MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC. AND AFFILIATES

BEREA, KENTUCKY

CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

April 30, 2007 and 2006

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
BEREA, KENTUCKY

C O N T E N T S

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Mountain Association for Community Economic
Development, Inc.
Berea, Kentucky

We have audited the accompanying consolidated statements of financial position of Mountain Association for Community Economic Development, Inc. and Affiliates as of April 30, 2007 and 2006, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain Association for Community Economic Development, Inc. and Affiliates as of April 30, 2007 and 2006 and the results of their operations and their 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 August 7, 2007 on our consideration of Mountain Association for Community Economic Development, Inc. and Affiliates' internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 audits.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of Mountain Association for Community Economic Development, Inc. and Affiliates taken as a whole. The accompanying Consolidated Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Potter & Company, LLP

POTTER & COMPANY, LLP
August 7, 2007

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
April 30, 2007 and 2006

ASSETS

	2007	2006
Current assets:		
Cash and cash equivalents	$ 2,517,186	$ 2,289,142
Current portion of loans receivable, net of allowance for bad debts of $128,935 and $82,670	1,517,641	1,340,665
Accounts receivable	73,499	66,830
Grants receivable	630,186	489,494
Prepaid expenses	6,791	9,213
Total current assets	4,745,303	4,195,344
Property and equipment, net	505,993	428,152
Other assets:		
Investments	232,550	564,943
Loans receivable, net of allowance for bad debts of $410,922 and $302,659	4,942,990	5,328,157
Total other assets	5,175,540	5,893,100
Total assets	$ 10,426,836	$ 10,516,596

LIABILITIES AND NET ASSETS

	2007	2006
Current liabilities:		
Current portion notes payable	$ 215,582	$ 224,987
Accounts payable and accrued expenses	166,303	590,868
Total current liabilities	381,885	815,855
Long-term liabilities:		
Notes payable, less current portion	4,737,724	4,159,686
Subordinated loans payable	700,000	700,000
Total long-term liabilities	5,437,724	4,859,686
Total liabilities	5,819,609	5,675,541
Commitments and contingencies		
Net assets:		
Unrestricted:		
Operating	1,550,467	1,235,206
Board designated	20,000	20,000
Total unrestricted net assets	1,570,467	1,255,206
Temporarily restricted	3,036,760	3,585,849
Total net assets	4,607,227	4,841,055
Total liabilities and net assets	$ 10,426,836	$ 10,516,596

See accompanying notes.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Year ended April 30, 2007

	Unrestricted	Temporarily Restricted	Total
Revenues and other support:			
Grants	$ 155,500	$ 1,143,667	$ 1,299,167
Project and fee income	62,527	7,408	69,935
Interest and dividend income	354,782	208,967	563,749
Rental income	16,940		16,940
Other	14,547	4,587	19,134
Realized gain on investments	22,858		22,858
Net assets released from restriction:			
Satisfaction of program restrictions	1,675,218	(1,675,218)	0
Total revenues and other support	2,302,372	(310,589)	1,991,783
Expenses:			
Salaries and wages	672,936		672,936
Payroll taxes and fringe benefits	182,783		182,783
Professional services	236,497		236,497
Office and computer supplies	30,078		30,078
Travel	45,795		45,795
Rent and utilities	16,060		16,060
Insurance	9,448		9,448
Postage	4,857		4,857
Duplication and printing	79,627		79,627
Telephone	16,447		16,447
Data services	22,529		22,529
Maintenance and equipment	44,449		44,449
Miscellaneous	17,738		17,738
Meetings, registration and training	24,689		24,689
Publications and subscriptions	12,913		12,913
Depreciation	44,981		44,981
Grants	75,100		75,100
Tax and license	6,906		6,906
Interest	62,994		62,994
Bad debt expense	380,284		380,284
Total expenses	1,987,111	0	1,987,111
Unrealized loss on impairment of investments		(238,500)	(238,500)
Change in net assets	315,261	(549,089)	(233,828)
Net assets at beginning of year	1,255,206	3,585,849	4,841,055
Net assets at end of year	$ 1,570,467	$ 3,036,760	$ 4,607,227

