

SOVEREIGN GRACE CHURCHES, INC.
AUDITED FINANCIAL STATEMENTS
YEARS ENDED AUGUST 31, 2021 AND 2020

Sovereign Grace Churches, Inc.

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Independent Auditor's Report

Executive Committee of the Council of Elders
Sovereign Grace Churches, Inc.
Louisville, Kentucky

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We have audited the accompanying financial statements of **Sovereign Grace Churches, Inc.** (a nonprofit organization), which comprise the Statements of Financial Position as of August 31, 2021 and 2020, and the related Statements of Activities and Changes in Net Assets, Functional Expenses, and Cash Flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

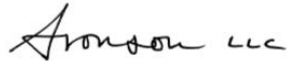
Independent Auditor's Report (Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Sovereign Grace Churches, Inc.** as of August 31, 2021 and 2020, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, effective July 1, 2020, **Sovereign Grace Churches, Inc.** changed its method of accounting for revenue in these financial statements due to the adoption of ASU 2014-09, Revenue from Contracts with Customers (Topic 606), as amended, using the modified retrospective adoption method. Our opinion is not modified with respect to this matter.



Rockville, Maryland
January 18, 2022

Sovereign Grace Churches, Inc.

Statements of Financial Position

<i>August 31,</i>	2021	2020
Assets		
Current assets		
Cash and cash equivalents	\$ 2,201,647	\$ 1,792,185
Investments	1,046,997	849,519
Accounts receivable - trade	208,669	135,123
Notes receivable, current portion	8,300	3,300
Prepaid expenses	42,022	51,268
Inventory	128,877	148,678
Total current assets	3,636,512	2,980,073
Property and equipment		
Furniture, fixtures and equipment	325,892	330,195
Less: Accumulated depreciation and amortization	(290,203)	(280,006)
Net property and equipment	35,689	50,189
Other assets		
Deposits and other assets	19,009	18,609
Long-term assets		
Notes receivable, net of current portion and discount	429,172	417,861
Total assets	\$ 4,120,382	\$ 3,466,732

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statements of Financial Position (continued)

<i>August 31,</i>	2021	2020
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued expenses	\$ 115,988	\$ 107,059
Deferred revenue	111,004	48,200
Deferred rent, current portion	10,345	7,843
Total current liabilities	237,337	163,102
Long-term liabilities		
Deferred rent, net of current portion	1,794	12,139
Note payable	-	175,800
Total liabilities	239,131	351,041
Net assets without restrictions		
Board designated	235,000	115,000
Undesignated	1,975,587	1,702,641
Total net assets without restrictions	2,210,587	1,817,641
Net assets with restrictions	1,670,664	1,298,050
Total net assets	3,881,251	3,115,691
Total liabilities and net assets	\$ 4,120,382	\$ 3,466,732

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statement of Activities and Changes in Net Assets

Year Ended August 31, 2021

	Without Restrictions	With Restrictions	Total
Operating support and revenue			
Contributions - churches	\$ 1,986,226	\$ 205,819	\$ 2,192,045
Contributions - other	462,538	166,795	629,333
Music and book sales, net	307,094	-	307,094
Music and book royalties	302,882	-	302,882
Tuition and fees	92,600	-	92,600
Conference receipts	6,683	-	6,683
Investment income	7,426	-	7,426
Paycheck Protection Plan loan forgiveness	175,800	-	175,800
Other income	35,549	-	35,549
Total operating support and revenue	3,376,798	372,614	3,749,412
Operating expenses			
Program services			
U.S. church missions	1,114,368	-	1,114,368
Global church missions	634,139	-	634,139
Pastoral training	375,594	-	375,594
Ministry resources	519,514	-	519,514
Total program services	2,643,615	-	2,643,615
Supporting services			
Fundraising	16,550	-	16,550
General and administrative	323,687	-	323,687
Total supporting services	340,237	-	340,237
Total expenses	2,983,852	-	2,983,852
Total of change in net assets	392,946	372,614	765,560
Net assets, beginning of year	1,817,641	1,298,050	3,115,691
Net assets, end of year	\$ 2,210,587	\$ 1,670,664	\$ 3,881,251

