MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC. AND AFFILIATES

BEREA, KENTUCKY

CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

April 30, 2006 and 2005

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

C O N T E N T S

MOORE STEPHENS POTTER LLP
CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Mountain Association for Community Economic
Development, Inc. and affiliates
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, 2006 and 2005, 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, 2006 and 2005 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 2, 2006 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.

Moore Stephens Potter, LLP

MOORE STEPHENS POTTER, LLP
August 2, 2006

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MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

April 30, 2006 and 2005

ASSETS

	2006	2005
Current assets:		
Cash and cash equivalents	$ 2,289,142	$ 1,968,763
Current portion of loans receivable, net of allowance for bad debts of $82,670 and $85,749	1,340,665	1,267,288
Accounts receivable	66,830	55,808
Grants receivable	489,494	326,555
Prepaid expenses	9,213	8,897
Total current assets	4,195,344	3,627,311
Property and equipment, net	428,152	519,496
Other assets:		
Investments	564,943	585,300
Loans receivable, net of allowance for bad debts of $302,659 and $276,024	5,328,157	3,527,352
Total other assets	5,893,100	4,112,652
Total assets	$ 10,516,596	$ 8,259,459

LIABILITIES AND NET ASSETS

	2006	2005
Current liabilities:		
Current portion notes payable	$ 224,987	$ 134,009
Accounts payable and accrued expenses	590,868	105,264
Total current liabilities	815,855	239,273
Long-term liabilities:		
Notes payable, less current portion	4,159,686	3,141,879
Subordinated loans payable	700,000	700,000
Total long-term liabilities	4,859,686	3,841,879
Total liabilities	5,675,541	4,081,152
Commitments and contingencies		
Net assets:		
Unrestricted:		
Operating	1,235,206	1,073,365
Board designated	20,000	20,000
Total unrestricted net assets	1,255,206	1,093,365
Temporarily restricted	3,585,849	3,084,942
Total net assets	4,841,055	4,178,307
Total liabilities and net assets	$ 10,516,596	$ 8,259,459

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 at beginning of year	1,093,365	3,084,942	4,178,307
Net assets at 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 STATEMENT OF ACTIVITIES

Year ended April 30, 2005

	Unrestricted	Temporarily Restricted	Total
Revenues and other support:			
Grants	$ 104,000	$ 445,834	$ 549,834
Project and fee income	62,110	3,340	65,450
Interest and dividend income	131,568	79,568	211,136
Rental income	21,944		21,944
Other	29,017		29,017
Realized gain on investments	20,953		20,953
Net assets released from restriction:			
Satisfaction of program restrictions	336,616	(336,616)	0
Total revenues and other support	706,208	192,126	898,334
Expenses:			
Salaries and wages	410,557		410,557
Payroll taxes and fringe benefits	119,970		119,970
Professional services	108,217		108,217
Office and computer supplies	10,409		10,409
Travel	38,130		38,130
Rent and utilities	16,966		16,966
Insurance	6,849		6,849
Postage	3,900		3,900
Duplication and printing	8,426		8,426
Telephone	14,951		14,951
Data services	16,287		16,287
Maintenance and equipment	21,534		21,534
Miscellaneous	5,442		5,442
Meetings, registration and training	8,351		8,351
Publications and subscriptions	5,945		5,945
Depreciation	38,349		38,349
Tax and license	9,926		9,926
Interest	29,144		29,144
Bad debt expense	68,851		68,851
Total expenses	942,204	0	942,204
Change in net assets	(235,996)	192,126	(43,870)
Net assets, beginning of year, as previously stated	829,361	3,392,816	4,222,177
Prior period adjustment, reclassification of net assets	500,000	(500,000)	0
Net assets, beginning of year, as restated	1,329,361	2,892,816	4,222,177
Net assets, end of year	$ 1,093,365	$ 3,084,942	$ 4,178,307