See accompanying notes.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
Year ended April 30, 2006

	Unrestricted	Temporarily Restricted	Total
Revenues and other support:			
Grants	$ 1,264	$ 1,268,787	$ 1,270,051
Project and fee income	66,601	6,003	72,604
Interest and dividend income	249,032	151,617	400,649
Rental income	23,738		23,738
Other	17,089		17,089
Realized gain on investments	24,583		24,583
Realized loss on sale of property	(753)		(753)
Net assets released from restriction:			
Satisfaction of program restrictions	925,500	(925,500)	0
Total revenues and other support	1,307,054	500,907	1,807,961
Expenses:			
Salaries and wages	466,733		466,733
Payroll taxes and fringe benefits	119,557		119,557
Professional services	111,217		111,217
Office and computer supplies	15,745		15,745
Travel	41,083		41,083
Rent and utilities	17,453		17,453
Insurance	7,842		7,842
Postage	3,728		3,728
Duplication and printing	10,606		10,606
Telephone	13,714		13,714
Data services	15,545		15,545
Maintenance and equipment	28,987		28,987
Miscellaneous	6,209		6,209
Meetings, registration and training	8,653		8,653
Publications and subscriptions	5,663		5,663
Depreciation	45,318		45,318
Grants	170		170
Tax and license	9,226		9,226
Interest	38,182		38,182
Bad debt expense	179,582		179,582
Total expenses	1,145,213	0	1,145,213
Change in net assets	161,841	500,907	662,748
Net assets, beginning of year, as restated	1,093,365	3,084,942	4,178,307
Net assets, end of year	$ 1,255,206	$ 3,585,849	$ 4,841,055

See accompanying notes.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended April 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Change in net assets	$ (233,828)	$ 662,748
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	44,981	45,318
Bad debt expense	380,284	179,582
Loss on impairment of investments	238,500	0
Realized gain on investments	(22,858)	(24,583)
Realized loss on sale of property	0	753
Changes in operating assets and liabilities:		
Accounts receivable	(6,669)	(11,022)
Grants receivable	(140,692)	(162,939)
Prepaid expenses	2,422	(316)
Accounts payable and accrued expenses	(424,565)	485,604
Net cash provided by (used in) operating activities	(162,425)	1,175,145
Cash flows from investing activities:		
Proceeds from sales of investments	116,751	52,083
Purchase of investments	0	(7,143)
Purchase of property and equipment	(122,824)	(5,139)
Proceeds from sales of property and equipment	0	50,412
Loans to other entities	(2,231,364)	(3,735,098)
Principal collections on loans receivable	2,059,273	1,681,334
Net cash used in investing activities	(178,164)	(1,963,551)
Cash flows from financing activities:		
Proceeds from notes payable, net	768,000	1,260,688
Principal payments on notes payable	(199,367)	(151,903)
Net cash provided by financing activities	568,633	1,108,785
Net increase in cash and cash equivalents	228,044	320,379
Cash and cash equivalents at beginning of year	2,289,142	1,968,763
Cash and cash equivalents at end of year	$ 2,517,186	$ 2,289,142

Supplemental disclosure of cash flow information:

Cash paid during the year for interest	$ 61,712	$ 38,965

See accompanying notes.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of Mountain Association for Community Economic Development, Inc. and Affiliates ("MACED") is presented to assist in understanding MACED's consolidated financial statements. The consolidated financial statements and notes are representations of MACED's management who is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the consolidated financial statements.

Consolidation and Nature of Activities:

The consolidated financial statements of MACED include the accounts of Mountain Association for Community Economic Development, Inc., its wholly owned subsidiary, Ridgecrest Enterprises, Inc. ("Ridgecrest") and its affiliate under common control, Appalachian Investment Corporation ("AIC"). Mountain Association for Community Economic Development, Inc. was founded in 1976 as a private, nonprofit corporation organized to provide comprehensive community development support to Appalachian communities by enhancing employment and living conditions in the area. MACED's major programs consist of business development, sustainable forestry, and public policy research and education. MACED generates revenue primarily through assistance provided by federal, state, and private grants; and program service revenue.