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statement of Activities and Changes in Net Assets

Year Ended August 31, 2020

	Without Restrictions	With Restrictions	Total
Operating support and revenue			
Contributions - churches	\$ 1,803,607	\$ 308,281	\$ 2,111,888
Contributions - other	405,258	141,182	546,440
Music and book sales, net	197,188	-	197,188
Music and book royalties	245,592	-	245,592
Tuition and fees	150	-	150
Conference receipts	67,466	-	67,466
Investment income	16,756	-	16,756
Other income	53,568	-	53,568
Total operating support and revenue	2,789,585	449,463	3,239,048
Operating expenses			
Program services			
U.S. church missions	888,922	-	888,922
Global church missions	632,289	-	632,289
Pastoral training	257,337	-	257,337
Ministry resources	510,480	-	510,480
Total program services	2,289,028	-	2,289,028
Supporting services			
Fundraising	10,807	-	10,807
General and administrative	403,180	-	403,180
Total supporting services	413,987	-	413,987
Total operating expenses	2,703,015	-	2,703,015
Change in net assets from operating activities	86,570	449,463	536,033
Nonoperating activities			
Loss on disposal of right to use asset	681,247	-	681,247
Total of change in net assets	(594,677)	449,463	(145,214)
Net assets, beginning of year	2,412,318	848,587	3,260,905
Net assets, end of year	\$ 1,817,641	\$ 1,298,050	\$ 3,115,691

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statement of Functional Expenses

Year Ended August 31, 2021

	Program Services					Supporting Services				Total
	U.S. Church Missions	Global Church Missions	Pastoral Training	Ministry Resources	Total	Fundraising	General and Administrative	Total		
Expenses										
Compensation and benefits	\$ 555,243	\$ 171,102	\$ 246,694	\$ 357,847	\$ 1,330,886	\$ 7,120	\$ 213,082	\$ 220,202	\$ 1,551,088	
Cost of goods sold	1,339	-	-	104,238	105,577	-	-	-	105,577	
Gifts and grants	326,207	361,538	4,767	2,039	694,551	-	315	315	694,866	
Travel and training	184,744	90,150	40,937	22,891	338,722	213	19,992	20,205	358,927	
Office expense	5,952	629	2,566	3,645	12,792	2,533	6,696	9,229	22,021	
Insurance	4,796	7,324	3,085	7,801	23,006	-	2,754	2,754	25,760	
Promotion	7,400	-	-	36,774	44,174	262	-	262	44,436	
Information technology	9,163	2,674	6,992	25,129	43,958	2,495	17,065	19,560	63,518	
Building occupancy	1,100	-	65,597	26,089	92,786	-	39,326	39,326	132,112	
Other expense	18,145	-	637	24,003	42,785	3,927	23,528	27,455	70,240	
Depreciation and amortization	1,618	722	4,319	13,296	19,955	-	929	929	20,884	
Total expenses	1,115,707	634,139	375,594	623,752	2,749,192	16,550	323,687	340,237	3,089,429	
Less: Cost of goods sold included with revenues in the Statement of Activities and Changes in Net Assets	(1,339)	-	-	(104,238)	(105,577)	-	-	-	(105,577)	
Total expenses reported in the Statement of Activities and Changes in Net Assets	\$ 1,114,368	\$ 634,139	\$ 375,594	\$ 519,514	\$ 2,643,615	\$ 16,550	\$ 323,687	\$ 340,237	\$ 2,983,852	

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statement of Functional Expenses

