MERCY CORPS AND AFFILIATES

Consolidated Financial Statements

June 30, 2010

(With Independent Auditors’ Report Thereon)

MERCY CORPS AND AFFILIATES

Table of Contents

KPMG LLP
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Independent Auditors' Report

The Board of Directors
Mercy Corps and affiliates:

We have audited the accompanying consolidated statement of financial position of Mercy Corps and affiliates (the Organization) as of June 30, 2010, and the related consolidated statements of activities, cash flows, and functional expenses for the year 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Mercy Corps and affiliates as of June 30, 2010, and the changes in their net assets and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 3 to the accompanying consolidated financial statements of Mercy Corps and affiliates, net assets as of June 30, 2009 have been restated to correct misstatements from the Organization's previously issued consolidated financial statements, which were audited by other auditors.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information included in Schedules I and II is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, accordingly, we express no opinion on it.

KPMG LLP

January 31, 2011

MERCY CORPS AND AFFILIATES

Consolidated Statement of Financial Position

June 30, 2010

Assets

Cash	$	57,570,896
Financial instruments, derivatives		264,393
Grants and accounts receivable		26,424,408
Microfinance loans receivable, net		42,999,778
Due from unconsolidated affiliates, net		2,626,060
Inventories		11,174,357
Prepaid expenses, deposits, and other assets		5,224,603
Pledges receivable, net		2,656,358
Notes receivable		11,230,120
Investments		512,745
Program-related investments		7,803,093
Property and equipment, net		39,399,400
Total assets	$	207,886,211

Liabilities and Net Assets

Liabilities:		
Accounts payable and accrued liabilities	$	23,005,065
Deferred revenue		32,498,617
Subsidiary and subordinated debt for microfinancing activities		40,888,574
Long-term debt		31,675,549
Total liabilities		128,067,805
Net assets:		
Unrestricted		44,612,389
Temporarily restricted		35,186,017
Permanently restricted		20,000
Total net assets		79,818,406
Total liabilities and net assets	$	207,886,211

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Activities

Year ended June 30, 2010

	Unrestricted	Temporarily restricted	Permanently restricted	Totals
Operating support and revenue:				
Public support and revenue:				
Government grants	$ 149,047,546	—	—	$ 149,047,546
Material aid	12,439,879	61,950	—	12,501,829
Material aid – monetized	5,325,434	—	—	5,325,434
Total public support and revenue	166,812,859	61,950	—	166,874,809
Private support and revenue:				
Other grants	20,869,882	19,014,946	—	39,884,828
Private contributions	17,407,975	13,404,922	—	30,812,897
Contributions for the acquisition of property	—	2,345,038	—	2,345,038
Total private support and revenue	38,277,857	34,764,906	—	73,042,763
Other revenue:				
Interest income	19,840,219	—	—	19,840,219
Other revenue	2,090,229	12,042	—	2,102,271
Total other revenue	21,930,448	12,042	—	21,942,490
Net assets released from restriction	41,581,257	(41,581,257)	—	—
Total operating support and revenue	268,602,421	(6,742,359)	—	261,860,062
Operating expenses:				
Program services:				
Humanitarian assistance – relief	65,235,070	—	—	65,235,070
Humanitarian assistance – recovery	34,287,630	—	—	34,287,630
Livelihood/economic development	70,418,564	—	—	70,418,564
Civil society and education	46,579,958	—	—	46,579,958
Health	15,259,481	—	—	15,259,481
Total program services	231,780,703	—	—	231,780,703
Supporting services:				
General and administrative	21,699,649	—	—	21,699,649
Resource development	8,843,200	—	—	8,843,200
Total supporting services	30,542,849	—	—	30,542,849
Total operating expenses	262,323,552	—	—	262,323,552
Operating support and revenue in excess of operating expense	6,278,869	(6,742,359)	—	(463,490)
Other nonoperating revenue and expenses, net:				
Foreign currency exchange gain	230,793	—	—	230,793
Realized and unrealized gain on investments	244,394	—	—	244,394
Unrealized loss on swap agreements	(2,193,439)	—	—	(2,193,439)
Other nonoperating expense	(74,408)	—	—	(74,408)
Total nonoperating revenue and expenses, net	(1,792,660)	—	—	(1,792,660)
Change in net assets	4,486,209	(6,742,359)	—	(2,256,150)
Net assets at beginning of year, as restated (note 3)	40,126,180	41,928,376	20,000	82,074,556
Net assets at end of year	$ 44,612,389	35,186,017	20,000	$ 79,818,406