Ridgecrest was organized by Mountain Association for Community Economic Development, Inc. as a for-profit corporation to assist Mountain Association for Community Economic Development, Inc. in its economic development activities. All significant inter-company accounts and transactions have been eliminated in consolidation.

AIC was established as a nonprofit organization to provide financing for the expansion and development of small businesses in eastern Kentucky. AIC obtains federal funding from the United States Department of Agriculture, Rural Business-Cooperative Service, through an Intermediary Relending Program ("IRP"), whereby they administer various loans that are made to qualified ultimate recipients. All relending activity is subject to formal approval by Rural Development. All significant inter-company accounts and transactions have been eliminated in consolidation.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Accounting:

The consolidated financial statements of MACED have been prepared on the accrual method of accounting. Accordingly, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Governmental grant awards are deemed to be earned and reported as grant revenues when MACED has incurred expenses in compliance with the specific restrictions of the applicable grants. Expenses incurred for which grant funds have not been received are reported as grants receivable, while grant funds received but not yet earned are reported as deferred grant revenue.

Non-governmental grant awards are deemed to be earned and reported as grant revenues once all conditions for an award have been met. If grant funds have not been received once conditions are met, MACED reports the present value of the grant award as a receivable.

Financial Statement Presentation:

The consolidated financial statements are presented in accordance with Statement of Financial Accounting Standard No. 117, "*Financial Statements of Not-For-Profit Organizations*". Under the provisions set forth therein, net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions as follows:

- Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations, and used for various program expenses and general operating functions.

- Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that can be fulfilled by actions of MACED pursuant to those stipulations or that expire by the passage of time.

- Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by MACED. At April 30, 2007 and 2006, MACED had no assets that were permanently restricted.

Use of Estimates:

Management uses estimates and assumptions in preparing the consolidated financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and reported revenues and expenses. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the determination of the valuation allowance for loan losses.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents:

For the purposes of the Consolidated Statements of Cash Flows, MACED considers cash and certificates of deposits with no prepayment penalty or with original maturities of three months or less to be cash equivalents.

Pursuant to its agreement with U.S. Small Business Administration (SBA, see discussion at Note 5), MACED is required to maintain separate bank accounts, Loan Loss Reserve Fund and Microloan Revolving Fund, for activities pertaining to SBA loans. Pursuant to its agreement with the Ford Foundation, MACED is required to maintain a separate bank account, Payday Lending Loan Fund, to deposit the proceeds of the grant.

Loans Receivable:

Loans receivable are executed by MACED based on a recipient's financial need. Generally real estate and various types of personal property collateralize the loans. Losses are provided for in the financial statements based upon management's evaluation of the recipient's ability to pay relative to current economic conditions. MACED has concentrations of loans receivable with certain privately owned businesses, all in Eastern Kentucky. The loans bear interest at various rates ranging up to 13 percent.

Investments:

Investment income and gains restricted by donors are reported as increases in unrestricted net assets if the restrictions are met (either a stipulated time period ends or a purpose restriction is accomplished) in the reporting period in which the income and gains are recognized. MACED's investments are carried at lower of cost or market value. Dividends are recognized in the statement of activities during the period they are earned.

Property and Equipment:

Property and equipment acquired is stated at cost. Depreciation is provided for using the straight-line method over the estimated useful lives of the respective assets, which range from 3 to 31 years. Acquisitions of property and equipment in excess of $1,000 are capitalized. The cost of repairs and maintenance is expensed as incurred.