Year Ended August 31, 2020

	Program Services					Supporting Services			Total
	U.S. Church Missions	Global Church Missions	Pastoral Training	Ministry Resources	Total	Fundraising	General and Administrative	Total	
Expenses									
Compensation and benefits	\$ 517,177	\$ 152,788	\$ 166,479	\$ 382,823	\$ 1,219,267	\$ 3,500	\$ 256,377	\$ 259,877	\$ 1,479,144
Cost of goods sold	1,250	-	-	128,529	129,779	-	-	-	129,779
Gifts and grants	155,965	404,460	1,129	1,352	562,906	-	173	173	563,079
Travel and training	134,339	63,754	11,183	13,075	222,351	-	2,771	2,771	225,122
Office expense	11,374	1,045	4,083	6,262	22,764	924	2,612	3,536	26,300
Insurance	4,402	6,612	2,079	8,105	21,198	-	3,245	3,245	24,443
Promotion	2,750	-	-	18,094	20,844	680	-	680	21,524
Information technology	10,482	2,949	4,430	23,694	41,555	1,178	9,483	10,661	52,216
Sound, video, and lighting	34,746	-	35	736	35,517	-	-	-	35,517
Building occupancy	1,758	98	62,742	26,130	90,728	-	37,389	37,389	128,117
Other expense	15,163	251	1,538	18,215	35,167	4,525	37,590	42,115	77,282
Depreciation and amortization	766	332	3,639	11,994	16,731	-	53,540	53,540	70,271
Total expenses	890,172	632,289	257,337	639,009	2,418,807	10,807	403,180	413,987	2,832,794
Less: Cost of goods sold included with revenues in the Statement of Activities and Changes in Net Assets	(1,250)	-	-	(128,529)	(129,779)	-	-	-	(129,779)
Total expenses reported in the Statement of Activities and Changes in Net Assets	\$ 888,922	\$ 632,289	\$ 257,337	\$ 510,480	\$ 2,289,028	\$ 10,807	\$ 403,180	\$ 413,987	\$ 2,703,015

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Statements of Cash Flows

<i>Years Ended August 31,</i>	2021	2020
Cash flows from operating activities		
Change in net assets	\$ 765,560	\$ (145,214)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	20,884	70,271
Amortization of discount on note receivable	(19,611)	-
Unrealized and realized (gain) loss on investments	(5,006)	25,678
Forgiveness of note payable	(175,800)	-
Loss from disposal of right to use asset	-	681,247
(Increase) decrease in		
Accounts receivable - trade	(73,546)	65,600
Prepaid expenses	9,246	(24,459)
Inventory	19,801	11,847
Deposits and other assets	(400)	(8,768)
(Decrease) increase in		
Accounts payable and accrued expenses	8,929	(35,893)
Deferred revenue	62,804	5,352
Deferred rent	(7,843)	(5,406)
Net cash provided by operating activities	605,018	640,255
Cash flows from investing activities		
Purchase of investments	(814,543)	(1,343,290)
Proceeds from sales of investments	622,071	2,082,330
Proceeds from notes receivable	3,300	-
Purchase of property and equipment	(6,384)	(9,398)
Issuance of notes receivable	-	(15,675)
Net cash (used) provided by investing activities	(195,556)	713,967
Cash flow from financing activities		
Proceeds from note payable	-	175,800
Net cash provided by financing activities	-	175,800
Net change in cash and cash equivalents	409,462	1,530,022
Cash and cash equivalents at beginning of year	1,792,185	262,163
Cash and cash equivalents at end of year	\$ 2,201,647	\$ 1,792,185

The accompanying Notes to Financial Statements are an integral part of these financial statements.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

1. Organization and significant accounting policies

Organization: Sovereign Grace Churches, Inc. (“SGC”) is a Maryland nonprofit corporation with offices in Louisville, Kentucky. SGC is an association of churches operated exclusively for religious, charitable, and educational purposes. SGC is a family of churches who partner together to advance the gospel of Jesus Christ through planting and strengthening churches, training pastors, producing resources, and engaging in missions throughout the world.

Basis of presentation: The financial statements of SGC have been prepared on the accrual basis of accounting whereby revenue and support are recognized when earned and expenses are recognized when incurred. Net assets and revenues are classified based on the existence or absence of donor-imposed restrictions and reported as follows:

Net assets without donor restrictions – net assets that are not subject to donor-imposed stipulations. Includes undesignated net assets available for general operations and board designated net assets.

