HALF THE SKY FOUNDATION

Financial Statements
December 31, 2005

Together with
Independent Auditors' Report

HALF THE SKY FOUNDATION

TABLE OF CONTENTS

DECEMBER 31, 2005

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statement of financial position of Half the Sky Foundation, as of December 31, 2005, and the related statements of activities and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of December 31, 2005, and the results of its activities and changes in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Ireland San Filippo LLP

San Jose, California
May 12, 2006

HALF THE SKY FOUNDATION

Statement of Financial Position

December 31, 2005

ASSETS

Assets:		
Cash	$	203,043
Cash held for reinvestment		376,415
Investments		176,015
Pledges receivable		957,926
Other receivables		79,937
Inventory		138,991
Prepaid program expenses		312,604
Deposits		12,450
Property and equipment, net		23,268
	$	2,280,649

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable	$	831
Accrued expenses		4,545
Lease payable		5,282
Total liabilities		10,658
Commitment		
Net assets:		
Unrestricted		1,146,450
Designated for investment		50,000
Total unrestricted net assets		1,196,450
Temporarily restricted		803,076
Permanently restricted		270,465
Total net assets		2,269,991
	$	2,280,649

The accompanying notes are an integral part of these financial statements

HALF THE SKY FOUNDATION

Statement of Activities and Changes in Net Assets

Year Ended December 31, 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains, and other support:				
Contributions	$ 1,615,776	$ 1,191,843	$ 270,465	$ 3,078,084
Merchandise sales	221,321	-	-	221,321
Interest income	8,028	-	-	8,028
Dividend income	5,159	-	-	5,159
Net realized and unrealized gains on investments	17,351	-	-	17,351
Net assets released from restriction	443,050	(443,050)	-	-
Total revenues	2,310,685	748,793	270,465	3,329,943
Expenses:				
Program services	1,518,645	-	-	1,518,645
Management and general	210,408	-	-	210,408
Fundraising	122,153	-	-	122,153
Total expenses	1,851,206	-	-	1,851,206
Change in net assets	459,479	748,793	270,465	1,478,737
Net assets, beginning of year	736,971	54,283	-	791,254
Net assets, end of year	$ 1,196,450.00	$ 803,076	270,465	$ 2,269,991

The accompanying notes are an integral part of these financial statements

HALF THE SKY FOUNDATION

Statement of Cash Flows

Year Ended December 31, 2005

Cash flows from operating activities:		
Cash received from general contributions	$	628,067
Cash received from temporarily restricted contributions		1,191,843
Cash received from merchandise, interest and other income		336,944
Cash disbursed for program expenses		(1,655,803)
Cash disbursed for fund-raising and management expenses		(320,578)
Cash disbursed for inventory, prepaid expenses and deposits		(151,441)
Net cash provided by operating activities		29,032
Cash flows from financing activities:		
Lease payments		(7,299)
Cash contributions restricted for long-term purposes		270,465
Net cash provided by investing activities		263,166
Cash flows from investing activities:		
Acquisition of fixed assets		(7,428)
Cash designated for reinvestment		(376,415)
Net cash used by investing activities		(383,843)
Decrease in cash		(91,645)
Cash, beginning of year		294,688
Cash, end of year	$	203,043

The accompanying notes are an integral part of these financial statements

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.

The Foundation's main objective is to enrich the lives and enhance the outcome for abandoned children living in China's welfare institutions. In order to create on-site childhood care and education for primarily girls eighteen months to twenty years of age, programs are developed to provide essential financial support and materials for certified childhood education teachers to train local teaching teams. Where needed, the Foundation develops programs that employ local women to provide physical contact, nurture and stimulation for abandoned infants less than eighteen months of age.

The Foundation is a not-for-profit organization that is exempt in 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).

Note 2 - Summary of significant accounting policies:

Basis of presentation - The 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.

HALF THE SKY FOUNDATION

Notes to Financial Statements

December 31, 2005

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

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.

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.

Pledges receivable - 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 4%. 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, stock sale settlements, and vendor receivables.

Prepaid program expenses – Prepaid program expenses represent amounts transferred to China that will be used for program expenses within one year.

Deposit – During the fiscal year ended December 31, 2005, the Foundation was making efforts to incorporate in China. In order to do so, the Foundation was required to pay a registration fee deposit in the amount of $12,450.

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

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

Property and equipment - 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 services, which require a specialized skill and which the Foundation would have paid for if not contributed, have been recorded at their estimated fair market value as appropriate. Due to the nature of government owned locations in Mainland China, through 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. Further, the Foundation has not been able to place a value upon pro bono legal services donated in China.

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 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 Statement of Financial Position as of December 31, 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 Statement of Financial Position at their estimated fair values using methodologies described above.

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

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 May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS 154 requires retrospective application to prior period financial statements for changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS 154 further requires a change in depreciation, amortization or depletion method for long-lived, non-financial assets to be accounted for as a change in accounting estimate affected by a change in accounting principle. The Foundation does not expect that the new standard will result in a significant effect on the financial statements.

Note 3 - Investments:

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

Equity securities	$ 108,469
Certificates of deposit	48,685
Bonds	18,861
Total	$ 176,015

Investment returns, including dividend income, realized and unrealized gains and losses, totaling $22,510 for the year ended December 31, 2005 are included in the Statement of Activities.

Note 4 - Pledges receivable:

Pledges receivable are expected to mature as follows:

Years Ending December 31,		Amount
2006	$	666,614
2007		216,812
2008		24,500
2009		10,000
2010		10,000
Thereafter		30,000
Total	$	957,926

The reserve for doubtful receivables and the discount to present value of future cash flows have been evaluated and are not material to these financial statements.

Note 5 - Property and equipment:

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

Equipment	$	41,551
Furniture and fixtures		14,308
		55,859
Less: accumulated depreciation		(32,591)
Property and equipment, net	$	23,268

HALF THE SKY FOUNDATION

Notes to Financial Statements

December 31, 2005

Note 6 - Temporarily restricted net assets:

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

AIDS Project	$	14,024
Anhui		1,200
Beihai		23,784
Chuzhou		1,280
Guangdong		5,000
Guangzhou		26,671
Guangzhou and Shenzhen		642,436
Lianyungang		25,710
Luoyang		18,262
Nanning		5,000
Shaoyang		11,364
Xiangtan Big Sisters		2,000
Yiyang		26,345
Total temporarily restricted net assets	$	803,076

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

Note 7 - Permanently restricted net assets:

Permanently restricted net assets consist of endowment fund cash and cash equivalents and investments that represent the principle 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.

HALF THE SKY FOUNDATION

Notes to Financial Statements

December 31, 2005

Note 8 - Commitments:

The Foundation leases one office facility in the United States and two apartments in Beijing, in the People's Republic of China, under operating leases which all expire in 2007. Rent paid under these leases was approximately $35,000 for the year ended December 31, 2005. Future minimum lease payments payable under these leases are approximately as follows:

Year Ending December 31,		Amount
2006	$	50,000
2007		21,000
	$	71,000

Note 9 - Major contributions:

In 2005, one donor accounted for 24% of contributed support.

Note 10 - Retirement plan:

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

Note 11 - Affiliated parties:

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

Note 12 - Subsequent event:

Half the Sky Foundation (Asia) Limited, a supporting organization of the Foundation, was incorporated in Hong Kong on March 18, 2006. It has been granted tax exempt status by the Hong Kong Inland Revenue Department.