2004
Note payable to a finance company, payable in monthly installments of $3,441, including interest at a rate of 7.25%, maturing July 2006. This note is unsecured.	$ 23,516	17,577
Note payable to financial institution, payable in monthly installments of $4,656 beginning March 2004, including interest at a rate of 7.5%, maturing February 2020. This note was secured by a mortgage on the corporate office and Nashville home. The note was paid off in February 2005.	-	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. This note was paid off in February 2006.	19,833	27,003
	43,349	343,580
Current portion	(31,110)	(50,836)
Long-term portion	$ 12,239	292,744

Future scheduled maturities of notes payable are as follows:

Year ending December 31,	
2006	$ 31,110
2007	8,042
2008	4,197
	$ 43,349

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2005 and 2004

(8) Capital Lease Obligation

The Ministry leased equipment with a book value of $27,940 net of accumulated depreciation of $960.

Future minimum lease payments are as follows:

Year ending December 31,	
2006	$11,560
2007	9,071
	20,631
Less amount representing interest	2,649
	$17,982

The Ministry has the option to dispose of the lease by paying the face amount within nine months of the leases inception after which, the Ministry retains 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 leases office equipment and an apartment in St. Louis under operating lease agreements. Total lease payments for these leases were $15,490 and $13,798 in 2005 and 2004, respectively. The Ministry's lease on the apartment terminated in 2005 and was not renewed.

Future minimum lease commitments are as follows:

Year ending December 31,	
2006	$ 5,676
2007	5,676
2008	3,784
	$15,136

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2005 and 2004

(10) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31, 2005 and 2004:

	2005	2004
Enhancements for education/classroom	$ 2,905	38,010
Care for Middle Tennessee residents	-	7,333
Christmas gifts	-	22,574
Care for girls in the Northwest area	35,255	35,255
St. Louis facility and operations	364,430	424,989
Houston facility	5,900	5,900
Northern California facility	30,322	-
Oklahoma facility	10,000	10,000
	$448,812	544,061

(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, 2005 and 2004:

	2005	2004
Purpose restrictions accomplished:		
Adoption expenses	$ 1,500	10,924
Classroom enhancements	35,105	11,745
Care for Middle Tennessee residents	7,333	667
St. Louis facility	606,124	76,686
Northern California facility	677	-
Care for Texas residents	5,000	-
Monroe facility	4,458	-
Nashville facility	20,000	-
Christmas gifts	62,994	23,922
Total restrictions released	$743,191	123,944

MERCY MINISTRIES OF AMERICA, INC.

Notes to Financial Statements (Continued)

December 31, 2005 and 2004

(12) Supplemental Cash Flow Disclosures

Operating activities reflect interest paid in the amounts of $5,313 and $32,735 for the years ending December 31, 2005 and 2004, respectively.

The Ministry received non-cash contributions of equity securities totaling $15,614 and $79,379 during 2005 and 2004, respectively.

During 2005 and 2004, the Ministry received and distributed donated materials totaling $52,379 and $35,453, respectively.

During 2005 and 2004, the Ministry prepaid expenses in the amount of $37,609 and $45,441, respectively, by incurring a note payable.

During 2005 and 2004, the Ministry received non-cash contribution of construction related to the renovation of the St. Louis facility in the amount of $692,063 and $96,844 respectively.

The Ministry acquired equipment under a capital lease obligation, in the amount of $28,900.

During 2005, the Ministry received donated equipment in the amount of $33,800.

(13) Royalty Income

The Ministry receives royalties on a recorded compilation titled "The Mercy Project" in which no formal agreement exists with the publisher.

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.

(14) Related Party Transactions

Members of the Board of Trustees regularly contribute to the Ministry. For the years ended December 31, 2005 and 2004, contributions from related parties totaled $105,831 and $102,913, 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 non-profit entity contributed $788,907 in funds to renovate this location during 2005 and 2004.

There are 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.