In October 2017, a Board Designated Reserve was established to fund future church plants when funds are not available in the annual operating budget. As of August 31, 2021 and 2020, the reserve balance was \$115,000. There was no activity in this reserve for the years ended August 31, 2021 and 2020.

In August 2021, a Board Designated Reserve of \$120,000 was established for a future recording studio for music and video.

Net assets with donor restrictions – net assets subject to donor-imposed stipulations that will be met either by actions of SGC and/or the passage of time. Donor-restricted contributions are classified as net assets without donor restrictions when restrictions are met in the same reporting period in which the contributions are received. As of August 31, 2021 and 2020, there were no net assets that were subject to donor-imposed stipulations that were permanent in nature.

Cash and cash equivalents: SGC classifies all highly liquid investments, with original maturities of less than ninety days, as cash equivalents. Cash and cash equivalents consist of demand deposit accounts and money market accounts. SGC maintains cash balances which may exceed federally insured limits. SGC does not believe that this results in any significant credit risk.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Investments: Investments consist of federal government bonds and notes, mortgage-backed securities, and unit investment trusts which are stated at fair value. Certificates of deposit are carried at cost plus accrued interest, which approximates fair value. The certificates bore interest at 1.70% and matured in February 2021. Investment income (including realized and unrealized gains and losses on investments, interest, and dividends) is recorded as unrestricted income, unless restricted by donor or law.

Purchases and sales of investments are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Net appreciation includes gains and losses on investments bought and sold as well as held during the year.

Accounts receivable: The face amount of accounts receivable is reduced by an allowance for doubtful accounts, if needed. The allowance for doubtful accounts reflects the best estimate of probable losses determined principally based on historical experience and specific allowances for known troubled accounts. All accounts or portion thereof that are deemed to be uncollectible or that require an excessive collection cost are written off to the allowance for doubtful accounts. Management believes that all accounts receivable are fully collectible; therefore, there is no provision for doubtful accounts in the accompanying financial statements.

Inventory: Inventory consists of books and CDs held for resale to members of related churches and the general public. Inventory is valued at the lower of cost or net realizable value, with cost determined on a weighted average basis.

Property and equipment: Property and equipment greater than \$3,000 are capitalized at original cost or estimated fair value in the case of donated assets. Depreciation is calculated on the straight-line method over estimated useful lives of three to ten years for personal property and eight years for the building improvements. Depreciation and amortization expense was \$20,884 and \$70,271 for the years ended August 31, 2021 and 2020, respectively.

SGC capitalized a payment of \$1,890,190 to Covenant Life Church, Inc. ("CLC") for its right to use 17,125 square feet of buildings and improvements, located in Gaithersburg, Maryland, placed in service by CLC beginning August 1, 2002. An agreement was established between SGC and CLC under which SGC was given use of the building for successive terms of ninety-nine years and CLC provided all services, maintenance and repairs required for the upkeep of the property. SGC reimbursed CLC for its share of these expenses at a mutually agreed upon rate, determined annually.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

In August 2012, SGC relocated its primary offices to Louisville, Kentucky. Starting in September 2012, CLC began paying rent for use of a portion of the SGC space. The lease was operated on a month-to-month basis. SGC received \$1,900 and \$19,000, from CLC in rental income for the years ended August 31, 2021 and 2020.

On July 30, 2020, SGC sold its right to use asset to CLC in exchange for a note receivable of \$525,000, at a 0% interest rate. The following joint public statement was issued on August 21, 2020:

“Covenant Life Church (CLC) and Sovereign Grace Churches (SGC) are pleased to announce the transfer of ownership and all obligations associated with their shared real estate in Gaithersburg, Maryland. The property consists of 17,125 square feet of office and warehouse space occupied by SGC in 2002 under a Shared Use Agreement. CLC has acquired full ownership for a sum of \$525,000 payable to SGC as a share of future rental income. CLC is currently seeking a tenant.