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Cash Flows

Year ended June 30, 2010

Cash flows from operating activities:	
Change in net assets	$ (2,256,150)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:	
Depreciation and amortization	3,096,277
Net realized and unrealized gain on investments	(475,187)
Unrealized loss on interest rate swap	2,193,439
Loss on disposition of fixed assets	1,921,291
Contributions restricted for long-term investment	(2,345,038)
Changes in assets and liabilities:	
Grants and accounts receivable	(7,568,956)
Due from unconsolidated affiliates, net	(1,223,515)
Inventories	3,634,683
Prepaid expenses, deposits, and other assets	(3,102,357)
Pledges receivable	3,439,853
Accounts payable and accrued liabilities	8,506,306
Deferred revenue	10,349,265
Net cash provided by operating activities	16,169,911
Cash flows from investing activities:	
Purchase of investments	(1,070,949)
Issuances of microfinance loans, net	(9,019,435)
Proceeds from sale of property and equipment	2,555,173
Acquisition of property and equipment	(8,839,958)
Repayment of notes receivable	76,096
Net cash used in investing activities	(16,299,073)
Cash flows from financing activities:	
Proceeds from issuance of loans by microfinance entities	9,677,856
Repayments on borrowings of microfinance entities	(13,210,658)
Contributions restricted for long-term investment	2,345,038
Proceeds from the issuance of long-term debt	1,812,882
Repayments on long-term debt	(6,695,497)
Net cash used in financing activities	(6,070,379)
Net decrease in cash and cash equivalents	(6,199,541)
Cash at beginning of year, as restated (note 3)	63,770,437
Cash at end of year	$ 57,570,896
Supplemental disclosures:	
Interest paid during the year	$ 5,436,729
Noncash contributions	27,853,854

See accompanying notes to consolidated financial statements.

MERCY CORPS AND AFFILIATES

Consolidated Statement of Functional Expenses

Year ended June 30, 2010

	Program Services						Support services		
	Humanitarian assistance – relief	Humanitarian assistance – recovery	Livelihood/ economic development	Civil society and education	Health	Total program services	General and administration	Resource development	Total expenses
Personnel	$ 9,439,184	6,234,717	15,646,533	12,486,895	4,117,645	47,924,974	12,592,578	4,208,841	64,726,393
Professional services	3,414,687	534,822	2,776,822	2,359,562	398,002	9,483,895	1,159,744	1,459,620	12,103,259
Professional services – in kind	—	—	—	—	—	—	1,069,618	—	1,069,618
Travel and vehicle expense	2,296,879	1,168,228	3,287,740	2,720,132	893,159	10,366,138	1,915,373	215,703	12,497,214
Office and occupancy expense	2,220,675	1,798,284	3,992,272	2,606,970	1,535,585	12,153,786	1,507,715	2,361,968	16,023,469
Other operating expenses	365,093	177,012	—	557,392	117,088	1,216,585	1,231,556	546,688	2,994,829
Material aid	19,491,575	—	—	32,592	—	19,524,167	—	—	19,524,167
Materials and supplies	11,249,964	4,090,369	6,556,374	3,527,832	875,598	26,300,137	1,221	2,033	26,303,391
Construction, non-owned assets	3,509,477	1,473,483	3,994,375	12,642,223	1,361,622	22,981,180	—	—	22,981,180
Training, monitoring, and evaluation	1,568,572	885,200	1,640,525	1,654,937	2,260,684	8,009,918	86,729	21,198	8,117,845
Subgrants	11,277,838	17,829,995	13,871,202	7,314,672	3,643,663	53,937,370	130,425	—	54,067,795
Microfinancing activity	—	—	12,414,527	—	—	12,414,527	82,274	—	12,496,801
Depreciation	401,126	95,520	996,510	622,119	56,435	2,171,710	897,418	27,149	3,096,277
Interest expense	—	—	5,241,684	54,632	—	5,296,316	1,024,998	—	6,321,314
	$ 65,235,070	34,287,630	70,418,564	46,579,958	15,259,481	231,780,703	21,699,649	8,843,200	262,323,552

See accompanying notes to consolidated financial statements.

(1) Organization and Purpose

Mercy Corps, headquartered in Portland, Oregon, is incorporated under the laws of the State of Washington as a nonprofit corporation. Mercy Corps' Mission is to alleviate suffering, poverty, and oppression by helping people build secure, productive, and just communities around the globe.

Mercy Corps' Vision for Change, based on the Universal Declaration of Human Rights, is that peaceful, secure, and just societies emerge when the private, public, and civil society sectors are able to interact with accountability, inclusive participation, and mechanisms for peaceful change.

Mercy Corps' Strategy is to work in countries in transition, where communities are suffering and recovering from disaster, conflict, or economic collapse. Mercy Corps' experience demonstrates that during these times of turmoil and tragedy, there exists the possibility for positive change. Mercy Corps adds its greatest value as an international relief and development agency by supporting those kernels of positive change with community-led and market-driven action.

Mercy Corps operates programs in more than 40 countries throughout the world. Mercy Corps classifies its program activities into five major types: Humanitarian Assistance – Relief, Humanitarian Assistance – Recovery, Livelihood and Economic Development, Civil Society, and Health.

The consolidated financial statements include the accounts of Mercy Corps and its controlled affiliates, collectively, "the Organization." All material intercompany transactions and balances have been eliminated. Consolidated affiliates include:

Mercy Corps Foundation (MCF)
Mercy Corps Headquarters Manager, Inc
Mercy Corps Headquarters Building, LLC
Mercy Corps Headquarters Master Tenant Manager, LLC
Mercy Corps Headquarters Master Tenant, LLC
Kompanion Financial Group Microfinance Closed Joint Stock Company
Asian Credit Public Fund
Ariana Financial Services JSC
Hunchun Association for Poverty Alleviation in the Tumen River Area
Yanbian Association for Poverty Alleviation in the Tumen River Area
MICRA Phillipines Foundation, Inc.
Yayasan Microfinance Innovation & Resource Center Foundation
Mercy Enterprise Corporation (MEC) d/b/a Mercy Corps Northwest
MC Hong Kong (dissolved 2010)
MC Canada (dissolved 2010)
MC Belgium (dissolved 2010)
MC Singapore (formed in 2010)

(2) Summary of Significant Accounting Principles

(a) Basis of Accounting

The accompanying consolidated financial statements of the Organization have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Net assets are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the Organization's net assets and changes therein are classified and reported as follows:

- Unrestricted net assets – net assets that are not subject to donor-imposed restrictions.
- Temporarily restricted net assets – net assets that are subject to donor-imposed restrictions that permit the Organization to use or expend the assets as specified. The restrictions are satisfied either by the passage of time, or by actions of Mercy Corps.
- Permanently restricted net assets – net assets that are subject to donor-imposed restrictions that they are maintained in perpetuity by the Organization.

