HALF THE SKY FOUNDATION
AND SUBSIDIARY

Consolidated Financial Statements
December 31, 2006 and 2005

Together with
Independent Auditors' Report

HALF THE SKY FOUNDATION AND SUBSIDIARY

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Half the Sky Foundation and Subsidiary
Berkeley, California

We have audited the accompanying consolidated statement of financial position of Half the Sky Foundation and its subsidiary, as of December 31, 2006 and 2005, and the related consolidated statements of activities and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Half the Sky Foundation (Asia) Limited, a wholly owned subsidiary, which reflect total assets of $199,824 and $0 as of December 31, 2006 and 2005, respectively and total revenues of $240,278 and $0, respectively, for the years then ended. Those statements were audited by other auditors who report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Half the Sky Foundation (Asia) Limited, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 Foundation'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 consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidating financial statements referred to above present fairly, in all material respects, the consolidated financial position of Half the Sky Foundation and its subsidiary, as of December 31, 2006 and 2005, and the related consolidated statements of activities and changes in net assets and of cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Ireland San Filippo LLP

San Jose, California
August 23, 2007

HALF THE SKY FOUNDATION AND SUBSIDIARY

Consolidated Statement of Financial Position

ASSETS

	December 31, 2006	December 31, 2005
Assets:		
Cash and cash equivalents	$ 906,893	$ 203,043
Contributions in kind	472,495	312,604
Cash held for reinvestment	-	376,415
Pledges receivable, net	2,142,883	957,926
Other receivables	357	79,937
Investments	545,117	176,015
Prepaid program expenses	34,393	-
Property and equipment, net	13,582	23,268
Inventory	141,305	138,991
Deposits	14,509	12,450
	$ 4,271,534	$ 2,280,649

LIABILITIES AND NET ASSETS

	2006	2005
Liabilities:		
Accounts payable	$ 28,643	$ 831
Accrued expenses	13,952	4,545
Lease payable	-	5,282
Total liabilities	42,595	10,658
Commitment		
Net assets:		
Unrestricted	1,111,708	1,146,450
Board designated for investment	150,000	50,000
Total unrestricted net assets	1,261,708	1,196,450
Temporarily restricted	2,432,668	803,076
Permanently restricted	534,563	270,465
Total net assets	4,228,939	2,269,991
	$ 4,271,534	$ 2,280,649

The accompanying notes are an integral part of these financial statements

HALF THE SKY FOUNDATION AND SUBSIDIARY

Consolidated Statement of Activities and Changes in Net Assets

For the Years Ended December 31, 2006 and 2005

	2006				2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains, and other support:								
Contributions	$ 1,964,455	$ 2,609,892	$ 264,098	$ 4,838,445	$ 1,615,776	$ 1,191,843	$ 270,465	$ 3,078,084
Contributions-in-kind	89,742	-	-	89,742	-	-	-	-
Merchandise sales	73,881	-	-	73,881	221,321	-	-	221,321
Investment income	33,617	-	-	33,617	13,187	-	-	13,187
Net realized and unrealized gains on investments	27,427	-	-	27,427	17,351	-	-	17,351
Net assets released from restriction	980,300	(980,300)	-	-	443,050	(443,050)	-	-
Total revenues	3,169,422	1,629,592	264,098	5,063,112	2,310,685	748,793	270,465	3,329,943
Expenses:								
Program services	2,524,699	-	-	2,524,699	1,518,645	-	-	1,518,645
Fundraising	304,428	-	-	304,428	122,153	-	-	122,153
Management and general	275,037	-	-	275,037	210,408	-	-	210,408
Total expenses	3,104,164	-	-	3,104,164	1,851,206	-	-	1,851,206
Change in net assets	65,258	1,629,592	264,098	1,958,948	459,479	748,793	270,465	1,478,737
Net assets, beginning of year	1,196,450	803,076	270,465	2,269,991	736,971	54,283	-	791,254
Net assets, end of year	$ 1,261,708	$ 2,432,668	$ 534,563	$ 4,228,939	$ 1,196,450	$ 803,076	$ 270,465	$ 2,269,991