Contributions:

Contributions, including unconditional promises to give, are recognized as revenues in the period received and are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and nature of any donor restrictions. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Restricted contributions whose restrictions are satisfied in the period the contributions are received are reported as unrestricted contributions. Restricted net assets are reclassified to unrestricted net assets upon satisfaction of the time or purpose restriction.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes:

MACED has been determined to qualify as a tax-exempt organization by the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code as a nonprofit organization other than a private foundation. AIC has been granted tax-exempt status by the Internal Revenue Service under section 501(c)(4) of the Internal Revenue Code. Ridgecrest is a for-profit company and recognizes federal and state income tax expense based on enacted rates currently applicable. Accordingly, the accompanying consolidated financial statements reflect income tax expense only to the extent that Ridgecrest has generated taxable income.

NOTE 2 - FUNCTIONAL EXPENSES

Expenses by functional classification for the years ended April 30, 2007 and 2006 are as follows:

		2007		2006
Program expenses	$	1,590,701	$	789,682
Fundraising		22,369		15,310
Support expenses		377,641		340,221
Total expenses	$	1,990,711	$	1,145,213

NOTE 3 - LOANS RECEIVABLE

At April 30, 2007 and 2006, loans receivable consist of current amounts of $1,646,576 and $1,423,335 and noncurrent amounts of $5,353,912 and $5,630,816, respectively.

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal adjusted by any charge-offs, and the allowance for loan losses. Interest on loans is recognized over the term of the loan and is calculated using the simple-interest method on principal amounts outstanding.

Loan origination fees are considered immaterial in amount and are recognized as income in the year collected.

Interest income is accrued on loan balances outstanding. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection.

NOTE 3 - LOANS RECEIVABLE (CONTINUED)

Loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal and interest is considered doubtful. When a loan is placed on non-accrual status, any uncollected interest in the current year is charged against current income. Subsequent interest on non-accrual loans is recognized as income only when collected, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans receivable at April 30, 2007 and 2006 consist of the following:

	2007	2006
Loans receivable	$ 7,000,488	$ 7,054,151
Allowance for loan losses	(539,857)	(385,329)
Loans receivable, net	$ 6,460,631	$ 6,668,822

Loans serving as collateral on notes payable amounted to approximately $2,700,000 and $2,900,000 at April 30, 2007 and 2006, respectively.

Accrued interest receivable amounted to approximately $29,267 and $32,974 at April 30, 2007 and 2006, respectively.

Non-accrual loans totaled $132,578 and $204,719, respectively, at April 30, 2007 and 2006.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectibility of a loan balance is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. It is reasonably possible that a change in the estimates will occur in the near term.

NOTE 3 - LOANS RECEIVABLE (CONTINUED)

A loan is considered to be impaired when, based on current information and events, it is probable that MACED will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

The following is an analysis of the allowance for loan losses for the years ended April 30, 2007 and 2006:

	2007	2006
Beginning balance	$ 385,329	$ 361,773
Provision charged to operations	380,284	179,582
Charge-offs	(227,220)	(157,674)
Recoveries	1,464	1,648
Ending balance	$ 539,857	$ 385,329

NOTE 3 - LOANS RECEIVABLE (CONTINUED)

The following is a summary of information pertaining to impaired loans at April 30, 2007 and 2006:

		2007		2006
Impaired loans with a valuation allowance	$	274,413	$	198,167
Valuation allowance related to impaired loans	$	135,623	$	50,995
Average investment in impaired loans	$	15,245	$	22,019
Interest income recognized on impaired loans	$	7,128	$	5,880
Interest income recognized on a cash basis on impaired loans	$	8,563	$	5,880

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows at April 30, 2007 and 2006:

		2007		2006
Land	$	40,000	$	40,000
Buildings and improvements		615,688		581,582
Equipment		116,536		105,115
Automobiles		53,590		41,965
Construction in progress		47,310		0
		873,124		768,662
Less accumulated depreciation		367,131		340,510
Property and equipment, net	$	505,993	$	428,152

NOTE 5 - GRANTS RECEIVABLE

Grants receivable consist of the following at April 30, 2007 and 2006:

		2007		2006
Federal grants receivable:				
Small Business Administration	$	14,326	$	29,415
USDA Rural Development (RBEG)		20,893		53,185
Local Initiative Support Corp.		7,783		1,894
Kentucky Division of Water		2,184		0
Total federal grants receivable		45,186		84,494
Other grants receivable:				
Grant Foundation		0		35,000
Blue Moon		0		70,000
Ford Foundation		222,500		150,000
F. B. Heron Foundation		75,000		0
New York Community Trust		0		37,500
Mary Reynolds Babcock Foundation		137,500		112,500
Cedar Tree		150,000		0
Total other grants receivable		585,000		405,000
Total grants receivable	$	630,186	$	489,494

NOTE 6 - INVESTMENTS

The total amount of all cost method investments for MACED was $232,550 and $564,943 at April 30, 2007 and 2006. During the year ended April 30, 2007 MACED sold $93,893 of its investments and recognized a gain of $22,858.

All cost method investments were evaluated for impairment at April 30, 2007. During the year ended April 30, 2007 MACED recognized an impairment loss on two equity investments. Investments of $140,000 and $125,000 were made in fiscal years 2003 and 2004 respectively, using restricted grant funds from the Appalachian Regional Commission. The purpose of the investments was to promote community economic development in West Virginia as part of MACED's business development program activities. Both businesses have had significant losses over a period of several years and are now in a negative equity position. In its annual review of equity investments, MACED management determined that an appropriate valuation would be ten percent of the cost of the investments. Total impairment loss for fiscal year 2007 was $238,500.

NOTE 7 - NOTES PAYABLE

Notes payable consist of the following at April 30, 2007 and 2006:

	2007	2006
Due to Farmers Home Association, semi-annual installments of $10,000 plus interest at one percent until maturity in September, 2010, unsecured.	$ 59,850	$ 80,000
IRP #1 - USDA (August, 1994), collateralized by all assets of AIC derived from the loans and essentially all assets of the respective ultimate recipients. Interest per annum at one percent. Annual payments of $53,063 due in August. The note matures in August, 2024.	869,061	912,276
IRP #2 - USDA (August, 1996), collateralized by all assets of AIC derived from the loans and essentially all assets of the respective ultimate recipients. Interest per annum at one percent. Annual payments of $31,838 due in August. The note matures in August, 2026.	574,242	599,949
IRP #3 - USDA (August, 2000), collateralized by all assets of AIC derived from the loans and essentially all assets of the respective ultimate recipients. Interest per annum at one percent. Annual payments of $31,838 due in August. The note matures in August, 2030.	676,221	700,612
IRP #4 - USDA (April, 2003), collateralized by all assets of AIC derived from the loans and essentially all assets of the respective ultimate recipients. Interest per annum at one percent. Annual payments of $31,834 due in April. The note matures in April, 2033.	725,306	631,996
Appalachian Development Alliance, quarterly interest-only payments at two percent until maturity in June 2008, collateralized by a $50,000 certificate of deposit.	125,000	125,000
Community Trust Bank (November 2004), annual interest-only payments at one percent until maturity in November 2011, unsecured.	350,000	350,000

NOTE 7 - NOTES PAYABLE (CONTINUED)

	2007	2006
U.S. Small Business Administration (September 2004), collateralized by all assets derived from loans made with proceeds, and with funds on deposit at Peoples Bank in MACED's SBA Loan Loss Reserve Fund and Microloan Revolving Fund. Interest at 2.5 percent. Monthly payments of $2,544. Amortization schedule for years two through ten based on 1.75 percent interest plus payments for first year interest. Balance due at maturity in September 2014.	208,521	234,840
U.S. Small Business Administration (August 2005), collateralized by all assets derived from loans made with proceeds, and with funds on deposit at Peoples Bank in MACED's SBA Loan Loss Reserve Fund. Interest at 2.5 percent. Monthly payments of $5,088. Amortization schedule for years two through ten based on 1.75 percent interest plus payments for first year interest. Balance due at maturity in September 2015.	465,105	500,000
Ford Foundation recoverable grant (January 2006). No interest. Repayable 2009 only to the extent that funds are available from interest earned on and repayments of funds lent from grant funds.	250,000	250,000
Mary Reynolds Babcock Foundation (January 2007), unsecured, interest only at two percent per annum. The note matures in January 2014.	200,000	0
Monarch Community Loan Fund (June 2006), unsecured, interest only at three percent per annum. The note matures in June 2009.	200,000	0
Peoples Bank (June 2006), unsecured, interest only at four percent per annum. The note matures in June 2011.	250,000	0
Total	4,953,306	4,384,673
Less current maturities	215,582	224,987
Long-term portion	$ 4,737,724	$ 4,159,686