(b) Use of Estimates

The preparation of consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates in the Organization's consolidated financial statements include loan loss reserves. Actual results may differ from those estimates.

(c) Revenue Recognition

The Organization recognizes nongovernmental grants, unconditional promises to give, and contributions as revenue in the period received. Revenues are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions.

Government grants are primarily treated as exchange transactions and recognized as revenue in the period the grant objectives are met and the grant expenditures are incurred (exchange transaction method). Revenues from exchange transactions are reported as increases in unrestricted net assets.

Donated services that meet the criteria for recognition in accordance with generally accepted accounting principles are reported as contributions and expenses in amounts equal to their estimated fair value on the date of receipt. During the current fiscal year, $1,069,068 of legal services were provided pro bono to the Organization.

Commodities are received and reported at fair value and recognized as revenue as the commodities are distributed for program purposes.

Gifts in kind and contributions of fixed assets are reported as contributions at their estimated fair value on the date of receipt and reported as expense when utilized.

(d) Functional Allocation of Expenses

The Organization allocates expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are charged directly. Other expenses that are common to several functions are allocated by various statistical bases.

(e) Operating Support and Revenue in Excess of Expense

Operating support and revenue in excess of expense excludes activities that Mercy Corps considers to be outside the scope of its business, as defined by their mission statement.

(f) Foreign Currency Translation

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect on reporting dates, and revenues and expenses are translated at rates that approximate the average rate for the period in which the transactions occurred. Net transaction and translation gains and losses are included in the accompanying statement of activities in the nonoperating section as foreign currency exchange gain or loss.

(g) Income Taxes

Mercy Corps has been granted tax-exempt status under Section 501(c) (3) of the Internal Revenue Code and corresponding sections of the State of Washington provisions as a publicly supported Organization, which is not a private foundation.

In 2010, Mercy Corps adopted the sections of Accounting Standards Codification (ASC) Topic 740, *Accounting for Income Taxes* (ASC 740), related to uncertainties in income taxes, which prescribes a comprehensive model for recognizing, measuring, presenting, and disclosing in the consolidated financial statements tax positions taken or expected to be taken on a tax return.

The Organization believes it has not taken any significant uncertain tax positions, and accordingly, the adoption of the applicable sections of ASC 740 did not have a significant impact on the Organization’s consolidated financial statements.

In July 2008 the Organization’s Canada operations (MC Canada) were audited by the Canada Revenue Agency (CRA). The CRA issued its audit report March 2009. The report identified several areas of noncompliance with provisions of the Canadian Income Tax Act and its Regulations. Following the audit, the Organization reassessed its business requirements in Canada and determined that an official presence, in the form of a separate Canadian registered charity, was no longer necessary.

The Organization requested a voluntary revocation of its charitable registration in Canada. The CRA granted the revocation in November 2009 and the Organization filed final dissolution documents with Canadian authorities in March 2010.

The Organization received a notice in August 2009 stating that the Internal Revenue Service (IRS) would be performing an examination of the Organization’s IRS Forms 990 for the years ended June 30, 2008 and 2007. This examination is currently in progress.

(Continued)

(h) Cash

Cash and cash equivalents consist of short-term, highly liquid investments with original maturities of three months or less at the date of acquisition. The Organization held no cash equivalents as of June 30, 2010.

Certain cash accounts are maintained as separate accounts that represent cash held in trust or as collateralized cash. The accounts totaled $2,543,798 at June 30, 2010.

(i) Investments

The Organization holds various types of investments, including money market accounts, and mutual funds. Investments are recorded at fair value. Interest and dividends earned on funds are included in other revenue classified as either unrestricted or temporary restricted based on donor stipulations. There are no significant concentrations as the portfolio is diversified among issuers, and immaterial to the overall net assets of the Organization.

(j) Derivative Financial Instruments

Derivative financial instruments include currency swaps and an interest rate swap. The Organization utilizes this strategy to minimize risk associated with fluctuations in both interest rates and foreign currency exchange rates. Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are recognized currently as a gain or loss in other nonoperating changes in net assets in the statement of activities.

(k) Fair Value Measurements

During 2009, the Organization adopted the accounting standard, *Fair Value Measurements and Disclosures* (ASC 820) that established a framework for measuring fair value. This standard defines the fair value as the amount that would be exchanged for an asset or to transfer a liability in an orderly transaction between market participants at the measurement date.

The standard establishes a three-level fair value hierarchy that prioritizes the valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted market prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the whole term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available.

The Organization used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value in the consolidated financial statements:

Investments – Fair values for these investments are based on quoted market prices (level 1).