See accompanying notes.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended April 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Change in net assets	$ 662,748	$ (43,870)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	45,318	38,349
Bad debt expense	179,582	68,851
Realized gain on investments	(24,583)	(20,953)
Realized loss on sale of property	753	0
Changes in operating assets and liabilities:		
Accounts receivable	(11,022)	(29,113)
Grants receivable	(162,939)	(137,100)
Prepaid expenses	(316)	(6,213)
Accounts payable and accrued expenses	485,604	35,588
Net cash provided by (used in) operating activities	1,175,145	(94,461)
Cash flows from investing activities:		
Proceeds from sales of investments	52,083	48,453
Purchase of investments	(7,143)	0
Purchase of equipment	(5,139)	(61,801)
Proceeds from sales of property	50,412	0
Loans to other entities	(3,735,098)	(3,180,497)
Principal collections on loans receivable	1,681,334	1,333,489
Net cash used in investing activities	(1,963,551)	(1,860,356)
Cash flows from financing activities:		
Proceeds from notes payable, net	1,260,688	1,422,750
Principal payments on notes payable	(151,903)	(91,200)
Net cash provided by financing activities	1,108,785	1,331,550
Net increase (decrease) in cash and cash equivalents	320,379	(623,267)
Cash and cash equivalents at beginning of year	1,968,763	2,592,030
Cash and cash equivalents at end of year	$ 2,289,142	$ 1,968,763

Supplemental disclosure of cash flow information:

Cash paid during the year for interest	$ 38,695	$ 29,657

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 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.

Through their relending program, AIC has received approval for borrowings of $3,500,000, consisting of a $1,250,000 loan approved in 1994, a $750,000 loan approved in 1996, a $750,000 loan approved in 2000, and another $750,000 loan approved in 2003. Maximum borrowings made under the initial IRP loan were made at various dates through 1997. Maximum borrowings under the second IRP loan were made at various dates from 1997 through 2000. Maximum borrowings under the third IRP loan were made at various dates during 2000 and 2001. As of the audit report date borrowings of $632,000 have been made under the fourth loan.

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, 2006 and 2005, MACED had no assets that were permanently restricted.

Included in unrestricted net assets is a $20,000 grant from the Kellogg Foundation which has been designated by the Board of Directors for the Helen Lewis Award.

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 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 11.5%.

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 granted tax-exempt status 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 as a nonprofit organization other than a private foundation. 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, 2006 and 2005 are as follows:

	2006	2005
Program expenses	$ 789,682	$ 626,792
Fundraising	15,310	19,560
Support expenses	340,221	295,852
Total expenses	$ 1,145,213	$ 942,204

NOTE 3 - LOANS RECEIVABLE

At April 30, 2006 and 2005, loans receivable consist of current amounts of $1,423,335 and $1,353,037 and noncurrent amounts of $5,630,816 and $3,803,376, 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, 2006 and 2005 consist of the following:

	2006	2005
Loans receivable	$ 7,054,151	$ 5,156,413
Allowance for loan losses	(385,329)	(361,773)
Loans receivable, net	$ 6,668,822	$ 4,794,640

Loans serving as collateral on notes payable amounted to approximately $2,900,000 and $2,355,000 at April 30, 2006 and 2005, respectively.

Accrued interest receivable amounted to approximately $32,974 and $8,512 at April 30, 2006 and 2005, respectively.

Non-accrual loans totaled $204,719 and $368,604, respectively, at April 30, 2006 and 2005.

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, 2006 and 2005:

	2006	2005
Beginning balance	$ 361,773	$ 459,700
Provision charged to operations	179,582	68,851
Charge-offs	(157,674)	(171,062)
Recoveries	1,648	4,284
Ending balance	$ 385,329	$ 361,773

NOTE 3 - LOANS RECEIVABLE (CONTINUED)

The following is a summary of information pertaining to impaired loans at April 30, 2006 and 2005:

	2006	2005
Impaired loans with a valuation allowance	$ 198,167	$ 137,647
Valuation allowance related to impaired loans	$ 50,995	$ 70,356
Average investment in impaired loans	$ 22,019	$ 46,904
Interest income recognized on impaired loans	$ 5,880	$ 390
Interest income recognized on a cash basis on impaired loans	$ 5,880	$ 390

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows at April 30, 2006 and 2005:

	2006	2005
Land	$ 40,000	$ 40,000
Buildings and improvements	581,582	656,457
Equipment	105,115	117,013
Automobiles	41,965	41,965
	768,662	855,435
Less accumulated depreciation	340,510	335,939
Property and equipment, net	$ 428,152	$ 519,496

NOTE 5 - GRANTS RECEIVABLE

Grants receivable consist of the following at April 30, 2006 and 2005:

		2006		2005
Federal grants receivable:				
Small Business Administration	$	29,415	$	5,489
USDA Rural Development (RBEG)		53,185		49,279
Johnson County Community Development Block Grant		0		4,568
Local Initiative Support Corp.		1,894		4,719
Total federal grants receivable		84,494		64,055
Other grants receivable:				
Grant Foundation		35,000		0
Blue Moon		70,000		0
Ford Foundation		150,000		0
F. B. Heron Foundation		0		50,000
New York Community Trust		37,500		25,000
Mary Reynolds Babcock Foundation		112,500		187,500
Total other grants receivable		405,000		262,500
Total grants receivable	$	489,494	$	326,555

NOTE 6 - NOTES PAYABLE

Notes payable consist of the following at April 30, 2006 and 2005:

	2006	2005
Due to Farmers Home Association, semi-annual installments of $10,000 plus interest at one percent until maturity in September, 2010, unsecured.	$ 80,000	$ 100,000
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. Principal and interest payments due annually in August. The note matures in August, 2024.	912,276	956,456
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. Principal and interest payments due annually in August. The note matures in August, 2026.	599,949	625,973
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. Interest only for the first three years, then principal and interest payments due annually in August. The note matures in August, 2030.	700,612	725,709
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. Interest only for the first three years, then principal and interest payments due annually in April. The note matures in April, 2033.	631,996	142,750
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

NOTE 6 - NOTES PAYABLE (CONTINUED)

	2006	2005
Community Trust Bank (November 2004), annual interest-only payments at one percent until maturity in November 2011, unsecured.	350,000	350,000
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. No payments due in first year. 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.	234,840	250,000
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. No payments due in first year. 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.	500,000	0
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	0
Total	4,384,673	3,275,888
Less current maturities	224,987	134,009
Long-term portion	$ 4,159,686	$ 3,141,879

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

Year ending April 30:	
2007	$ 224,987
2008	248,414
2009	627,335
2010	256,338
2011	240,422
Thereafter	2,787,177
	$ 4,384,673

NOTE 7 - SUBORDINATED LOANS PAYABLE

	2006	2005
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
Less current maturities	0	0
Long-term portion	$ 700,000	$ 700,000

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

Year ending April 30:	
2007	$ 0
2008	0
2009	0
2010	0
2011	0
Thereafter	700,000
	$ 700,000

NOTE 8 - RESTRICTED NET ASSETS

Temporarily restricted net assets at April 30, 2006 and 2005 are available for the following uses:

	2006	2005
Business development	$ 2,915,553	$ 3,083,666
Community development	252,366	0
Natural resources	124,980	0
Alternative payday lending	289,460	0
Other	3,490	1,276
Total temporarily restricted net assets	$ 3,585,849	$ 3,084,942

NOTE 9 - 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, 2006 and 2005, contributions to the Plan were $21,085 and $19,682.

NOTE 10 - CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the 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. 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, 2006, eleven groups of common borrowers and/or guarantors of loans outstanding accounted for 46% of the loans receivable balance. At April 30, 2005, 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, 2006 and 2005, MACED's investments consisted of stock in four 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, 2006 and 2005, MACED had equity investments which totaled $564,943 and $585,300, respectively.

NOTE 11 - MAJOR GRANTORS

For the years ended April 30, 2006 and 2005 approximately 70% and 61%, respectively, of MACED's revenues consist of grants received from federal agencies and private foundations.

NOTE 12 - 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.

MACED has guaranteed a $300,000 loan from Jackson Energy Cooperative to B & H Tool Works, Inc. of Rockcastle County which is scheduled to be fully repaid in 2007. The balance of the loan at April 30, 2006 and 2005 was $38,889 and $72,222, respectively.

NOTE 13 - CONTRIBUTED SERVICES RECEIVED

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. During the year ended April 30, 2005, two businesses contributed in-kind communications consulting services to MACED's forestry program. The value of the contributed services was $5,487. Also during the year ended April 30, 2005, MACED received an in-kind contribution of rent for a field office. The value of the contributed rent was $2,800 and was used for the business development program.

NOTE 14 - RECLASSIFICATION OF NET ASSETS

At April 30, 2004, certain amounts were reported as temporarily restricted net assets which were unrestricted at the time of donation. These amounts have been reclassified from temporarily restricted net assets to unrestricted net assets as of April 30, 2005, in the accompanying financial statements.

