

SOVEREIGN GRACE CHURCHES, INC.
AUDITED FINANCIAL STATEMENTS
YEARS ENDED AUGUST 31, 2022 AND 2021

Sovereign Grace Churches, Inc.

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Independent Auditor's Report

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

Opinion

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, 2022 and 2021, 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.

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, 2022 and 2021, 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.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of **Sovereign Grace Churches, Inc.** and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about **Sovereign Grace Churches, Inc.'s** ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

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Independent Auditor's Report (Continued)

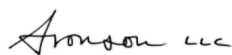
Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 **Sovereign Grace Churches, Inc.'s** internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about **Sovereign Grace Churches, Inc.'s** ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.



Rockville, Maryland
December 9, 2022

Sovereign Grace Churches, Inc

Statements of Financial Position

<i>August 31,</i>	2022	2021
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,182,777	\$ 2,201,647
Investments	1,591,540	1,046,997
Accounts receivable - trade	279,940	208,669
Notes receivable, current portion	60,000	8,300
Prepaid expenses	23,000	42,022
Inventory	160,874	128,877
Total current assets	3,298,131	3,636,512
Property and equipment		
Land	459,000	-
Building and improvements	1,239,673	-
Furniture, fixtures and equipment	392,168	325,892
Less: Accumulated depreciation and amortization	(304,302)	(290,203)
Net property and equipment	1,786,539	35,689
Other assets		
Deposits and other assets	21,157	19,009
Long-term assets		
Notes receivable, net of current portion and discount	378,212	429,172
Total assets	\$ 5,484,039	\$ 4,120,382

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

Sovereign Grace Churches, Inc

Statements of Financial Position

<i>August 31,</i>	2022	2021
Liabilities and Net Assets		
Current Liabilities		
Accounts payable and accrued expenses	\$ 214,853	\$ 115,988
Deferred revenue	112,218	111,004
Deferred rent, current portion	1,794	10,345
Total current liabilities	328,865	237,337
Long-term liabilities		
Deferred rent, net of current portion	-	1,794
Total liabilities	328,865	239,131
Net assets without restrictions		
Board designated	110,000	235,000
Undesignated	2,459,265	1,975,587
Total net assets without restrictions	2,569,265	2,210,587
Net assets with restrictions	2,585,909	1,670,664
Total net assets	5,155,174	3,881,251
Total liabilities and net assets	\$ 5,484,039	\$ 4,120,382

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, 2022

	Without Donor Restrictions	With Donor Restrictions	Total
Operating support and revenue			
Contributions - churches	\$ 2,525,877	\$ 56,935	\$ 2,582,812
Contributions - other	847,505	867,690	1,715,195
Music and books sales, net	338,478	-	338,478
Music and books royalties	386,493	-	386,493
Tuition and fees	70,400	-	70,400
Conference receipts	212,381	-	212,381
Investment loss	(67,082)	-	(67,082)
Other income	69,303	-	69,303
Total operating support and revenue	4,383,355	924,625	5,307,980
Operating Expenses			
Program services:			
U.S. church missions	1,587,676	-	1,587,676
Global church missions	955,274	-	955,274
Pastoral training	374,895	-	374,895
Ministry resources	724,627	-	724,627
Total program services	3,642,472	-	3,642,472
Supporting services:			
Fundraising	16,951	-	16,951
General and administrative	374,634	-	374,634
Total supporting services	391,585	-	391,585
Total expenses	4,034,057	-	4,034,057
Total of change in net assets	349,298	924,625	1,273,923
Net assets, beginning of year	2,210,587	1,670,664	3,881,251
Net assets, end of year	\$ 2,559,885	\$ 2,595,289	\$ 5,155,174

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 Donor Restrictions	With Donor 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 books sales, net	307,094	-	307,094
Music and books 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 Functional Expenses