NOTE 7 - NOTES PAYABLE (CONTINUED)

The aggregate principal repayments required on notes payable are as follows:

Year ending April 30:		
2008	$	215,582
2009		593,845
2010		422,018
2011		205,254
2012		808,552
Thereafter		2,708,055
	$	4,953,306

In fiscal year 2007, MACED obtained a $500,000 operating line of credit. As of April 30, 2007, MACED had not borrowed under the line of credit. The unsecured line of credit bears interest at the rate banks lend money to each other. Interest is payable monthly, while the outstanding principal together with any unpaid interest accrued thereon is due on December 22, 2007.

Also in fiscal year 2007, MACED obtained financing from USDA for $750,000 (IRP #5). The first draw on the note did not occur until after April 30, 2007. The note payable has an interest rate of 1 percent with semi-annual installments. The note matures on October 31, 2036.

NOTE 8 - SUBORDINATED LOANS PAYABLE

		2007		2006
Community Trust Bank (December 2004), equity-equivalent loan at no-interest for first five years, thereafter annual interest-only payments at prime minus one percent. Lender must extend term annually as long as MACED maintains 501(c)(3) tax-exempt status, unsecured.	$	500,000	$	500,000
CNC Development Foundation, Inc. (April 2005), equity-equivalent loan, annual interest-only payments at one percent. Lender must extend term annually as long as MACED maintains 501(c)(3) tax-exempt status, unsecured.		200,000		200,000
Total		700,000		700,000
Current maturities		0		0
Long-term portion	$	700,000	$	700,000

NOTE 8 - SUBORDINATED LOANS PAYABLE (CONTINUED)

The aggregate principal repayments required on subordinated loans payable are as follows:

Year ending April 30:		
2008	$	0
2009		0
2010		0
2011		0
2012		0
Thereafter		700,000
	$	700,000

NOTE 9 - RESTRICTED NET ASSETS

Temporarily restricted net assets at April 30, 2007 and 2006 are available for the following uses:

	2007	2006
Business development	$ 2,159,591	$ 2,915,553
Community development	201,435	252,366
Natural resources	208,793	124,980
Alternative to payday lending	106,038	289,460
Research on public policy	360,903	0
Other	0	3,490
Total temporarily restricted net assets	$ 3,036,760	$ 3,585,849

NOTE 10 - RETIREMENT PLAN

MACED sponsors a defined contribution retirement plan (“Plan”) covering all eligible employees, including employees of certain affiliates that participate in the Plan. MACED contributes 5 percent of each employee’s annual compensation to the Plan. For the years ended April 30, 2007 and 2006, contributions to the Plan were $38,172 and $21,085.

NOTE 11 - MAJOR GRANTORS

For the years ended April 30, 2007 and 2006 approximately 74% and 70%, respectively, of MACED's revenues consist of grants received from federal agencies and private foundations.

NOTE 12 - CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject MACED to concentrations of credit risk include cash, accounts receivable, loans receivable and investments. MACED maintains its cash accounts with federally insured banks primarily in Berea, Kentucky and Mount Vernon, Kentucky. Four of these accounts are collateralized by investments in governmental securities for amounts in excess of $20,000. Other accounts may, from time to time, exceed the $100,000 limit of the Federal Deposit Insurance Corporation.