Derivative financial instruments – The fair value of the Organization's interest rate and currency swaps are based on estimates using standard pricing models that take into account the present value of future cash flows as of the date of the statement of financial position. The fair values of the interest and currency rate swaps are based on models that rely on observable market-based data (level 2).

(l) Fair Value of Financial Instruments

The carrying value of cash, grants and other receivables, loans receivable and payable, and borrowings approximates their estimated fair value as of June 30, 2010, due to the relative short maturities of these instruments.

(m) Grants and Accounts Receivable

The majority of the Organization's grant and accounts receivables are due from private foundations and federal agencies. Grants and accounts receivable are expected to be collected within one year and are recorded at net realizable value.

Pledges receivable and notes receivable that are expected to be collected in future years are recorded at fair value, as determined using the net present value of future cash flows.

(n) Microfinance Loans Receivable

Financial services are an essential element of the Organization's integrated approach to helping people. In this sector, the Organization has established microfinance institutions (MFI's), structured loan guarantee programs, built capacity in existing MFI's, and created service organizations to contribute to the development of the overall microfinance industry. Activities from these services are reported as economic livelihood program activities, and it is the Organization's intent to reinvest all proceeds generated back into mission-related programs.

The following MFI's are consolidated in the accompanying consolidated financial statements.

Kompanion Financial Group Microfinance Closed Joint Stock Company (Kompanion), a for-profit entity, was formed in 2004 in the Kyrgyz Republic to engage in microfinance activities. Mercy Corps is the Founder and only shareholder of Kompanion.

Asian Credit Public Fund (ACF) was formed in 2001, and is registered in the Republic of Kazakhstan as a nonprofit nonmember organization to carry out certain types of banking operations. Mercy Corps is the Founder of ACF.

Asian Credit Fund Microcredit Organization, Limited Liability Company (ACF MCO LLC) was incorporated in 2007 as a for-profit commercial microcredit organization in the Republic of Kazakhstan, and wholly owned by ACF. In 2009, ACF MCO LLC was reregistered with Mercy Corps becoming a Participant, owning 60% of the capital, and ACF owning 40%. As Mercy Corps is the Founder of ACF, Mercy Corps controls ACF MCO LLC.

Ariana Financial Services JSC (AFS), a nondistributive joint stock company in Afghanistan, was formed in 2007 to engage in humanitarian purposes and social welfare activities with respect to the development of poor people in Afghanistan through the use of microfinance and microcredit. Mercy Corps owns 96% of outstanding shares of AFS, with the balance owned by employees of Mercy Corps and AFS.

Hunchun Association for Poverty Alleviation in the Tumen River Area and the Yanbian Association for Poverty Alleviation in the Tumen River Area (collectively, the PATRA's) were formed in 2002 and 2003, respectively, as a means toward the alleviation of poverty and suffering in certain areas in China. These organizations are registered under Chinese law and are considered local projects of Mercy Corps. Under a Memorandum of Understanding, Mercy Corps controls the PATRA entities.

In 2001 Mercy Corps established Mercy Enterprise Corporation (MEC), dba Mercy Corps Northwest, as a nonprofit corporation under the laws of the State of Oregon in order to provide economic development services to low-income populations in the states of Oregon and Washington. Mercy Corps maintains control of the board of directors along with control and management of MEC's programs.

Microfinance loans receivable are recorded in the consolidated statement of financial position at their unpaid principal balances net of allowance for loan losses. Interest income is accrued based on the outstanding principal amount and contractual terms of each individual loan. The Organization reviews its loans to assess impairment on a regular basis. A loan is considered impaired when, based on current information, it is probable that the Organization will not receive all amounts due in accordance with the contractual terms of the underlying loan agreement. When an impairment loss has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan receivable and the present value of the estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan receivable's original effective interest rate. All loan receivable losses are recognized in the consolidated statement of activities. When a loan is uncollectible, it is written off against the related reserve for loan impairment. Loan balances are written off when management determines that the loans are uncollectible and when all necessary steps to collect the loan are complete.

(o) Inventories and Material Aid

The Organization receives agricultural commodities from governments for distribution via Organization programs and for monetization in which proceeds are to be used to fund Organization programs. Commodities received for distribution are recorded at estimated fair value as inventory and deferred revenue. Revenue is recognized as inventory is distributed, and is recorded in the statement of activities as "Material Aid." Funds received from monetization of commodities are deferred until utilized in program activities. Revenue earned from monetization proceeds is recognized in the consolidated financial statements as "Material aid – monetized."

(Continued)

The Organization also receives nonfood commodities and supplies from private donors for distribution in the Organization's programs. These contributions are recorded as inventory and temporarily restricted revenue. As inventory is distributed, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions.

Material aid commodities received from the U.S. government that are held for sale are valued at the lesser of the fair value on the contribution date or the expected sales price in the foreign location, if impaired. Material aid commodities held for distribution and not for sale are valued at estimated fair value.

Inventories consist primarily of agricultural commodities.

(p) Program-Related Investments

Program-related investments represent the Organization's investments in domestic and overseas MFI's that do not meet the standard of control for consolidation under U.S. generally accepted accounting principles. The investments are typically in the form of equity investments funded with grants or the Organization's unrestricted funds. The purpose of these investments is the furtherance of the Organization's mission rather than the generation of income. Investments are recorded on either a cost or equity basis, depending on the Organization's level of ownership and influence over the MFI's.

