

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

**CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

April 30, 2005 and 2004

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

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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, 2005 and 2004, 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, 2005 and 2004 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 8, 2005 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 grants. 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 8, 2005

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**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

April 30, 2005 and 2004

	<u>A S S E T S</u>	
	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents	\$ 1,968,763	\$ 2,592,030
Current portion of loans receivable, net of allowance for bad debts of \$85,749 and \$128,370	1,267,288	926,524
Accounts receivable	55,808	26,695
Grants receivable	326,555	189,455
Prepaid expenses	8,897	2,684
Total current assets	<u>3,627,311</u>	<u>3,737,388</u>
Property and equipment, net	<u>519,496</u>	<u>496,044</u>
Other assets:		
Investments	585,300	612,800
Loans receivable, net of allowance for bad debts of \$276,024 and \$331,330	3,527,352	2,089,959
Total other assets	<u>4,112,652</u>	<u>2,702,759</u>
Total assets	<u>\$ 8,259,459</u>	<u>\$ 6,936,191</u>
 <u>L I A B I L I T I E S A N D N E T A S S E T S</u>		
Current liabilities:		
Current portion notes payable	\$ 134,009	\$ 113,148
Accounts payable and accrued expenses	105,264	69,676
Total current liabilities	<u>239,273</u>	<u>182,824</u>
Long-term liabilities:		
Notes payable, less current portion	3,141,879	2,531,190
Subordinated loans payable	700,000	0
Total long-term liabilities	<u>3,841,879</u>	<u>2,531,190</u>
Total liabilities	<u>4,081,152</u>	<u>2,714,014</u>
Commitments and contingencies		
Net assets:		
Unrestricted:		
Operating	573,365	809,361
Board designated	20,000	20,000
Total unrestricted net assets	<u>593,365</u>	<u>829,361</u>
Temporarily restricted	<u>3,584,942</u>	<u>3,392,816</u>
Total net assets	<u>4,178,307</u>	<u>4,222,177</u>
Total liabilities and net assets	<u>\$ 8,259,459</u>	<u>\$ 6,936,191</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended April 30, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
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	<u>336,616</u>	<u>(336,616)</u>	<u>0</u>
Total revenues and other support	<u>706,208</u>	<u>192,126</u>	<u>898,334</u>
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	<u>68,851</u>		<u>68,851</u>
Total expenses	<u>942,204</u>	<u>0</u>	<u>942,204</u>
Change in net assets	(235,996)	192,126	(43,870)
Net assets at beginning of year	<u>829,361</u>	<u>3,392,816</u>	<u>4,222,177</u>
Net assets at end of year	<u>\$ 593,365</u>	<u>\$ 3,584,942</u>	<u>\$ 4,178,307</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