At April 30, 2007, ten groups of common borrowers and/or guarantors of loans outstanding accounted for 48% of the loans receivable balance. At April 30, 2006, eight similar groups of loans outstanding accounted for 49% of the loans receivable balance. Assets, in addition to personal guarantees, independently collateralize each loan.

At April 30, 2007 and 2006, MACED's investments consisted of stock in three privately owned companies in the Appalachian region and an equity investment in a consortium of not-for-profit economic development organizations in the region. For the years ended April 30, 2007 and 2006, MACED had equity investments which totaled $232,550 and $564,943, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

In the normal course of business, MACED makes commitments and incurs certain contingent liabilities that are not reflected in the accompanying financial statements. MACED does not anticipate any material losses as a result of these commitments and contingent liabilities.

The federal government retains a reversionary interest in two grants totaling $400,000 that have been previously expended by MACED. The funds have been invested in equities of qualifying entities. If the funds are subsequently paid back to MACED, they would need to be reinvested or would be subject to reclaim.

NOTE 14 - CONTRIBUTED SERVICES RECEIVED

During the year ended April 30, 2007, MACED had in-kind contribution of rent for a field office valued at $4,200 which was used in the business development program. During the year ended April 30, 2006, MACED received a donation from two sources of seven computer monitors and a camera, collectively valued at $1,050; an in-kind contribution of rent for a field office valued at $4,200 which was used in the business development program; and an in-kind contribution of accounting services valued at $2,172.

NOTE 15 - SUBSEQUENT EVENTS

Subsequent to April 30, 2007 MACED was awarded several grants from federal and private foundations. The total amount of these grants is $1,046,020. Effective July 2, 2007, MACED obtained financing from a private lender for $158,333. The note payable has an interest rate of 2 percent. The note matures on June 30, 2012.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended April 30, 2007

Federal Grantor/Program	CFDA Number	Grantor Number	Federal Expenditures
MAJOR PROGRAMS			
Appalachian Regional Commission			
Business Development Revolving Loan Fund	23.011	KY-11801-94-I-302-0830	$ 345,932
Total major programs			345,932
NONMAJOR PROGRAMS			
USDA Rural Development			
Intermediary Relending Program	10.767	20-076-0611254830 Loan 4	118,000
Small Business Administration			
SBA Microloan Program	59.046	SBAHQ-05-Y-0006	66,385
		SBAHQ-05-Y-0007	14,326
USDA Rural Development			
Rural Business Enterprise Grant	10.769	200-76-0310900246	52,681
Pass- Through Awards:			
Local Initiatives Support Corporation			
U.S. Department of Housing and Urban Development	14.218	41942-0010	13,106
U.S. Department of Housing and Urban Development	14.218	41942-0011	7,783
Kentucky Division of Water			
U.S. EPA Nonpoint Source Pollution Control Program	66.460	#C9994861-00	86,312
Total nonmajor programs			358,593
Total			$ 704,525

See accompanying notes.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
NOTE TO CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended April 30, 2007

NOTE 1 - BASIS OF PRESENTATION

The accompanying Consolidated Schedule of Expenditures of Federal Awards includes the federal grant activity of MACED and is presented on the accrual basis of accounting with the following exception.

Appalachian Regional Commission Business Development Revolving Loan Fund:

The amount of expenditures for the Appalachian Regional Commission Business Development Revolving Loan Fund (RLF) is computed as defined in Appalachian Regional Commission Business Development Revolving Loan Fund Guidelines, October 1999 revision (the Guidelines). The Guidelines define current year expenditures, identified as the RLF contribution, as the grantee's fiscal year beginning balance of outstanding loans plus current year loan expenditures plus the amount of RLF income earned and expended on eligible administrative costs during the grantee's fiscal year.

NOTE 2 - LOANS OUTSTANDING

At April 30, 2006, MACED had $345,932 outstanding for the Appalachian Regional Commission (ARC) Business Development Revolving Loan Fund (BDRLF). If MACED is not using ARC Grant Funds for lending activities, grants may be revoked as grant funds recovered as defined in the ARC BDRLF Guidelines.