(q) Property and Equipment, net

Land, buildings, and equipment are stated at acquisition cost or fair value on date of contribution. Depreciation is computed on a straight-line basis over the shorter of the estimated useful lives of the respective assets or the related lease term. The estimated useful lives by asset class are as follows:

	Years
Buildings	30 - 39
Leasehold improvements	3 - 30
Furniture, fixtures & equipment	3 - 10
Vehicles	3 - 5

The Organization has adopted a policy of applying a time restriction that expires over the useful life of the long-lived assets acquired, or constructed with contributions restricted for that purpose, and therefore releases amounts from temporarily restricted net assets ratably over the same useful life.

(3) Restatement

The Organization's June 30, 2009 net assets have been restated for the following:

	Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets	Total
Net assets, as previously reported at June 30, 2009	$ 22,568,961	$ 41,928,376	$ 20,000	64,517,337
(1) Adjustment to carrying value of program-related investments and elimination of program-related liabilities	11,560,500	—	—	11,560,500
(2) Recognition of capital assets previously expensed	2,139,458	—	—	2,139,458
(3) Elimination of revolving loan funds payable for satisfaction of oligations	3,857,261	—	—	3,857,261
Total correction to net assets	17,557,219	—	—	17,557,219
Net assets, as restated at June 30, 2009	$ 40,126,180	$ 41,928,376	$ 20,000	82,074,556

The Organization restated its net assets at June 30, 2009 to correct misstatements for the matters listed above as follows:

(1) An adjustment to the carrying value of program-related investments and elimination of program-related liabilities were required, as certain entities requiring consolidation under the guidance of SOP 94-3, as subsequently incorporated into ASC 958-810, *Consolidation,* had not been previously consolidated. Additionally, the carrying value of certain equity and cost method investments had not been updated, and program-related liabilities previously recorded as offsets to certain program related investments were determined to be satisfied in prior periods. The entities that were not previously fully consolidated included Kompanion Financial Group Microfinance Closed Joint Stock Company, Asian Credit Public Fund, and Ariana Financial Services JSC.

(2) Certain donor-funded capital asset purchases were immediately expensed upon purchase, although the Organization retains title to these assets. According to ASC 958-360-35, these assets should have been capitalized and depreciated. This adjustment has been recorded to reflect property, plant and equipment placed in service.

(3) Historically, a portion of the funding for microfinance entities has been provided via grants. As these grants qualified as exchange transactions, the grants were recorded as liabilities when the funding was

received. Such liabilities were not eliminated when microfinance loans were extended and grant obligations were satisfied. This adjustment removes liabilities that have been satisfied.

In addition, the Organization restated its cash from $43,097,149 to $63,770,437 for amounts held at the previously unconsolidated entities.

(4) Fair Value of Financial Instruments

Fair value measurements at June 30, 2010 consisted of the following:

	Level 1	Level 2	Total
Assets:			
Investments:			
Mutual funds	$ 426,772	—	426,772
Exchange-traded fund	76,720	—	76,720
Money market	9,253	—	9,253
Total investments	512,745	—	512,745
Derivative financial instruments:			
Foreign currency swap arrangements	—	264,393	264,393
Total	$ 512,745	264,393	777,138

Mercy Corps had no Level 3 assets or liabilities measured at fair value at June 30, 2010.

(5) Pledges Receivable

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net assets category. Pledges receivable are expected to be collected in future years and are recorded after discounting at 0.5% to 3.5% to the present value of expected future cash flows.

Unconditional promises are expected to be collected in the following periods:

One year or less	$ 1,560,648
Between one year and five years	1,111,800
	2,672,448
Less discount	(16,090)
Net pledges receivable	$ 2,656,358

(6) Notes Receivable

At June 30, 2010, notes receivable comprises the following:

A note receivable from a U.S. corporation, interest at prime less 2.00% and at a guaranteed minimum 3.00% and maximum 6.00%, matures January 17, 2013	$	242,631
A note receivable from Mercy Corps Investment Fund, LLC, interest at 4.75%, matures April 1, 2015		10,987,489
Total notes receivable	$	11,230,120

(7) Microfinance Loans Receivable, net

Microcredit loans comprise variable and fixed rate loans with individuals and groups. Group loans are unsecured loans granted to a group of borrowers who sign a loan agreement with joint liability to repay a loan. The loans bear interest at rates generally at or below the local market industry average available. Microcredit loans are issued with original maturities ranging from 3 to 36 months. Individual microcredit loans are generally secured by real estate or business assets and have fixed payments.

Microfinance loans receivable were concentrated in the following countries as of June 30, 2010:

Afghanistan	$	3,513,316
China		1,010,119
Kazakhstan		2,059,423
Kyrgyzstan		37,129,462
Other		991,207
		44,703,527
Less loan loss reserves		(1,703,749)
Microfinance loans receivable, net	$	42,999,778

Activity in the provision for loan loss reserve on microcredit loans is as follows for the year ended June 30, 2010:

Loan loss reserve, June 30, 2009	$	(2,039,747)
Loan write-offs – current year, net		335,998
Loan loss reserve, June 30, 2010	$	(1,703,749)

(8) Property and Equipment

Land	$	3,787,172
Building and leasehold improvements		32,669,288
Vehicles		3,051,315
Furniture, fixtures, and equipment		6,824,033
Property and equipment		46,331,808
Less accumulated depreciation and amortization		(6,932,408)
Property and equipment, net	$	39,399,400

Depreciation and amortization expense for the year ended June 30, 2010 was $3,096,277.