CONSOLIDATED STATEMENT OF ACTIVITIES

Year ended April 30, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Revenues and other support:			
Grants	\$ 203,000	\$ 398,796	\$ 601,796
Project and fee income	16,451	12,752	29,203
Interest and dividend income	164,616	66,644	231,260
Rental income	26,785		26,785
Other	15,280		15,280
Realized gain on investments	23,213		23,213
Net assets released from restriction:			
Satisfaction of program restrictions	<u>209,296</u>	<u>(209,296)</u>	<u>0</u>
Total revenues and other support	<u>658,641</u>	<u>268,896</u>	<u>927,537</u>
Expenses:			
Salaries and wages	351,728		351,728
Payroll taxes and fringe benefits	102,045		102,045
Professional services	123,051		123,051
Office and computer supplies	6,640		6,640
Travel	25,212		25,212
Rent and utilities	11,563		11,563
Insurance	8,836		8,836
Postage	1,655		1,655
Duplication and printing	23,737		23,737
Telephone	12,747		12,747
Data services	14,335		14,335
Maintenance and equipment	23,474		23,474
Miscellaneous	2,152		2,152
Meetings, registration and training	10,825		10,825
Publications and subscriptions	5,381		5,381
Depreciation	25,886		25,886
Grants	300		300
Tax and license	8,954		8,954
Interest	31,604		31,604
Bad debt expense (net recoveries)	<u>(30,038)</u>		<u>(30,038)</u>
Total expenses	<u>760,087</u>	<u>0</u>	<u>760,087</u>
Change in net assets	(101,446)	268,896	167,450
Net assets at beginning of year	<u>930,807</u>	<u>3,123,920</u>	<u>4,054,727</u>
Net assets at end of year	<u>\$ 829,361</u>	<u>\$ 3,392,816</u>	<u>\$ 4,222,177</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended April 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ (43,870)	\$ 167,450
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	38,349	25,886
Bad debt expense (net recoveries)	68,851	(30,038)
Gain on investments	(20,953)	(23,213)
Changes in operating assets and liabilities:		
Accounts receivable	(29,113)	11,734
Grants receivable	(137,100)	55,623
Prepaid expenses	(6,213)	1,778
Accounts payable and accrued expenses	<u>35,588</u>	<u>(14,004)</u>
Net cash provided by (used in) operating activities	<u>(94,461)</u>	<u>195,216</u>
 Cash flows from investing activities:		
Sale of investments	48,453	229,281
Purchase of investments	0	(127,316)
Purchase of equipment	(61,801)	(13,263)
Loans to other entities	(3,180,497)	(1,001,728)
Principal collections on loans receivable	<u>1,333,489</u>	<u>1,503,016</u>
Net cash provided by (used in) investing activities	<u>(1,860,356)</u>	<u>589,990</u>
 Cash flows from financing activities:		
Proceeds from notes payable, net	1,422,750	125,000
Principal payments on notes payable	<u>(91,200)</u>	<u>(86,885)</u>
Net cash provided by financing activities	<u>1,331,550</u>	<u>38,115</u>
 Net increase (decrease) in cash and cash equivalents	(623,267)	823,321
 Cash and cash equivalents at beginning of year	<u>2,592,030</u>	<u>1,768,709</u>
 Cash and cash equivalents at end of year	<u>\$ 1,968,763</u>	<u>\$ 2,592,030</u>
 Supplemental disclosure of cash flow information:		
 Cash paid during the year for interest	<u>\$ 29,657</u>	<u>\$ 32,954</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2005 and 2004

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 and state grants.

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 \$142,750 have been made under the fourth loan.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2005 and 2004

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, 2005 and 2004, 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.

Expenses are allocated to certain program services or general functions based on direct identification and management estimates that are reviewed annually. For the year ended April 30, 2005 total expenses consisted of program service expenses of \$626,792, fundraising expenses of \$19,560 and other support expenses of \$295,852. For the year ended April 30, 2004 total expenses consisted of program service expenses of \$486,326, fundraising expenses of \$62,053 and other support expenses of \$211,708.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Cash and Cash Equivalents:

For the purposes of the Consolidated Statement 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.

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 10.0%.

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.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 - LOANS RECEIVABLE

At April 30, 2005 and 2004, loans receivable consist of current amounts of \$1,353,037 and \$1,054,894 and noncurrent amounts of \$3,803,376 and \$2,421,289, 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.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 2 - 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, 2005 and 2004 consist of the following:

	<u>2005</u>	<u>2004</u>
Loans receivable	\$ 5,156,413	\$ 3,476,183
Allowance for loan losses	<u>(361,773)</u>	<u>(459,700)</u>
Loans receivable, net	\$ <u>4,794,640</u>	\$ <u>3,016,483</u>

Loans serving as collateral on notes payable amounted to approximately \$2,355,000 and \$1,641,000 at April 30, 2005 and 2004, respectively.

Accrued interest receivable amounted to approximately \$8,512 and \$5,723 at April 30, 2005 and 2004, respectively.

Non-accrual loans totaled \$368,604 and \$468,841, respectively, at April 30, 2005 and 2004.