The above reclassification had no effect on total assets, total liabilities or total net assets of MACED as previously reported at April 30, 2005. The effect of the reclassification on the net assets previously reported at April 30, 2005 is summarized as follows:

	Unrestricted	Temporarily Restricted	Total
Net assets at April 30, 2005, as previously reported	$ 593,365	$ 3,584,942	$ 4,178,307
Effect of reclassification	500,000	(500,000)	0
Net assets at April 30, 2005	$ 1,093,365	$ 3,084,942	$ 4,178,307

The effect of the above errors did not affect the change in unrestricted or temporarily restricted net assets as previously reported for the year ended April 30, 2005.

NOTE 15 - SUBSEQUENT EVENTS

Subsequent to April 30, 2006 MACED was awarded several grants from private foundations. The total amount of these grants is $355,000. Effective June 19, 2006, MACED obtained financing from a bank for $250,000. The note payable has an interest rate of 4 percent. The note matures on June 19, 2011. Effective June 30, 2006, MACED obtained financing from a private lender for $200,000. The note payable has an interest rate of 3 percent with semi-annual installments. The note matures on June 30, 2009.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES

CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended April 30, 2006

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	$	385,194
USDA Rural Development				
Intermediary Relending Program	10.767	20-076-0611254830 Loan 4		489,250
Small Business Administration				
SBA Microloan Program	59.046	#7540884004		500,000
		SBAHQ-05-Y-0006		60,426
				560,426
Total major programs				1,434,870
NONMAJOR PROGRAMS				
U.S. Department of Treasury				
Community Development Finanical Institutions Fund	21.020	041TA005011		19,959
USDA Rural Development				
Rural Business Enterprise Grant	10.769	200-76-0310900246		88,133
Pass- Through Awards:				
Local Initiatives Support Corporation				
U.S. Department of Housing and Urban Development	14.218	41942-0009		10,281
U.S. Department of Housing and Urban Development	14.218	41942-0010		1,894
Total nonmajor programs				120,267
Total			$	1,555,137

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, 2006

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 $385,194 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, 2006 consist of the following:

IRP #1 - USDA (August, 1994)	$	912,276
IRP #2 - USDA (August, 1996)		599,949
IRP #3 - USDA (August, 2000)		700,612
IRP #4 - USDA (April, 2003)		631,996
U.S. Small Business Administration (September 2004)		234,840
U.S. Small Business Administration (August 2005)		500,000
Total	$	3,579,673

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. and affiliates
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, 2006, and have issued our report thereon dated August 2, 2006. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 2, 2006.

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.

Moore Stephens Potter, LLP

MOORE STEPHENS POTTER, LLP
August 2, 2006

MOORE STEPHENS POTTER LLP
CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS ADVISORS

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. and affiliates
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 programs for the year ended April 30, 2006. MACED's major federal programs are 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 programs for the year ended April 30, 2006.

Internal Control Over Compliance

The management of MACED is responsible for establishing and maintaining effective internal control over compliance with 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 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 and to test and report on internal control over compliance in accordance with OMB Circular A-133.

To the Board of Directors
Mountain Association for Community Economic
Development, Inc. and affiliates

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Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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.

Moore Stephens Potter, LLP

MOORE STEPHENS POTTER, LLP
August 2, 2006

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC. AND AFFILIATES
CONSOLIDATED SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended April 30, 2006

Summary of Auditor's Results

The auditor's report dated August 2, 2006, expresses an unqualified opinion on the consolidated financial statements of Mountain Association for Community Economic Development, Inc. (a nonprofit organization) and affiliates (MACED).

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

The auditor's report dated August 2, 2006 on compliance for MACED's major programs, expresses an unqualified opinion.

No audit findings relative to the major federal award programs for MACED are reported in this Schedule.

MACED's major federal programs for the year ended April 30, 2006 were the Appalachian Regional Commission Business Development Revolving Loan Fund (CFDA No. 23.011), the Small Business Administration Microloan Program (CFDA No. 59.046), and the USDA Rural Development Intermediary Relending Program (CFDA No. 10.767).

The dollar threshold used to distinguish between Type A and Type B programs was $300,000.

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

Findings - Financial Statement Audit

Our audit disclosed no findings that are required to be reported in accordance with *Government Auditing Standards*.

MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES
CONSOLIDATED SCHEDULE OF PRIOR YEAR AUDIT FINDINGS AND THEIR RESOLUTIONS
Year ended April 30, 2006

No findings or questioned costs were reported for the year ended April 30, 2005.