The existing Shared Use Agreement made this transaction complex and required both parties to work closely together over the last 12 months. We are grateful for this resolution and pray that it honors our Lord. May He be glorified as we steward these resources for the advancement of the gospel and the good of God’s people.”

The loss on the disposal of the right to use asset totaled \$681,247 and is included within the Statements of Activities and Changes in Net Assets under nonoperating activities in the year ended August 31, 2020. See Note 5 for a description of the note receivable, the related discount, and a schedule of amounts receivable.

Assets held for use: SGC evaluates long-lived assets held for use for impairment based upon comparison of the undiscounted future net cash flows for the asset to the net book value when an indicator of impairment is observed. These evaluations for impairment are significantly impacted by estimates of revenue, costs and expenses, sales rates, and other factors. If the net book value is greater than the future undiscounted cash flow, SGC records an impairment adjustment to reduce its asset cost basis to its fair value.

During the years ended August 31, 2021 and 2020, SGC recorded no impairment adjustments on assets held for use.

Deferred revenue: Consists of conference registration receipts and pastors college tuition received in advance.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Deferred rent: SGC recognizes the minimum non-contingent rents required under operating leases as rent expenses on a straight-line basis over the life of the lease, with differences between amounts recognized as expense and the amounts actually paid recorded as deferred rent on the accompanying Statements of Financial Position.

Revenue recognition: SGC recognizes certain revenue under Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (ASC 606). The standard outlines a five-step model whereby revenue is recognized as performance obligations within a contract are satisfied. The five-step model is outlined below:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Accordingly, the following revenue streams are within the scope of ASC 606:

Music and book sales – Sales of books and music are recorded as revenue at the point in time the item is shipped or downloaded. Payments for music and book sales are made quarterly and are provided to SGC no later than 60 days after the end of each quarter. Sales for two months of each year are required to be estimated based on projected sales and are recorded as accounts receivable until the actual balances are received.

Music and book royalties – Revenue is recognized at a point in time based on the date royalties are remitted to SGC by the distributors. Payments for music and book sales are made quarterly and are provided to SGC no later than 90 days after the end of each quarter.

Tuition and fees – Amounts received as tuition and fees for the upcoming school year are recognized as revenue ratably over the school year. Amounts received in advance are recorded as deferred revenue until earned over the course of the school year.

Conference receipts – Amounts received as registration for future events are recognized as revenue at the point in time when the event occurs. Amounts received in advance are recorded as deferred revenue until earned at the date of the conference.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Disaggregation of Revenue:

For the year ended August 31, 2021	Amount
Revenue recognized at a point in time	\$ 616,659
Revenue recognized over time	92,600
Total operating revenue:	\$ 709,259

Contract liabilities – Contract liabilities include amounts paid by customers for which goods or services have not yet been provided and are included in deferred revenue. As of August 31, 2021 and September 1, 2020, \$111,004 and \$48,200, respectively, of deferred revenue related to revenue was recognized under ASC 606.

Contract assets – Contract assets include amounts receivable to SGC for which goods and services have been provided and are included in accounts receivable. As of August 31, 2021 and September 1, 2020, \$208,669 and \$135,123, respectively, of receivables related to revenue were recognized under ASC 606.

Contract costs: Contract costs generally include direct costs such as compensation expenses for program personnel and other direct costs incurred including costs of materials and indirect costs identifiable with and allocable to the contract program. Costs are expensed as incurred. SGC does not incur significant incremental costs for obtaining contracts.

The following revenue streams are outside the scope of ASC 606:

Contributions – SGC recognizes all contributions, including unconditional promises to give, as support in the period pledged or received. Contributions restricted as to their use are recognized as net assets with donor restrictions until these funds have been disbursed or committed as the donor intended.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the Statements of Activities and Changes in Net Assets as net assets released from restrictions.

Other income – Consists mostly of rental fees and imputed loan interest income. All are recognized when the services are performed or when earned.