Year Ended August 31, 2022

	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	\$ 588,421	\$ 196,752	\$ 236,785	\$ 464,769	\$ 1,486,727	\$ 6,100	\$ 232,547	\$ 238,647	\$ 1,725,374
Cost of goods sold	1,524	-	-	116,575	118,099	-	-	-	118,099
Gifts and grants	507,565	663,889	4,070	9,862	1,185,386	-	612	612	1,185,998
Travel and training	352,630	76,487	43,562	61,098	533,777	982	28,270	29,252	563,029
Office expense	11,716	496	3,472	9,784	25,468	728	3,731	4,459	29,927
Insurance	4,392	7,552	3,271	9,522	24,737	-	3,112	3,112	27,849
Promotion	40,132	-	-	46,415	86,547	-	-	-	86,547
Information Technology	5,535	2,847	2,610	24,071	35,063	3,215	18,224	21,439	56,502
Building Occupancy	33,643	222	70,476	54,328	158,669	-	40,996	40,996	199,665
Other expenses	42,414	6,367	1,763	24,055	74,599	5,926	44,250	50,176	124,775
Depreciation and amortization	1,228	662	8,886	20,723	31,499	-	2,892	2,892	34,391
Total expenses	1,589,200	955,274	374,895	841,202	3,760,571	16,951	374,634	391,585	4,152,156
Less: Cost of goods sold included with revenues in the Statement of Activities and Changes in Net Assets	(1,524)	-	-	(116,575)	(118,099)	-	-	-	(118,099)
Total expenses reported in the Statement of Activities and Changes in Net Assets	\$ 1,587,676	\$ 955,274	\$ 374,895	\$ 724,627	\$ 3,642,472	\$ 16,951	\$ 374,634	\$ 391,585	\$ 4,034,057

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 expenses	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

Statements of Cash Flows

<i>Years Ended August 31,</i>	2022	2021
Cash flows from operating activities		
Change in net assets	\$ 1,273,923	\$ 765,560
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	34,390	20,884
Amortization of discount of note receivable	(18,116)	(19,611)
Unrealized and realized loss (gain) on investments	86,875	(5,006)
Forgiveness of note payable	-	(175,800)
Forgiveness of notes receivable	9,900	-
(Increase) decrease in:		
Accounts receivable - trade	(71,271)	(73,546)
Prepaid expenses	19,022	9,246
Inventory	(31,997)	19,801
Deposits and other assets	(2,148)	(400)
Increase (decrease) in:		
Accounts payable	98,865	8,929
Deferred revenue	1,214	62,804
Deferred rent	(10,345)	(7,843)
Net cash provided by operating activities	1,390,312	605,018
Cash flows from investing activities		
Purchases of investments	(1,169,072)	(814,543)
Proceeds from the sale of investments	537,654	622,071
Payments on notes receivable	7,476	3,300
Purchases of property and equipment	(1,785,240)	(6,384)
Net cash used by investing activities	(2,409,182)	(195,556)
Net change in cash and cash equivalents	(1,018,870)	409,462
Cash and cash equivalents, beginning of year	2,201,647	1,792,185
Cash and cash equivalents, end of year	\$ 1,182,777	\$ 2,201,647

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, 2022 and 2021, the reserve balance was \$110,000. \$5,000 and \$0 were disbursed from this reserve for years ended August 31, 2022 and 2021, respectively.

In August 2021, a Board Designated Reserve of \$120,000 was established for a future recording studio for music and video. This reserve was released in August 2022 in conjunction with a decision to proceed to build-out the new studio space.

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, 2022 and 2021, 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, indexed corporate bonds, and fixed income mutual funds which are stated at fair value. 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 (depreciation) 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 \$34,390 and \$20,884 for the years ended August 31, 2022 and 2021, respectively.

On July 30, 2020, SGC sold its right to use asset comprised of 17,125 square feet of buildings and improvements, located in Gaithersburg, Maryland, to Covenant Life Church, Inc. ("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:

Sovereign Grace Churches, Inc.

Notes to Financial Statements

“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.”

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

On April 27, 2022, SGC and Sovereign Grace Church of Louisville, Inc. (SGCL) jointly purchased a 30,450 square foot building at 12912 Shelbyville Rd, Louisville, KY, 40243 for a price of \$5,500,000. SGC owns 30% and SGCL owns 70%, with both organizations listed on the deed. SGC paid \$1,650,000 cash for its 30% portion. SGCL borrowed \$2.5 million from L&N Federal Credit Union as part of its 70% share of the purchase. SGC is not a borrower, nor a party to the SGCL promissory note or business loan agreement with L&N Federal Credit Union. However, SGC’s 30% share is collateral for the SGCL loan.