The accompanying notes are an integral part of these financial statements

HALF THE SKY FOUNDATION AND SUBSIDIARY

Consolidated Statement of Cash Flows

	For the Years Ended December 31, 2006	2005
Cash flows from operating activities:		
Cash received from general contributions	$ 1,825,237	$ 628,067
Contributions in kind	1,504,515	1,191,843
Cash received from merchandise, interest and other income	107,498	336,944
Cash disbursed for program expenses	(2,592,022)	(1,655,803)
Cash disbursed for fundraising and management expenses	(567,113)	(320,578)
Cash disbursed for inventory, prepaid expenses and deposits	(4,373)	(151,441)
Net cash provided by operating activities	273,742	29,032
Cash flows from financing activities:		
Lease payments	(5,282)	(7,299)
Cash contributions received, restricted for long-term purposes	264,098	270,465
Net cash provided by financing activities	258,816	263,166
Cash flows from investing activities:		
Acquisition of fixed assets	(2,666)	(7,428)
Cash designated for reinvestment	376,415	(376,415)
Proceeds from sales of investments	534,820	-
Purchase of investments	(737,277)	-
Net cash provided (used) by investing activities	171,292	(383,843)
Increase (decrease) in cash and cash equivalents	703,850	(91,645)
Cash and cash equivalents, beginning of year	203,043	294,688
Cash and cash equivalents, end of year	$ 906,893	$ 203,043

The accompanying notes are an integral part of these financial statements

HALF THE SKY FOUNDATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2006

Note 1 - Organization and operations:

Half the Sky Foundation ("the Foundation"), a non-profit public benefit corporation was incorporated in November 1998, with its corporate office located in Berkeley, California.

Half the Sky Foundation (Asia) Limited ("Asia Ltd."), a supporting organization of the Foundation, was incorporated in Hong Kong on March 18, 2006. The consolidated financial statements include the accounts of the Foundation and Asia Ltd.

The Foundation was created in order to enrich the lives and enhance the prospects for orphaned children in China. The Foundation creates and operates infant nurture and early education programs, provides personalized learning for older children, and establishes loving permanent family care and guidance for children whose disabilities prevent them from finding adoptive families. It is the Foundation's goal to ensure that every orphaned child has a caring adult in her life and a chance at a bright future. The Foundation works in 34 state-run welfare institutions in 12 provinces and municipalities and offers four primary programs:

a) The Baby Sisters Infant Nurture Program – In this program, designed to give infants 0-18 months a healthy start in life, the Foundation employs "nannies," retired or laid-off workers from the local community, to cuddle, love and provide orphaned babies (0-2 years) the physical and emotional stimulation essential to normal development. The Foundation renovates rooms in the welfare institutions and provides training, salaries and other program expenses and supervision of staff.

b) The Little Sisters Preschool Program - In this program, the Foundation-trained teachers use a unique and progressive curriculum that blends principles of the Reggio Emilia approach to early childhood education with contemporary Chinese teaching methods. The program is designed not only to prepare the children (2-7 years) to succeed in Chinese schools, but also to help develop the "whole child", facilitating healthy emotional and physical development as well as cognitive. The Foundation renovates rooms in the welfare institution and provides training, salaries and other program expenses and supervision of staff.

c) The Big Sisters Program - In this program, individualized learning opportunities are provided for older children (8-21yrs) who remain in the institutions. The Foundation tailors each program to the specific child, offering such services as tutoring prior to entrance exams, tuition to vocational schools, funds for music, dance, computer or art classes, and tutors for learning a second language. The Foundation also provides school fees for a growing number of orphans to attend universities throughout China.

Note 1 - Organization and operations (continued):

c) The Family Village Program - In this program, children whose disabilities or special needs preclude adoption, live in permanent foster families in comfortable apartments in or nearby the welfare institution. This program enables children, who will never be adopted, to grow up knowing the love of family while also receiving the support services that the welfare institution and the Foundation programs provide. The children attend the Foundation preschools and then go on to enjoy the enrichment opportunities of the Big Sisters Program. The Foundation partners with local governments to renovate apartments, provides furnishings, a small stipend for foster parents, ongoing training and miscellaneous fees.

The Foundation is a not-for-profit organization that is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and classified by the Internal Revenue Service as other than a private foundation, and is exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d). Asia Ltd. has been granted tax exempt status by the Hong Kong Inland Revenue Department.

Note 2 - Summary of significant accounting policies:

Principles of consolidation - The accompanying consolidated financial statements include the accounts of the Foundation and its supporting organization, Asia Ltd. Inter-organization transactions and balances have been eliminated upon consolidation.

Foreign currency - Assets and liabilities denominated in foreign currencies are translated into United States of America dollars, the reporting currency, at exchange rates in effect on reporting dates, and revenue and expenses are translated at rates which approximate those in effect on transaction dates. Most of the Foundation's expenses were paid for using the Chinese Renminbi for the years ended December 31, 2006 and 2005. Translation gains and losses were not material to the financial statements taken as a whole and therefore are not reflected in the financial statements.