Functional allocation of expenses: The costs of providing the various programs and other activities have been summarized on a functional basis in the Statements of Activities and Changes in Net Assets. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Expenses that are allocated include the following:

Expenses	Method of Allocation
Compensation and benefits	Direct allocation & percentage of compensation and benefits
Gifts and grants	Direct allocation & percentage of compensation and benefits
Travel and training	Direct allocation & percentage of compensation and benefits
Office expenses	Direct allocation & percentage of compensation and benefits
Insurance	Direct allocation & percentage of compensation and benefits
Information technology	Direct allocation & percentage of compensation and benefits
Building occupancy	Direct allocation & percentage of compensation and benefits
Other expense	Direct allocation & percentage of compensation and benefits
Depreciation and amortization	Direct allocation & percentage of compensation and benefits

Income taxes: SGC is a nonprofit organization that is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code (IRC), and is classified as an organization which is not a private foundation.

SGC evaluates uncertainty in income tax positions based on a more-likely-than-not recognition standard. If that threshold is met, the tax position is then measured at the largest amount that is greater than 50% likely of being realized upon ultimate settlement. As of August 31, 2021 and 2020, there are no accruals for uncertain tax positions. If applicable, SGC records interest and penalties as a component of income tax expense. Tax years from 2018 through the current year remain open for examination by tax authorities.

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 and disclosure of contingent 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 those estimates.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

New accounting pronouncement adopted during 2021: In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides a five-step analysis of contracts to determine when and how revenue is recognized and replaces most existing revenue recognition guidance in U.S. generally accepted accounting principles. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. Topic 606 was originally effective for annual reporting periods beginning after December 15, 2018. However, in accordance with ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities, SGC can now elect to follow the original effective dates for Topic 606, or elect to adopt the guidance on September 1, 2020. Accordingly, effective September 1, 2020 SGC adopted the requirements of Topic 606 using the modified retrospective method. The guidance was not applied to contracts that were complete at September 1, 2020, and comparative information for the year ended August 31, 2020 has not been retrospectively adjusted.

As part of the adoption of ASC 606, SGC elected to use the following practical expedients: (1) ASC 606 is applied only to contracts that are not completed at the initial date of application, and (2) SGC elected to use the portfolio approach for similar contracts. Electing these practical expedients resulted in no significant impact to the financial statements. There were no significant changes that resulted from adoption in Topic 606; however, the presentation and disclosures have been enhanced.

Recent accounting pronouncements not yet adopted: In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes the existing lease accounting standard and sets out principles for the recognition, measurement, presentation and disclosure of leases. Under the new guidance, a lessee will be required to recognize lease assets and lease liabilities for all leases with lease terms in excess of twelve months. The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. ASU 2016-02 was originally effective for SGC on September 1, 2021. In June 2020, the FASB issued ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities, which delays the effective date of ASU 2016-02 to annual reporting periods beginning after December 15, 2021. Entities are also allowed to choose to adopt the standard as of the original effective date. SGC plans to adopt this new standard as of September 1, 2022. SGC is in the process of evaluating the impact from this new guidance.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Subsequent events: Management has evaluated subsequent events for disclosure in these financial statements through January 18, 2022, which is the date the financial statements were available to be issued.

2. Liquidity and availability of resources

The following reflects SGC’s financial assets as of the Statement of Financial Position date, reduced by amounts not available for general use because of donor imposed restrictions within one year of the Statement of Financial Position date, or because of an internal board designation. SGC strives to maintain total net financial assets sufficient to cover 90 to 270 days of general expenditures, which are estimated at \$600,000 to \$1,800,000. Financial assets in excess of daily cash requirements are invested in various instruments which are sources of liquidity. These include certificates of deposit, money market funds, U.S. Treasuries, other short-term investments, mortgage-backed securities, and marketable debt and equity securities.

