

**SOVEREIGN GRACE CHURCHES, INC.**  
**AUDITED FINANCIAL STATEMENTS**  
**YEARS ENDED AUGUST 31, 2020 AND 2019**

# 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, 2020 and 2019, 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.

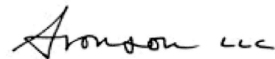
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or 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, 2020 and 2019, 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.



Rockville, Maryland  
January 25, 2021

## Sovereign Grace Churches, Inc.

### Statements of Financial Position

<i>August 31,</i>	2020	2019
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 1,792,185	\$ 262,163
Investments	849,519	1,614,237
Accounts receivable - trade	135,123	200,723
Notes receivable, current portion	3,300	-
Prepaid expenses	51,268	26,809
Inventory	148,678	160,525
<b>Total current assets</b>	<b>2,980,073</b>	<b>2,264,457</b>
<b>Property and equipment</b>		
Buildings	-	2,041,452
Furniture, fixtures and equipment	330,195	650,312
<b>Total</b>	<b>330,195</b>	<b>2,691,764</b>
Less: Accumulated depreciation and amortization	(280,006)	(1,493,969)
<b>Net property and equipment</b>	<b>50,189</b>	<b>1,197,795</b>
<b>Other assets</b>		
Deposits and other assets	18,609	9,841
<b>Long-term assets</b>		
Notes receivable, net of current portion and discount	417,861	-
<b>Total assets</b>	<b>\$ 3,466,732</b>	<b>\$ 3,472,093</b>

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>	2020	2019
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 107,059	\$ 142,952
Deferred revenue	48,200	42,848
Deferred rent, current portion	7,843	5,405
<b>Total current liabilities</b>	<b>163,102</b>	<b>191,205</b>
<b>Long-term liabilities</b>		
Deferred rent, net of current portion	12,139	19,983
Note payable	175,800	-
<b>Total liabilities</b>	<b>351,041</b>	<b>211,188</b>
<b>Net assets without restrictions</b>		
Board designated	115,000	115,000
Undesignated	1,702,641	2,297,318
<b>Total net assets without restrictions</b>	<b>1,817,641</b>	<b>2,412,318</b>
<b>Net assets with restrictions</b>	<b>1,298,050</b>	<b>848,587</b>
<b>Total net assets</b>	<b>3,115,691</b>	<b>3,260,905</b>
<b>Total liabilities and net assets</b>	<b>\$ 3,466,732</b>	<b>\$ 3,472,093</b>

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
<b>Operating support and revenue</b>			
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
<b>Total operating support and revenue</b>	<b>2,789,585</b>	<b>449,463</b>	<b>3,239,048</b>
<b>Operating expenses</b>			
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
<b>Total program services</b>	<b>2,289,028</b>	<b>-</b>	<b>2,289,028</b>
Supporting services			
Fundraising	10,807	-	10,807
General and administrative	403,180	-	403,180
<b>Total supporting services</b>	<b>413,987</b>	<b>-</b>	<b>413,987</b>
<b>Total operating expenses</b>	<b>2,703,015</b>	<b>-</b>	<b>2,703,015</b>
<b>Change in net assets from operating activities</b>	<b>86,570</b>	<b>449,463</b>	<b>536,033</b>
<b>Nonoperating activities</b>			
Loss on disposal of right to use asset	681,247	-	681,247
<b>Total of change in net assets</b>	<b>(594,677)</b>	<b>449,463</b>	<b>(145,214)</b>
<b>Net assets, beginning of year</b>	<b>2,412,318</b>	<b>848,587</b>	<b>3,260,905</b>
<b>Net assets, end of year</b>	<b>\$ 1,817,641</b>	<b>\$ 1,298,050</b>	<b>\$ 3,115,691</b>