Note 2 - Summary of significant accounting policies (continued):

Basis of presentation - The consolidated financial statements have been prepared on the accrual basis of accounting which recognizes revenue and support when earned and expenses when incurred and accordingly, reflect all significant receivables, payables, and other liabilities.

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations.* Under SFAS No. 117, the Foundation is required to report information regarding its financial position and activities according to permanently restricted, temporarily restricted, and unrestricted net assets with the change in each of these classes of net assets to be presented in the statement of activities. Unrestricted net assets have no donor-imposed restrictions and include those revenues and expenses associated with program and supporting services. Permanently restricted net assets are restricted by the donor for investment in perpetuity, such as endowments. The income from such invested assets is available to support the activities of the Foundation.

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents - The Foundation considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Cash, other - The Foundation is unable to maintain a Chinese bank account under their name and have setup two accounts maintained by the Managing Director of Programs. Overseas program operations, such as employee salaries, are funded through wire transfers from the Foundation’s Berkeley office.

Investments - The Foundation invests in marketable securities and money market funds. All debt securities and equity securities are carried at quoted market prices as of the last trading date of the Foundation’s fiscal year. Contributions of public stock are recorded at quoted market prices at the date of donation. The Foundation sells securities received as soon as reasonably possible. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses resulting from sales or maturities are calculated on an adjusted cost basis. Adjusted cost is the estimated fair value of the security at the beginning of the year, or the cost if purchased during the year. Dividend and interest income are accrued when earned.

Note 2 - Summary of significant accounting policies (continued):

Pledges receivable, net - Pledges receivable are associated with contributions from donors who have pledged funds to be received after the year-end. Pledges that are expected to be collected after one year are evaluated at a discount rate of 5%. Pledges are also evaluated for collectibility. Such present value and collectibility reserves are recorded only if material to the financial statements.

Other receivables - Other receivables are associated activities such as accrued interest, and stock sale settlements.

Inventory - Inventory consists principally of merchandise sold in the Foundation's on-line store and is stated at the lower of weighted average cost or market value.

Property and equipment, net - Acquisitions of property and equipment in excess of $500 are capitalized. Purchased property and equipment are stated at cost. Significant donated property and equipment are recorded at their estimated fair value on the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

Contributions-in-kind - Contributions-in-kind are recognized in accordance with SFAS 116. Contributed goods are recorded at estimated fair value at the date of receipt and have been recorded at their estimated fair market value of $75,644 for the year ended December 31, 2006. The Foundation received contributed services, of pro bono legal services donated in China, for the years ended December 31, 2006 and 2005. The Foundation recorded the contributed services at their estimated fair market value of $14,098 for the year ended December 31, 2006. For the year ended December 31, 2005, the value of contributed services and goods were not material to the financial statements taken as a whole and therefore are not reflected in the financial statements. Due to the nature of government owned locations in the People's Republic of China, within which the Foundation runs operations, the Foundation has not been able to determine a reasonable basis to estimate the fair value of the donated use of facilities for the years ended December 31, 2006 and 2005.

Reclassification - Certain 2005 balances have been reclassified to conform to the 2006 financial statement presentation. These reclassifications have no effect on the previously reported change in net assets.

Note 2 - Summary of significant accounting policies (continued):

Revenue recognition - Contributed support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other contributed support is recognized as revenue when received or un-conditionally promised. The Foundation reports gifts of cash and other assets as restricted support if such gifts are received with donor stipulations that limit the use of the donated assets. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions.

Functional expense allocations - The costs of providing the various program and supporting services have been summarized on a functional basis in the Consolidated Statement of Activities and Changes in Net Assets. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Fair value of financial instruments - Financial instruments included in the Foundation's Consolidated Statement of Financial Position as of December 31, 2006 and 2005 include cash and cash equivalents, investments, receivables, and accrued liabilities. For cash and cash equivalents and accrued liabilities, the carrying amounts approximate fair value due to their short maturity. Investments are reflected in the accompanying Consolidated Statement of Financial Position at their estimated fair values using methodologies described above.

Concentration of credit risk - Financial instruments, which potentially subject the Foundation to credit risk, consist primarily of cash, cash equivalents, and investments. The Foundation maintains cash, cash equivalents and investments with major financial institutions. Cash equivalents include overnight investments in money market funds. At times, such amounts might exceed FDIC limits.

New accounting pronouncements - In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," which prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 is effective for fiscal periods beginning on or after December 15, 2006. The Foundation is currently in the process of evaluating the effect of FIN 48 on its Financial Statements.