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.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 2 - LOANS RECEIVABLE (CONTINUED)

A loan is considered to be impaired when, based on current information and events, it is probable that the Organization 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 year ended April 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Beginning balance	\$ 459,700	\$ 398,217
Provision (credited to) charged to operations	68,851	(30,038)
Charge-offs	(171,062)	0
Recoveries	<u>4,284</u>	<u>91,521</u>
Ending balance	\$ <u>361,773</u>	\$ <u>459,700</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 2 - LOANS RECEIVABLE (CONTINUED)

The following is a summary of information pertaining to impaired loans at April 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Impaired loans with a valuation allowance	\$ <u>137,647</u>	\$ <u>50,246</u>
Valuation allowance related to impaired loans	\$ <u>70,356</u>	\$ <u>42,702</u>
Average investment in impaired loans	\$ <u>46,904</u>	\$ <u>25,123</u>
Interest income recognized on impaired loans	\$ <u>390</u>	\$ <u>3,617</u>
Interest income recognized on a cash basis on impaired loans	\$ <u>390</u>	\$ <u>3,539</u>

NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows at April 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Land	\$ 40,000	\$ 40,000
Buildings and improvements	656,457	649,539
Equipment	117,013	72,708
Automobiles	<u>41,965</u>	<u>31,387</u>
	855,435	793,634
Accumulated depreciation	<u>(335,939)</u>	<u>(297,590)</u>
Property and equipment, net	\$ <u>519,496</u>	\$ <u>496,044</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 4 - GRANTS RECEIVABLE

Grants receivable consist of the following at April 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Federal grants receivable:		
Small Business Administration	\$ 5,489	\$ 0
Appalachian Regional Commission RLF	0	85,000
USDA Rural Development (RBEG)	49,279	0
Natural Resources & Environmental Protection Cabinet	0	38,453
Johnson County Community Development Block Grant	4,568	0
Local Initiative Support Corp.	<u>4,719</u>	<u>16,002</u>
Total federal grants receivable	<u>64,055</u>	<u>139,455</u>
Other grants receivable:		
Kellogg Foundation	0	50,000
F. B. Heron Foundation	50,000	0
New York Community Trust	25,000	0
Mary Reynolds Babcock Foundation	<u>187,500</u>	<u>0</u>
Total other grants receivable	<u>262,500</u>	<u>50,000</u>
Total grants receivable	\$ <u>326,555</u>	\$ <u>189,455</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 5 - NOTES PAYABLE

Notes payable consist of the following at April 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Due to Farmers Home Association, semi-annual installments of \$10,000 plus interest at one percent until maturity in September, 2010, unsecured.	\$ 100,000	\$ 120,000
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.	956,456	999,035
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.	625,973	650,981
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.	725,709	749,322
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.	142,750	0
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

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 5 - NOTES PAYABLE (CONTINUED)

	<u>2005</u>	<u>2004</u>
Community Trust Bank (November 2004), annual interest-only payments at one percent until maturity in November 2011, unsecured.	350,000	0
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 for first 24 months, thereafter 3.75 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.	<u>250,000</u>	<u>0</u>
Total	3,275,888	2,644,338
Current maturities	<u>(134,009)</u>	<u>(113,148)</u>
Long-term portion	<u>\$ 3,141,879</u>	<u>\$ 2,531,190</u>

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

<u>Year ending April 30:</u>		
2006	\$	132,019
2007		161,890
2008		163,215
2009		290,297
2010		167,426
Thereafter		<u>2,361,041</u>
	\$	<u>3,275,888</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
April 30, 2005 and 2004

NOTE 6 - SUBORDINATED LOANS PAYABLE

	<u>2005</u>	<u>2004</u>
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	\$ 0
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	0
Total	<u>700,000</u>	<u>0</u>
Current maturities	0	0
Long-term portion	<u>\$ 700,000</u>	<u>\$ 0</u>

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

<u>Year ending April 30:</u>		
2006	\$	0
2007		0
2008		0
2009		0
2010		0
Thereafter		700,000
	\$	<u>700,000</u>

NOTE 7 - RESTRICTED NET ASSETS

Temporarily restricted net assets at April 30, 2005 and 2004 are available for the following uses:

	<u>2005</u>	<u>2004</u>
Business development	\$ 3,583,666	\$ 3,036,858
Public policy	0	65,738
Strategic capital fund	0	290,220
Other	<u>1,276</u>	<u>0</u>
Total temporarily restricted net assets	<u>\$ 3,584,942</u>	<u>\$ 3,392,816</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2005 and 2004

NOTE 8 - 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, 2005 and 2004, contributions to the Plan were \$19,682 and \$24,451.