	2021	2020
Cash and cash equivalents	\$ 2,201,647	\$ 1,792,185
Investments	1,046,997	849,519
Accounts receivable - trade	208,669	135,123
Notes receivable, current portion	8,300	3,300
Total financial assets	3,465,613	2,780,127
 Donor-imposed restrictions		
Net assets with donor restrictions	(1,670,664)	(1,298,050)
Net financial assets after donor-imposed restrictions	1,794,949	1,482,077
 Internal designations		
Board designated music studio reserve	(120,000)	-
Board designated church planting reserve	(115,000)	(115,000)
Net financial assets available to meet cash needs for general expenditures within one year	\$ 1,559,949	\$ 1,367,077

3. Investments

Investments are presented in the financial statements at fair market value. The following is a summary of the investments as of August 31:

	2021	2020
Federal government bonds and notes	\$ 201,284	\$ 204,922
Mortgage-backed securities	396,373	-
Indexed corporate bonds	148,567	144,353
Certificates of deposit	-	241,661
Unit investment trust	-	258,583
Fixed income mutual funds - domestic	300,773	-
Total	\$ 1,046,997	\$ 849,519

Sovereign Grace Churches, Inc.

Notes to Financial Statements

4. Fair value

SGC values its investments at fair value in accordance with a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. There have been no changes in the fair value methodologies used at August 31, 2021 and 2020.

The fair value of investments as of August 31, is as follows:

August 31, 2021	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	No Quoted Prices In Active Markets nor Observable Inputs (Level 3)
Federal government bonds and notes	\$ 201,284	\$ -	\$ 201,284	\$ -
Mortgage-backed securities	396,373	-	396,373	-
Indexed corporate bonds	148,567	-	148,567	-
Fixed income mutual funds - domestic	300,773	300,773	-	-
Total	\$ 1,046,997	\$ 300,773	\$ 746,224	\$ -

Sovereign Grace Churches, Inc.

Notes to Financial Statements

August 31, 2020	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	No Quoted Prices In Active Markets nor Observable Inputs (Level 3)
Federal government bonds and notes	\$ 204,922	\$ -	\$ 204,922	\$ -
Certificates of deposit	241,661	-	241,661	-
Unit investment trust	258,583	258,583	-	-
Indexed corporate bonds	144,353	-	144,353	-
Total	\$ 849,519	\$ 258,583	\$ 590,936	\$ -

Level 2 values for federal government bonds and notes, and mortgage-backed securities, were developed utilizing fluctuations in the attached indices or basket funds from the inception date to the maturity date. Values for certificates of deposit were developed utilizing the current interest rates with similar time to maturity, discounting the future payments to present value at year end. Indexed certificates of deposit values were developed utilizing fluctuations in the attached indices or basket funds from the instrument's inception date to the maturity date.

5. Notes receivable

As described in Note 1, on July 30, 2020, SGC sold its "right to use" asset to CLC in exchange for a note receivable of \$525,000, at a 0% interest rate. The loan amount is discounted with an imputed interest rate of 5%. Monthly payments on the note commence on the earlier of the date the space is leased to a third party or the second anniversary of the date of the agreement, July 30, 2022. The note is a secondary lien on property mortgaged through a reputable financial institution. Per the terms of that agreement, payment is subordinated and deferred to the extent necessary prior to the payment in full of the senior debt to the financial institution.

On March 10, 2020, SGC entered into an arrangement with a member church for a note receivable of \$16,500 at a 0% interest rate. Quarterly payments on the note occur in fifteen quarterly installments commencing on July 1, 2020.

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Notes to Financial Statements

The borrowers made all required payments under the notes as of August 31, 2021, totaling \$3,300, and the remaining \$537,375 was outstanding as of August 31, 2021.

Year ended August 31,	
2022	\$ 8,300
2023	63,300
2024	63,300
2025	62,476
2026	60,000
Thereafter	280,000
Subtotal	537,375
Less: present value discount:	(99,903)
Total notes receivable, net	437,472
Less: current portion	(8,300)
Long-term notes receivable	\$ 429,172

6. Operating lease

SGC entered into a commercial lease for 7,619 square feet of office space at 10509 Timberwood Circle, Louisville, Kentucky. The date of occupancy was July 10, 2017. The lease expires on October 31, 2022. The agreement included three months of rent abatement. A liability was accrued such that the rent expense was recognized on a straight-line basis over the life of the agreement. Rent expense under the lease agreement was \$117,082 for both the years ended August 31, 2021 and 2020, respectively.