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, 2019*

	<b>Without Restrictions</b>	<b>With Restrictions</b>	<b>Total</b>
<b>Support and Revenue</b>			
Contributions - churches	\$ 1,728,060	\$ 235,099	\$ 1,963,159
Contributions - other	272,916	-	272,916
Music and book sales, net	235,704	-	235,704
Music and book royalties	239,903	-	239,903
Tuition and fees	90,850	-	90,850
Conference receipts	167,532	-	167,532
Investment income	48,683	-	48,683
Other income	109,946	-	109,946
<b>Total support and revenue</b>	<b>2,893,594</b>	<b>235,099</b>	<b>3,128,693</b>
<b>Expenses</b>			
Program services			
U.S. church missions	967,384	-	967,384
Global church missions	462,581	-	462,581
Pastoral training	434,322	-	434,322
Conferences	249,321	-	249,321
Ministry resources	469,079	-	469,079
<b>Total program services</b>	<b>2,582,687</b>	<b>-</b>	<b>2,582,687</b>
Supporting services			
Fundraising	21,973	-	21,973
General and administrative	408,603	-	408,603
<b>Total supporting services</b>	<b>430,576</b>	<b>-</b>	<b>430,576</b>
<b>Total expenses</b>	<b>3,013,263</b>	<b>-</b>	<b>3,013,263</b>
<b>Change in net assets</b>	<b>(119,669)</b>	<b>235,099</b>	<b>115,430</b>
<b>Net assets, beginning of year</b>	<b>2,531,987</b>	<b>613,488</b>	<b>3,145,475</b>
<b>Net assets, end of year</b>	<b>\$ 2,412,318</b>	<b>\$ 848,587</b>	<b>\$ 3,260,905</b>

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

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, 2019

	Program Services					Supporting Services			Total	
	U.S. Church Missions	Global Church Missions	Pastoral Training	Conferences	Ministry Resources	Fundraising	General and Administrative			
<b>Expenses</b>										
Compensation and benefits	\$ 448,996	\$ 127,444	\$ 289,308	\$ 108,987	\$ 314,244	\$ -	\$ 219,979	\$ 219,979	\$ 1,508,958	
Cost of goods sold	-	-	-	-	77,926	77,926	-	-	77,926	
Gifts and grants	236,927	239,610	3,016	12,685	-	492,238	569	569	492,807	
Travel and training	252,766	84,952	48,746	60,493	22,806	469,763	18,179	18,179	487,942	
Office expense	5,545	645	5,799	6,208	4,015	22,212	7,106	2,355	31,673	
Insurance	368	7,291	5,698	2,147	8,273	23,777	-	3,497	27,274	
Promotion	-	-	-	2,221	22,586	24,807	7,309	-	32,116	
Information technology	5,610	2,009	8,653	3,492	20,548	40,312	2,333	13,973	56,618	
Sound, video, and lighting	600	-	58	32,567	5,110	38,335	-	-	38,335	
Building occupancy	2,475	4	63,049	9,904	26,806	102,238	-	37,085	139,323	
Other expense	14,008	298	5,341	9,408	33,203	62,258	5,225	55,309	122,792	
Depreciation and amortization	89	328	4,654	1,209	11,488	17,768	-	57,657	75,425	
<b>Total expenses</b>	<b>967,384</b>	<b>462,581</b>	<b>434,322</b>	<b>249,321</b>	<b>547,005</b>	<b>2,660,613</b>	<b>21,973</b>	<b>408,603</b>	<b>430,576</b>	<b>3,091,189</b>
Less: Cost of goods sold included with revenues in the Statement of Activities and Changes in Net Assets	-	-	-	-	(77,926)	(77,926)	-	-	-	(77,926)
<b>Total expenses reported in the Statement of Activities and Changes in Net Assets</b>	<b>\$ 967,384</b>	<b>\$ 462,581</b>	<b>\$ 434,322</b>	<b>\$ 249,321</b>	<b>\$ 469,079</b>	<b>\$ 2,582,687</b>	<b>\$ 21,973</b>	<b>\$ 408,603</b>	<b>\$ 430,576</b>	<b>\$ 3,013,263</b>