NOTE 9 - CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the Organization 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, 2005, eight groups of common borrowers and/or guarantors of loans outstanding accounted for 49% of the loans receivable balance. At April 30, 2004, five similar groups of loans outstanding accounted for 42% of the loans receivable balance. Assets, in addition to personal guarantees, independently collateralize each loan.

At April 30, 2005 and 2004, 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, 2005 and 2004, MACED had equity investments which totaled \$585,300 and \$612,800, respectively.

NOTE 10 - MAJOR GRANTORS

For the years ended April 30, 2005 and 2004 approximately 61% and 74%, respectively, of MACED's revenues consist of grants received from federal agencies and private foundations.

NOTE 11 - 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. The Organization 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, 2005 and 2004 was \$72,222 and \$105,555, respectively.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 2005 and 2004

NOTE 12 - CONTRIBUTED SERVICES RECEIVED

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. During the year ended April 30, 2004, two businesses contributed in-kind communications consulting and printing services to MACED's forestry program. The value of the contributed services was \$7,399.

NOTE 13 - SUBSEQUENT EVENT

Effective June 1, 2005, MACED entered into a 2-year grant agreement with a private foundation. The total amount of the grant is \$1.5 million. \$500,000 will be available for operations and \$1,000,000 will be regranted to other nonprofit organizations.

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended April 30, 2005

Federal Grantor/Program	CFDA Number	Grantor Number	Federal Expenditures
<u>MAJOR PROGRAMS</u>			
<u>Appalachian Regional Commission</u> Business Development Revolving Loan Fund	23.011	KY-11801-94-I-302-0830	\$ 355,378
<u>Small Business Administration</u> SBA Microloan Program	59.046	#7540884004 SBAHQ-05-Y-0006	250,000 <u>5,489</u> <u>255,489</u>
Total major programs			<u>610,867</u>
<u>NONMAJOR PROGRAMS</u>			
<u>USDA Rural Development</u> Intermediary Relending Program	10.767	20-076-0611254830 Loan 4	142,750
<u>U.S. Department of Treasury</u> Community Development Financial Institutions Program	21.020	001TA002529	29,610
<u>USDA Rural Development</u> Rural Business Plan Grant	10.769	200-76-0310900246	48,416
Pass- Through Awards:			
<u>Local Initiatives Support Corporation</u> U.S. Department of Housing and Urban Development	14.218	99-844-41942-0006	4,556
U.S. Department of Housing and Urban Development	14.218	99-844-41942-0007	2,442
U.S. Department of Housing and Urban Development	14.218	99-844-41942-0008	4,719
<u>Commonwealth of Kentucky Cabinet for Natural Resources & Environmental Protection</u> Division of Water Environmental Protection Agency	66.460	C9994861-98	<u>16,567</u>
Total nonmajor programs			<u>249,060</u>
Total			<u>\$ 859,927</u>

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
NOTES TO CONSOLIDATED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended April 30, 2005

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.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND NONCOMPLIANCE
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, 2005, and have issued our report thereon dated August 8, 2005. 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 that we reported to management of MACED in a separate letter dated August 8, 2005.

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 8, 2005

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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. 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, 2005. 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, 2005.

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 8, 2005

**MOUNTAIN ASSOCIATION FOR COMMUNITY ECONOMIC DEVELOPMENT, INC.
AND AFFILIATES**
CONSOLIDATED SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended April 30, 2005

Summary of Auditor's Results

The auditor's report dated August 8, 2005, 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 8, 2005 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, 2005 were the Appalachian Regional Commission Business Development Revolving Loan Fund (CFDA No. 23.011) and the Small Business Administration Microloan Program (CFDA No. 59.046).

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 RESOLUTION
Year ended April 30, 2005

No findings or questioned costs were reported for the year ended April 30, 2004.