The following is a schedule of future minimum lease payments:

Year ending August 31,	
2022	\$ 127,428
2023	21,308
Total	\$ 148,736

Sovereign Grace Churches, Inc.

Notes to Financial Statements

7. Paycheck Protection Program Assistance In April 2020, the Organization entered into a term note with a bank under the Paycheck Protection Program (PPP) in the amount of \$175,800. The note carries interest at a rate of 1% and is due in full on April 18, 2022, less any portion that is forgiven under the specifications pursuant to the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The PPP loan had a two-year term and bore interest at a rate of 1.00% per annum. Monthly principal and interest payments were deferred for sixteen months after the date of disbursement. The PPP loan could be prepaid at any time prior to maturity with no prepayment penalties. The CARES Act provides that the PPP loans may be partially or wholly forgiven if the funds are used for certain qualifying expenses as described in the CARES Act. On February 28, 2021, SGC was notified that the Small Business Administration approved the SGC's loan forgiveness application and the balance of the loan was recognized as a contribution.

8. Net assets with donor restrictions Net assets with donor restrictions were available for the following purposes as of August 31:

	2021	2020
U.S. church regions	\$ 1,362,687	\$ 1,156,867
International church regions	307,977	141,183
Total net assets with donor restrictions	\$ 1,670,664	\$ 1,298,050

Net assets were released from restrictions by incurring expenses satisfying the restricted purposes or by the passage of time as follows for the years ended August 31:

	2021	2020
U.S. church regions	\$ 658,282	\$ 479,063
International church regions	196,205	70,532
Total release of restrictions	854,487	549,595
Less: Amounts received and released in the same fiscal year	(854,487)	(549,595)
Total releases presented on the Statements of Activities and Changes in Net Assets	\$ -	\$ -

Sovereign Grace Churches, Inc.

Notes to Financial Statements

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- 9. Retirement plan** SGC maintains a retirement plan that is qualified under Section 403(b) of the IRC. The plan covers all full-time employees. SGC will match each participant's salary deferred contribution to the plan based upon a formula outlined in the plan document, up to a maximum employer contribution of 3% of compensation. Employees vest immediately in all employer contributions to the plan. Retirement plan expense for the years ended August 31, 2021 and 2020 was \$20,851 and \$24,509, respectively.
- For the pastoral staff who are not participating in the social security system, SGC also provides an amount equal to what would have been the normal employer Social Security and Medicare contribution (currently 7.65% of salary), which is then to be used to purchase any combination of life insurance, disability insurance, and retirement investments. SGC paid \$30,627 and \$30,654 for the years ended August 31, 2021 and 2020, respectively.
- 10. Commitments and contingencies** During the normal course of business, SGC has entered into agreements with a hotel to reserve room and facility space for future meetings scheduled to be held through 2025. In the event of cancellation, SGC is required to pay various costs of hotel rooms as stipulated in the contracts, the amounts of which are dependent upon the date of cancellation. As of August 31, 2021, such commitments are approximately \$332,000.
- 11. Risks and uncertainties** The impact of the coronavirus outbreak, or similar widespread health concerns, could negatively impact the Organization's operations, donors, staff, and student body. The operations for certain services could be negatively impacted by the outbreak of illnesses, including coronavirus (COVID-19). Any quarantines, labor shortages or other disruptions to operations may adversely impact the Organization's revenues, ability to deliver its services, and operating results. In addition, a significant outbreak of epidemic, pandemic or contagious diseases in the human population could result in a widespread health crisis that could adversely affect the economies and financial markets in which the Organization operates, resulting in an economic downturn that could affect demand for our services. As a result of the spread of the COVID-19 coronavirus, SGC has experienced some disruptions to normal operations including canceled events, but with minimal immediate financial impact. Economic uncertainties have arisen which may negatively impact future events, sales, or donor contributions. The Organization is unable to accurately predict the possible future effect if coronavirus or another disease expands globally.