Note 2 - Summary of significant accounting policies (continued):

New accounting pronouncements (continued) -

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements," which defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures and is effective for fiscal periods beginning after November 15, 2007. The Foundation is currently evaluating what effect, if any, the adoption of SFAS No. 157 will have on the Foundation's Financial Statements.

In February 2007, the FASB issued FAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115", (effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The Foundation does not anticipate that the adoption of FAS No. 157 will have a material impact on the Foundation's financial position, results of operations, or cash flows.

Other accounting standards that have been issued or proposed by FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Foundation's financial statements upon adoption.

Note 3 - Investments:

The estimated fair value of the Foundation's investments is as follows at December 31, 2006 and 2005:

	2006	2005
Equity securities	$ 487,321	$ 108,469
Certificates of deposit	39,049	48,685
Bonds	18,747	18,861
Total	$ 545,117	$ 176,015

Investment returns, including dividend income, realized and unrealized gains and losses, totaling $61,044 and $22,510 respectively, for the years ended December 31, 2006 and 2005 are included in the Consolidated Statement of Activities and Changes in Net Assets.

Note 4 - Pledges receivable, net:

Pledges receivable are recorded after discounting the future cash flows to present value using a discount rate of 5%. The maturities of these receivables are as follows:

Years Ending December 31,	Amount
2007	$ 1,061,546
2008	431,429
2009	342,524
2010	307,524
2011	95,812
Thereafter	20,000
	2,258,835
Less: discount for present value	(115,952)
Total	$ 2,142,883

Note 5 - Property and equipment, net:

Property and equipment consisted of the following at December 31, 2006 and 2005:

	2006	2005
Equipment	$ 47,550	$ 41,551
Furniture and fixtures	10,975	14,308
	58,525	57,864
Less: accumulated depreciation	(44,942)	(32,590)
Property and equipment, net	$ 13,582	$ 23,268

Note 6 - Temporarily restricted net assets:

Temporarily restricted net assets were available for the following purposes at December 31, 2006 and 2005:

	2006	2005
Guangzhou and Shenzhen	$ 953,938	$ 642,436
Tianjin and Guangzhou center & 8 additional Foster Villages	719,624	-
AIDS Project	160,764	14,024
Maonan	112,380	-
Shaoguan	94,592	-
Sponsorships	89,730	-
Maoming	83,000	-
Nanjing	54,790	-
Lianyungang	37,534	25,710
Luoyang	29,905	18,262
Yiyang	20,862	26,345
Yibin	17,802	-
Xiangtan	17,563	2,000
Wuzhou	13,700	-
Fuzhou	13,522	-
Guangdong	10,200	5,000
Guangzhou Extension	2,762	-
Guangzhou	-	26,671
Beihai	-	23,784
Shaoyang	-	11,364
Nanning	-	5,000
Chuzhou	-	1,280
Anhui	-	1,200
Total temporarily restricted net assets	$ 2,432,668	$ 803,076

Net assets of $980,300 and $443,050 were released from restrictions by incurring expenses satisfying the restricted purposes during the years ended December 31, 2006 and 2005.

Note 7 - Permanently restricted net assets:

Permanently restricted net assets consist of endowment fund cash and cash equivalents and investments that represent the principal amounts of gifts and bequests accepted with donor stipulation that the principal be maintained intact in perpetuity, with only the income to be utilized for operations.

Note 8 - Commitments:

The Foundation leases an office facility in the United States, an apartment unit in Beijing, People's Republic of China, and an office facility in Hong Kong. The operating leases expire at various dates through August 31, 2007. Rent paid under these leases was approximately $58,000 and $35,000, in the years ended December 31, 2006 and 2005. Future minimum lease payments payable under these leases are not material to the financial statements taken as a whole.

The Foundation has prepaid rent of $30,000 through December 31, 2007 which is included in prepaid program expenses.

Subsequent to December 31, 2006, the Foundation entered into a new operating lease for their United States office facility that requires annual payments of approximately $13,600 with a three percent increase each year, expiring in February 2010.

Note 9 - Retirement plan:

The Foundation provides a defined contribution plan, which provides for United States employee contributions only, under Section 403(b) of the Internal Revenue Code for all qualified United States employees.

Note 10 - Affiliated parties:

Half the Sky Foundation Canada (Foundation HTS du Canada) is an independent charitable entity, registered with the Canadian government, which raises funds and makes unrestricted donations to the Foundation.

Note 11 – Major contributions:

For the year ended December 31, 2006, one donor accounted for 31% of contributions and another donor accounted for 24% of contributions for the year ended December 31, 2005.