SGC and SGCL have signed a tenancy-in-common agreement to formalize the 70/30 share of ownership and operating expenses, and use of the building. This agreement defines all the square footage in the building as either dedicated or common shared space. SGC has 9,089 square feet and SGLC has 21,361 square feet. The agreement provides that after ten years, in 2032, either organization can exercise certain option rights that would terminate the agreement and require disposition of the property.

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, 2022 and 2021, 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

	2022	2021
Disaggregation of Revenue:		
Revenue recognized at a point in time	\$ 937,352	\$ 616,659
Revenue recognized over time	70,400	92,600
Total operating revenue:	\$ 1,007,752	\$ 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. Contract liabilities totaled \$112,218, \$111,004, \$48,200 at August 31, 2022, August 31, 2021, and September 1, 2020, 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. Contract assets totaled \$279,941, \$208,669, \$135,123 at August 31, 2022, August 31, 2021, and September 1, 2020, 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:

<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, 2022 and 2021, 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 2019 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

Recent accounting pronouncements not yet adopted: In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 adopted this new standard as of September 1, 2022. SGC is in the process of evaluating the impact from this new guidance.

Subsequent events: Management has evaluated subsequent events for disclosure in these financial statements through December 9, 2022, which is the date the financial statements were available to be issued.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

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 30 to 270 days of general expenditures, which are estimated at \$225,000 to \$2,025,000. 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. A \$750,000 line of credit is in place to meet the cash requirements if necessary.

	2022	2021
Cash and cash equivalents	\$ 1,182,777	\$ 2,201,647
Investments	1,591,540	1,046,997
Accounts receivable - trade	279,940	208,669
Notes receivable, current portion	60,000	8,300
Total financial assets	3,114,257	3,465,613
Donor-imposed restrictions		
Net assets with donor restrictions	(2,595,289)	(1,670,664)
Net financial assets after donor-imposed restrictions	518,968	1,794,949
Internal designations		
Board designated music studio reserve	-	(115,000)
Board designated church planting reserve	(110,000)	(120,000)
Net financial assets available to meet cash needs for general expenditures within one year	\$ 408,968	\$ 1,559,949

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:

	2022	2021
Federal government bonds and notes	\$ 591,445	\$ 201,284
Mortgage-backed securities	130,761	396,373
Indexed corporate bonds	572,355	148,567
Fixed income mutual funds - domestic	296,979	300,773
Total	\$ 1,591,540	\$ 1,046,997

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, 2022 and 2021.

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

August 31, 2022	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	\$ 591,445	\$ -	\$ 591,445	\$ -
Mortgage-backed securities	130,761	-	130,761	-
Indexed corporate bonds	572,355	-	572,355	-
Fixed income mutual funds - domestic	296,979	296,979	-	-
Total	\$ 1,591,540	\$ 296,979	\$ 1,294,561	\$ -

Sovereign Grace Churches, Inc.

Notes to Financial Statements

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	\$ -

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. 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. Loan forgiveness for the remaining balance of \$9,900 was given to this church in August 2022.

The borrowers made all required payments under the notes as of August 31, 2022, totaling \$7,476, and the remaining \$520,000 was outstanding as of August 31, 2022.

Sovereign Grace Churches, Inc.

Notes to Financial Statements

Year ended August 31,		
2023	\$	60,000
2024		60,000
2025		60,000
2026		60,000
2027		60,000
Thereafter		220,000
Subtotal		520,000
Less: present value discount:		(81,788)
Total notes receivable, net		438,212
Less: current portion		(60,000)
Long-term notes receivable	\$	378,212

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, 2022 and 2021, respectively. SGC will pay out the remaining lease payments of \$21,308 during 2023.

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:

	2022	2021
U.S. church regions	\$ 1,419,622	\$ 1,362,687
International church regions	1,175,667	307,977
Total net assets with donor restrictions	\$ 2,595,289	\$ 1,670,664

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:

	2022	2021
U.S. church regions	\$ 926,876	\$ 685,282
International church regions	497,691	196,205
Total release of restrictions	1,424,567	854,487
Less: Amounts received and released in the same fiscal year	(1,424,567)	(854,847)
Total releases presented on the Statements of Activities and Changes in Net Assets	\$ -	\$ -

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, 2022 and 2021 was \$18,056 and \$20,851, 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 \$32,083 and \$30,627 for the years ended August 31, 2022 and 2021, 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 2023. 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, 2022, such commitments are approximately \$111,750.

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).