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>	<b>2020</b>	<b>2019</b>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ (145,214)	\$ 115,430
<b>Adjustments to reconcile change in net assets to net cash (used) provided by operating activities</b>		
Depreciation and amortization	70,271	75,425
Unrealized and realized loss (gain) on investments	25,678	(9,444)
Loss from disposal of right to use asset	681,247	-
<b>(Increase) decrease in</b>		
Accounts receivable - trade	65,600	(86,676)
Prepaid expenses	(24,459)	15,266
Inventory	11,847	(45,722)
Deposits and other assets	(8,768)	350
<b>(Decrease) increase in</b>		
Accounts payable and accrued expenses	(35,893)	56,383
Deferred revenue	5,352	(31,875)
Deferred rent	(5,406)	(2,980)
<b>Net cash provided by operating activities</b>	<b>640,255</b>	<b>86,157</b>
<b>Cash flows from investing activities</b>		
Purchase of investments	(1,343,290)	(1,410,272)
Proceeds from sales of investments	2,082,330	830,050
Purchase of property and equipment	(9,398)	(3,650)
Issuance of notes receivable	(15,675)	-
<b>Net cash provided (used) by investing activities</b>	<b>713,967</b>	<b>(583,872)</b>
<b>Cash flow from financing activities</b>		
Proceeds from note payable	175,800	-
<b>Net cash provided by financing activities</b>	<b>175,800</b>	<b>-</b>
<b>Net change in cash and cash equivalents</b>	<b>1,530,022</b>	<b>(497,715)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>262,163</b>	<b>759,878</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 1,792,185</b>	<b>\$ 262,163</b>

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 of \$250,000 was established for church planting to keep church planting a priority and to ensure plans for future church plants are not limited by an annual budget. This reserve is the funding source for church plant grants when total grants exceed the annual budget for grants in a fiscal year. For the year ended August 31, 2019, total church planting grants of \$100,000 exceeded the budget of \$50,000 by \$50,000. The reserve was reduced to \$115,000 accordingly. There were no similar church plant grants or spending from this reserve during the year ended August 31, 2020, and the balance remained at \$115,000 throughout the year.

**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, 2020 and 2019, 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

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**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 bear interest at 1.70% and mature 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.

In 2018, SGC placed \$100,000 in collateral within their investments accounts with Fifth Third Securities in exchange for \$100,000 of credit in a commercial credit card purchasing program. The credit card program with the collateral requirement ended in March 2020.

**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 ten to forty years for the building and improvements. Depreciation and amortization expense was \$70,271 and \$75,425 for the years ended August 31, 2020 and 2019, respectively.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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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.

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 \$19,000 and \$22,800, from CLC in rental income for the years ended August 31, 2020 and 2019, respectively.

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. See Note 5 for a description of the note receivable, the related discount, and a schedule of amounts receivable.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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**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, 2020 and 2019, SGC recorded no impairment adjustments on assets held for use.

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

**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:**

**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.

**Music and book sales** – Sales of books and music are recorded as revenue at the time the item is shipped or downloaded.

**Music and book royalties** – Revenue is recognized based on the contract terms.

**Tuition and fees** – Amounts received as tuition for the upcoming school year are recognized as revenue ratably over the school year.

**Conference receipts** – Amounts received as registration for future events are recognized as revenue when the event occurs.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

**Other income** – Consists mostly of conference administrative services and rental fees. 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.

Expenses that are allocated include the following:

<u>Expenses</u>	<u>Method of Allocation</u>
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, 2020 and 2019, 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 2017 through the current year remain open for examination by tax authorities.



# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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**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.

**Recently adopted accounting standards:** In June 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which provides additional guidance on characterizing grants and similar contracts with resource providers as either exchange transactions or contributions, as well as distinguishing between conditional contributions and unconditional contributions. The updated standard was effective for resource recipients for annual reporting periods beginning after December 15, 2018 and resource providers one year later. ASU 2018-08 was adopted by the Organization in September 2019 and was applied to all agreements not completed as of September 1, 2019. The adoption of this standard did not have a material effect on the Organization’s financial statements.

**Recent accounting pronouncements not yet adopted:** In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contract with Customers (Topic 606): Deferral of the Effective Date*, which delayed the effective date of ASU 2014-09 by one year to years beginning after December 15, 2018. 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 allows organizations to elect to further delay the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2019. Entities are also allowed to choose to adopt the standard as of the original effective date. Additionally, various updates have been issued to clarify the guidance in Topic 606. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. The new standard permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of applying the guidance recognized at the date of initial application (the modified retrospective method). The Organization adopted this new standard as of September 1, 2020. The Organization has not yet selected a transition method and is currently evaluating the effect that the standard will have on the financial statements.

**Reclassifications:** Certain prior year amounts have been reclassified to conform to the current year presentation. There is no impact on net assets or changes in net assets as a result of the reclassifications.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

**Subsequent events:** Management has evaluated subsequent events for disclosure in these financial statements through January 25, 2021, 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.