Other federal loans outstanding at April 30, 2007 consist of the following:

IRP #1 - USDA (August, 1994)	$	869,061
IRP #2 - USDA (August, 1996)		574,242
IRP #3 - USDA (August, 2000)		676,221
IRP #4 - USDA (April, 2003)		725,306
U.S. Small Business Administration (September 2004)		208,521
U.S. Small Business Administration (August 2005)		465,105
Total	$	3,518,456

NOTE 3 - GENERAL

The grant revenue amounts received and expensed are subject to audit and adjustment. If any expenditures are disallowed by the grantor as a result of such an audit, any claim for reimbursement to the grantor would become a liability of MACED. In the opinion of management, all grant expenditures are in compliance with the terms of the grant agreements and applicable federal laws and regulations.

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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*

To the Board of Directors
Mountain Association for Community Economic
 Development, Inc.
Berea, Kentucky

We have audited the consolidated financial statements of Mountain Association for Community Economic Development, Inc. (a nonprofit organization) and Affiliates (MACED) as of and for the year ended April 30, 2007, and have issued our report thereon dated August 7, 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 MACED's internal control over financial reporting as a basis for designing our audit 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 MACED's internal control over financial reporting.

A control deficiency exists when the design or operation of a control 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 entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the entity's basis of accounting or generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's 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.

Our consideration of 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 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 MACED's consolidated 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 consolidated 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*.

We noted certain matters involving compliance and other matters that we reported to management of MACED in a separate letter dated August 7, 2007.

This report is intended solely for the information of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Potter & Company, LLP

POTTER & COMPANY, LLP
August 7, 2007

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Mountain Association for Community Economic
Development, Inc.
Berea, Kentucky

Compliance

We have audited the compliance of Mountain Association for Community Economic Development, Inc. (a nonprofit organization) and Affiliates (MACED) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal program for the year ended April 30, 2007. MACED's major federal program is identified in the Summary of Auditor's Results section of the accompanying Consolidated Schedule of Findings and Questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of MACED's management. Our responsibility is to express an opinion on MACED's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133*, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about MACED's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on MACED's compliance with those requirements.

In our opinion, MACED complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal program for the year ended April 30, 2007.

Internal Control Over Compliance

The management of MACED is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered MACED's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of MACED's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program 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 material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

This report is intended for the information of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Potter & Company, LLP

POTTER & COMPANY, LLP
August 7, 2007

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC. AND AFFILIATES
CONSOLIDATED SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended April 30, 2007

Summary of Auditor's Results

The independent auditor's report dated August 7, 2007, expresses an unqualified opinion on the consolidated financial statements of Mountain Association for Community Economic Development, Inc. (a nonprofit organization) and Affiliates (MACED) as of and for the year ended April 30, 2007.

Our audit disclosed no material weaknesses or significant deficiencies that are considered to be material weaknesses in relation to internal control over financial reporting or internal control.

No instances of noncompliance material to MACED's consolidated financial statements were disclosed during the audit.

The auditor's report dated August 7, 2007 on compliance for MACED's major program, expresses an unqualified opinion.

Our audit disclosed no findings required to be reported under the provisions of the OMB Circular A-133

MACED's major federal program for the year ended April 30, 2007 was the Appalachian Regional Commission Business Development Revolving Loan Fund (CFDA No. 23.011).

The dollar threshold used to distinguish between Type A and Type B programs was $300,000. All loan and loan guarantee programs were considered Type A programs.

MACED qualified as a low-risk auditee under the provisions of OMB Circular A-133.

Findings - Financial Statement Audit

No matters were reported.

Federal Award Findings and Questioned Costs

No matters were reported.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED SCHEDULE OF PRIOR YEAR AUDIT FINDINGS AND THEIR RESOLUTIONS
Year ended April 30, 2007

No findings or questioned costs were reported for the year ended April 30, 2006.