(9) Program-Related Investments

The Organization's program-related investments in MFI's and MFI investment entities at June 30, 2010 are as follows:

PT Bank Andara, Indonesia	$	6,974,342
TenGer Financial Group LLC (previously, XAC-GE LLC), Mongolia		623,543
MicroVest I, LLP		200,000
MLO IMON International LLC, Tajikistan		5,208
	$	7,803,093

PT Bank Andara (Andara), a limited liability company, was organized under the laws of the Republic of Indonesia in 2009 by an investor consortium, led by Mercy Corps. Mercy Corps founded Bank Andara to deliver innovative financial services to millions of low-income Indonesian families. Andara serves as the strategic banking partner to the Indonesian microfinance sector, which encompasses over 50,000 institutions. In September 2009, Mercy Corps purchased an additional 7,450 shares of Andara for $995,723. At June 30, 2010, the Organization owned 33.39% of the outstanding shares of Andara. This investment is reported on the equity method of accounting. The summarized financial data for Andara is as follows:

Total assets	$	30,507,000
Total liabilities		14,659,000
Total equity		15,848,000
Total operating revenue	$	1,886,000
Total operating expense		(4,540,000)
Nonoperating gain		256,000
Net loss	$	(2,398,000)

TenGer Financial Group, LLC (TenGer), formerly, XAC-GE LLC, is a Mongolian company, whose largest holding is XacBank. XacBank was formed in 2001 through a combination of microfinance activities from local nonbank financial institutions. Mercy Corps was one of the initial funders of this entity through a variety of investments that started in December 1999, when Mercy Corps formed a for-profit, nonbanking institution whose mission was to serve the credit needs of small and medium enterprises (SMEs) in the Mongolian Gobi region. At June 30, 2010, the Organization owns 13.67% of the outstanding shares of TenGer. This investment is recorded on a cost basis.

MicroVest I, LP (the Fund) is a Delaware limited partnership. The investment objective of the Fund is to provide social impact and capital appreciation by lending to and making equity investments in MFI's located throughout the developing world. At June 30, 2010, the Organization owns 1.17% of the Fund and accordingly reports this investment on a cost basis.

MLO IMON International LLC (IMON) is a microfinance institution established in 2008 in the Republic of Tajikistan. At June 30, 2010, the Organization owns less than 1% of IMON. This investment is recorded on a cost basis. Mercy Corps is also one of two Founders of International Micro lending Fund IMON, a noncommercial microfinance fund that owns 90.82% of IMON.

(10) Debt

On September 14, 2009, Mercy Corps occupied a new headquarter building in Portland, Oregon. Financing for the $38 million project was provided by a Mercy Corps capital campaign, commercial loans, sale of a condominiumized unit, and both New Market Tax Credit (NMTC) and Federal Historic Tax Credit (FHTC) funding. In order to accommodate the structure, eight new entities were created:

Mercy Corps Investment Fund, LLC (MCIF) is the investor for the NMTC program. MCIF is funded by a commercial loan, a loan from Mercy Corps Foundation and equity investment from a private investor. As the NMTC program investor, MCIF is required to make Qualified Equity Investments (QEIs) in eligible Community Development Entities (CDEs) with available tax credit allocations. MCIF contributed QEI funds to three separate CDEs. Each of the three CDEs used the QEI funds, through designated sub-CDEs, to make Qualified Low-Income Community Investments (QLICIs) in the form of loans to Mercy Corps Headquarters Building, LLC, as a Qualified Active Low-Income Community Investment Business (QALICB). Mercy Corps does not control or have an interest in MCIF or in the sub-CDEs, and accordingly, MCIF and the sub-CDEs are not consolidated in the Organization's consolidated financial statements. Mercy Corps guarantees MCIF's commercial loan. The guaranty requires that Mercy Corps set aside funds monthly into a bank-controlled account, the balance of which is reported as a deposit on the Organization's consolidated statement of financial position.

Mercy Corps Headquarters Building, LLC's (Building) sole purpose is to function as a QALICB. Building is funded by QLICI loans from sub-CDEs, FHTC equity investment from Mercy Corps Headquarters Master Tenant, LLC (Tenant), and other equity investment from Mercy Corps Headquarters Manager, Inc. (Manager).

At June 30, 2010, long-term debt consisted of the following:

		Principal
NCF Sub-CDE, LLC: Interest rate of LIBOR+1.9% (2.28% at June 30, 2010) for 28.12% of the outstanding principal balance and a fixed rate of 4.11% for 71.88% of the outstanding principal balance. Interest-only payments are due monthly, until the loan matures on March 3, 2038, secured by real property	$	9,801,000
NNMF Sub-CDE III, LLC: Interest rate of LIBOR+1.9% (2.28% at June 30, 2010) for 28.12% of the outstanding principal balance and a fixed rate of 3.67% for 71.88% of the outstanding principal balance. Interest only payments are due monthly, until the loan matures on March 19, 2038, secured by real property		7,275,000
U.S. Bank Sub-CDE XX, LLC: Interest rate of LIBOR+1.9% (2.28% at June 30, 2010) for 28.12% of the outstanding principal balance and a fixed rate of 3.35% for 71.88% of the outstanding principal balance. Interest-only payments are due monthly, until the loan matures on March 19, 2038, secured by real property		6,930,000
Wells Fargo Term Loan: Interest rate of LIBOR+2.25% (2.63% at June 30, 2010) Secured by receivables and other assets. A balloon payment for the balance outstanding is due November 2010.		2,000,000
U.S. Bank: Interest rate of LIBOR+1.90% (2.28% at June 30, 2010) Interest is payable monthly, and the entire principal balance is due and payable on September 1, 2010, secured by real property		1,441,661
Meyer Memorial Trust: Interest rate is fixed at 2.00%. The unsecured loan is payable in three installments from June 2011 through June 2013.		1,000,000
U.S. Bank: Interest rate of LIBOR+1.90% (2.28% at June 30, 2010) principal is due in varying aggregate minimums annually and matures in March 2013, secured by Capital Campaign pledges		2,319,376
Wainright Bank and Trust Company: Interest rate of Prime+1.00% (4.25% at June 30, 2010, and payable in monthly principal and interest installments, with a balloon payment due in November 2018), secured by real property.		537,291
Portland Development Commission: Interest is variable (1.00% at June 30, 2010), payable in monthly principal and interest installments, with a balloon payment due in March 2018, secured by real property		371,221
	$	31,675,549

Future maturities of long-term debt outstanding at June 30, 2010 are as follows:

		Principal
Year ended:		
2011	$	3,716,585
2012		857,235
2013		2,267,363
2014		29,418
2015		30,693
Thereafter		24,774,255
	$	31,675,549

(a) Line of Credit

The Organization has a $3,500,000 line of credit commitment with a bank for working capital purposes, which bears interest at LIBOR plus 1.90% or LIBOR plus 2.15%, depending on the term selected by the Organization and a fee of 0.50% on the unused portion of the line of credit. The line is collateralized by a security interest in the Organization’s non-building assets and expires on July 1, 2011. As of June 30, 2010, the Organization has no outstanding borrowings under the line of credit.

(b) Covenants

The credit agreements with U.S. Bank, Wainwright Bank and Trust Company and the line of credit bank contain certain restrictive covenants that require, among other things, that the Organization maintain certain fixed charge coverage ratios and minimum levels of unrestricted cash and cash equivalents.

(11) Subsidiary and Subordinated Debt for Microfinancing Activities

Microfinancing debt proceeds are primarily used to finance the Organization’s microfinance lending activities. Typically, this debt is not collateralized and principal payments are expected to be made from the flow of cash from collection of the MFI loan receivables. Mercy Corps does not guarantee the repayment on this debt. Payment terms on these loans vary.

Debt maturities and interest rate ranges as of June 30, 2010 were as follows:

	Interest rate range		Principal
Year ended:			
2011	5.00% – 11.61%	$	13,947,150
2012	3.00% – 11.61%		13,853,597
2013	2.00% – 9.72%		2,785,931
2014	5.00% – 5.00%		480,649
2015	10.50% – 11.67%		7,559,353
Thereafter	2.00% – 5.00%		2,261,894
		$	40,888,574

The above debt is held by the following subsidiaries of Mercy Corps:

Mercy Enterprise Corporation	$	600,000
Kompanion		32,879,263
ACF		3,530,503
AFS		3,878,808
	$	40,888,574

The above debt also includes subordinated debts of $7,380,639. Subordinated debt is referred to as equity equivalents because they are subordinate to all other Organization debt. Payment terms can be accelerated only if the Organization fails to make interest payments, uses proceeds for a purpose other than that stated in the debt agreements, or ceases its normal operations. The subordinated debt maturity dates range from 2013 to 2018; however, the actual maturity dates are automatically extended each year unless the lender exercises its rights to set the final maturity date.

(12) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of June 30, 2010:

Organization programs	$	27,418,327
Headquarters building		7,548,606
Material aid		219,084
	$	35,186,017

(13) Permanently Restricted Net Assets

The Organization adopted FSP 117-1 (as subsequent incorporated into ASC 958-205, *Presentation of Financial Statements*) effective for the beginning of fiscal year 2009. The Organization has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The earnings on the donor-restricted endowment fund that are classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with standard of prudence prescribed by UPMIFA. As of June 30, 2010, the Organization had one donor-restricted endowment of $20,000.

(14) Obligations under Operating Leases

The Organization leases office space under operating leases that require payments through 2015. The leases contain annual escalation clauses at fixed percentages or based on the consumer price index. At June 30, 2010, the Organization's aggregate minimum annual operating lease commitments are as follows:

2011	$ 937,912
2012	727,043
2013	590,164
2014	341,846
2015	110,527
Thereafter	—
	$ 2,707,492

Total rent expense was $3,443,637 for the fiscal year ended June 30, 2010. A portion of this rent expense relates to facilities that are not under a formal lease agreement.

(15) Commitments and Contingencies

The Organization receives a substantial portion of its funding in the form of grants from the U.S. government. These grants contain certain compliance and internal control requirements that, if violated, may result in the disallowance of some costs incurred under the grant programs. As of June 30, 2010, the Organization recorded a liability for estimated disallowances based on management's review of prior history and assessment of the potential for disallowances.

The Organization is involved in various other legal matters and claims in the ordinary course of its operations. While it is not possible to determine the ultimate liability, if any, in these matters at this time, in the opinion of management, such matters will not have a material adverse effect on the financial condition of the Organization.