	2020	2019
Cash and cash equivalents	\$ 1,792,185	\$ 262,163
Investments	849,519	1,614,237
Accounts receivable - trade	135,123	200,723
Notes receivable, current portion	3,300	-
Total financial assets	2,780,127	2,077,123
Donor-imposed restrictions		
Net assets with donor restrictions	(1,298,050)	(848,587)
Investments held as collateral	-	(100,000)
Net financial assets after donor-imposed restrictions	1,482,077	1,128,536
Internal designations		
Board designated church planting reserve	(115,000)	(115,000)
Net financial assets available to meet cash needs for general expenditures within one year	\$ 1,367,077	\$ 1,013,536

**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:

	2020	2019
Federal government bonds and notes	\$ 204,922	\$ 904,812
Mortgage-backed securities	144,353	100,715
Certificates of deposit	241,661	490,039
Unit investment trusts	258,583	118,671
<b>Total</b>	<b>\$ 849,519</b>	<b>\$ 1,614,237</b>

# 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, 2020 and 2019.

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

		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)
August 31, 2020	Total			
Federal government bonds and notes	\$ 204,922	\$ -	\$ 204,922	\$ -
Mortgage-backed securities	144,353	-	144,353	-
Certificates of deposit	241,661	-	241,661	-
Unit investment trusts	258,583	258,583	-	-
<b>Total</b>	<b>\$ 849,519</b>	<b>\$ 258,583</b>	<b>\$ 590,936</b>	<b>\$ -</b>
<hr/>				
August 31, 2019				
Federal government bonds and notes	\$ 904,812	\$ -	\$ 904,812	\$ -
Mortgage-backed securities	100,715	-	100,715	-
Certificates of deposit	490,039	-	490,039	-
Unit investment trusts	118,671	118,671	-	-
<b>Total</b>	<b>\$ 1,614,237</b>	<b>\$ 118,671</b>	<b>\$ 1,495,566</b>	<b>\$ -</b>

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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.

The borrowers made all required payments under the notes as of August 31, 2020, totaling \$825, and the remaining \$540,675 was outstanding as of August 31, 2020.

Year ended August 31,	
2021	\$ 3,300
2022	8,300
2023	63,300
2024	63,300
2025	62,475
Thereafter	340,000
Subtotal	540,675
Less: present value discount:	(119,514)
Total notes receivable, net	421,161
Less: current portion	(3,300)
<b>Long-term notes receivable</b>	<b>\$ 417,861</b>

### 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, 2020 and 2019, respectively.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

The following is a schedule of future minimum lease payments:

Year ending August 31,

2021	\$	124,926
2022		127,428
2023		21,308
<b>Total</b>	<b>\$</b>	<b>273,662</b>

**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. Neither principle nor interest is due until the date on which the Small Business Administration (“SBA”) remits the Organization’s forgiveness amount or for 10 months after the last day of the covered period if the Organization has not applied for forgiveness (“the deferral period”). Upon expiration of the deferral period, the note calls for equal payments of principal and interest (less amounts forgiven) through April 2022. The Organization has recorded the note as a long-term liability on the accompanying Statements of Financial Position.

**8. Net assets with donor restrictions**

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

		2020		2019
U.S. church regions	\$	1,156,867	\$	848,587
International church regions		141,183		-
<b>Total net assets with donor restrictions</b>	<b>\$</b>	<b>1,298,050</b>	<b>\$</b>	<b>848,587</b>

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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:

	2020	2019
U.S. church regions	\$ 479,063	\$ 509,103
International church regions	70,532	-
<b>Total release of restrictions</b>	<b>549,595</b>	509,103
Less: Amounts received and released in the same fiscal year	(549,595)	(509,103)
<b>Total releases presented on the Statements of Activities and Changes in Net Assets</b>	<b>\$ -</b>	<b>\$ -</b>

**9. Retirement plan**

SGC maintains a retirement plan that is qualified under Section 403(b) of the Internal Revenue Code. 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, 2020 and 2019 was \$24,509 and \$17,767, 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 \$30,654 and \$29,975 for the years ended August 31, 2020 and 2019, 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, 2020, such commitments are approximately \$267,000.

# Sovereign Grace Churches, Inc.

## Notes to Financial Statements

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### 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.