(16) Employee Benefit Plan

The Organization has a defined contribution plan under Internal Revenue Code Section 403(b) for employees who meet the eligibility conditions. Employees are eligible to make voluntary pretax contributions beginning the first day of the month following their employment date. Employees are eligible to receive employer contributions equal to 6% of gross salary after one year of service. The Organization's contributions to the plan for the year ended June 30, 2010 amounted to $952,954.

The Organization also has an employee benefit plan for certain third-country nationals who are otherwise ineligible for the defined contribution plan under Internal Revenue Code Section 403(b). These employees are eligible to receive employer contributions equal to 6% of gross salary after one year of service. The Organization's contributions to the program for the year ended June 30, 2010 amounted to $212,633.

Within the various countries in which the Organization operates outside the U.S., most employees are citizens of the host country. These employees are generally not eligible for the Organization's defined contribution plan or for the employee benefit plan for third-country nationals; however, they are eligible for certain local government sponsored plans appropriate for that country.

(17) Related Parties

Mercy Corps Scotland (MCS) is a nonprofit corporation registered in the United Kingdom. MCS has a separate board of directors and controls and manages its own programs. MCS possesses legal and fiscal responsibility and final oversight for projects implemented with grants and contributions that it receives from donors and government agencies. MCS has a clear and unequivocal responsibility to ensure that any program it supports or undertakes falls within the scope of its activities as set forth under Scottish charity legislation and that all funds are used appropriately. The Organization does not and cannot exert direct financial or operational control over MCS, and as such, MCS is not included in the Organization's consolidated financial statements.

MCS and the Organization share the same mission, purpose, and values as partners in an international network of colleagues working together to fulfill the basic purpose of the Organization's programs worldwide. MCS and the Organization work closely together as affiliates and, in some instances, both organizations will pool administrative and technical resources for the benefit of their respective projects. In such cases, an invoice for the actual costs incurred will be sent between MCS and the Organization.

The Organization entered into a Memorandum of Understanding (MOU) with MCS on April 14, 2005. This MOU states that the Organization will assume any of MCS' financial liabilities that might arise from donor disallowances. Additionally, the Organization has agreed to indemnify MCS for all expenses related to material aid transactions in Europe. As of June 30, 2010, the Organization is not aware of any material known or contingent donor disallowances arising from program activities carried out by MCS.

As of June 30, 2010, the net amount due from MCS and other affiliates was $2,626,060.

(18) Significant Sources of Revenue and Concentration of Risk

(a) Significant Sources of Revenue

The Organization receives a majority of its funding through grants from the U.S. government. A reduction in the amount of grants available or in the Organization's ability to receive government grants would have a material impact on its programs and operations.

(b) Concentration of Risk

For cash held in the United States of America, the Organization places its cash in high credit quality institutions. At times, such amounts may be in excess of the Federal Deposit Insurance Company (FDIC) limits. Management believes that the risk with respect to the balances in excess of FDIC limits is minimal. At June 30, 2010, the Organization held $33,453,737 of cash and cash equivalents in U.S. financial institutions, of which $32,289,609 was uninsured.

In order to fulfill grant agreements, the Organization maintains cash balances inside foreign countries and in the local currencies. The Organization's MFI's also hold cash overseas for purposes of ongoing operations. Uninsured cash held overseas, in approximately 38 countries, was $23,035,223 at June 30, 2010.

(19) Subsequent Events

The Organization has performed an evaluation of subsequent events through January 31, 2011, which is the date the consolidated financial statements were available to be issued.

In November 2010, the Organization repaid in full the $2,000,000 Wells Fargo Term Loan. Additionally, the Organization repaid in full the $1,441,661 U.S. Bank loan in August 2010.

SCHEDULE I

MERCY CORPS AND AFFILIATES

Supplementary Schedule – Statement of Financial Position (unaudited)

Selected subsidiary entities

June 30, 2010

The following is a summary of the statement of financial position and statement of activities for the Organization's MFI entities and investments included as part of the consolidated financial statements of Mercy Corps and affiliates for the fiscal year ended June 30, 2010 (numbers are in thousands):

Cash	$	7,215
Financial instruments, derivatives		849
Grants and accounts receivable		366
Microfinance loans receivable, net		42,895
Due from affiliates, net		(390)
Prepaid expenses, deposits, and other assets		1,105
Note receivable		—
Program related investments		7,803
Property and equipment, net		2,555
Total assets	$	62,398
Liabilities:		
Accounts payable and accrued liabilities	$	2,696
Deferred revenue		204
Subsidiary debt for microfinancing activities		40,889
Subordinated debt and other long-term debt		—
Total liabilities		43,789
Unrestricted net assets		18,609
Total liabilities and net assets	$	62,398

SCHEDULE II

MERCY CORPS AND AFFILIATES

Supplementary Schedule – Statement of Activities (unaudited)

Selected subsidiary entities

June 30, 2010

Operating support and revenue:		
Government grants	$	833
Private contributions		49
Interest income		18,294
Other revenue		784
Total operating support and revenue		19,960
Operating expenses:		
Livelihood/economic development		18,261
General and administrative		83
Total operating expenses		18,344
Operating support and revenue in excess of operating expense		1,616
Other nonoperating changes in net assets:		
Foreign exchange loss		(227)
Realized and unrealized gain on investments		244
Unrealized loss on swap agreements		(1,991)
Total nonoperating revenue and expenses		(1,974)
Change in net assets	$	(358)