

Bay Area Fellowship

Financial Statements
and
Report of Independent Certified Public Accountants

August 31, 2009 and 2008

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Report of Independent Certified Public Accountants

To the Ministry Leadership Team
Bay Area Fellowship

We have audited the accompanying statements of financial position of Bay Area Fellowship (a Texas not-for-profit corporation) (the "Church") as of August 31, 2009 and 2008, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Church's management. Our responsibility is to express an opinion on the 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bay Area Fellowship as of August 31, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Tulsa, Oklahoma
February 3, 2010

Stanfield & O'Dell, P.C.

Bay Area Fellowship

Statements of Financial Position

August 31,

Assets	<u>2009</u>	<u>2008</u>
Current assets		
Cash and cash equivalents	\$ 1,161,420	\$ 787,715
Prepaid expenses and other assets	75,368	23,430
Fair value of derivative financial instruments	-	17,577
Total current assets	<u>1,236,788</u>	<u>828,722</u>
Fixed assets		
Land and improvements	4,035,062	3,963,591
Buildings and improvements	13,161,636	13,043,429
Furniture, fixtures and equipment	992,790	682,820
Total fixed assets	<u>18,189,488</u>	<u>17,689,840</u>
Less accumulated depreciation	(1,275,353)	(675,255)
Fixed assets, net	<u>16,914,135</u>	<u>17,014,585</u>
Other assets		
Property held for sale	-	82,005
Debt origination fees, net	140,583	88,596
Total other assets	<u>140,583</u>	<u>170,601</u>
Total assets	<u>\$ 18,291,506</u>	<u>\$ 18,013,908</u>

The accompanying notes are an integral part of these financial statements.

Bay Area Fellowship

Statements of Financial Position - Continued

August 31,

	<u>2009</u>	<u>2008</u>
Liabilities and Net Assets		
Current liabilities		
Accounts payable	\$ 66,194	\$ 80,676
Accrued wages and compensated absences	115,664	53,882
Accrued interest	38,535	32,752
Fair value of derivative financial instruments	167,084	-
Notes payable, current portion	131,150	144,619
Total current liabilities	<u>518,627</u>	<u>311,929</u>
Notes payable, net of current portion	<u>8,138,871</u>	<u>8,230,142</u>
Total liabilities	8,657,498	8,542,071
Net assets - unrestricted	<u>9,634,008</u>	<u>9,471,837</u>
Total liabilities and net assets	<u>\$ 18,291,506</u>	<u>\$ 18,013,908</u>

The accompanying notes are an integral part of these financial statements.

Bay Area Fellowship

Statements of Activities

Years Ended August 31,

	<u>2009</u>	<u>2008</u>
Support and other revenue		
General contributions	\$ 6,038,428	\$ 4,938,308
Building and land contributions	-	429,288
Sales of religious materials	52,830	61,689
Interest and other income	7,366	36,451
Unrealized gain (loss) on derivative financial instruments	(184,661)	17,577
Total support and other revenue	<u>5,913,963</u>	<u>5,483,313</u>
 Expenses		
Program:		
Church activities	4,467,178	4,776,797
Missions and outreach	306,049	219,830
Cost of religious materials	22,683	40,197
Support services:		
General and administrative	737,809	453,831
Fund-raising	218,073	149,431
Total expenses	<u>5,751,792</u>	<u>5,640,086</u>
 Change in net assets	162,171	(156,773)
 Net assets, Beginning of year	<u>9,471,837</u>	<u>9,628,610</u>
 Net assets, End of year	<u>\$ 9,634,008</u>	<u>\$ 9,471,837</u>

The accompanying notes are an integral part of these financial statements.

Bay Area Fellowship

Statements of Cash Flows

Years Ended August 31,

	2009	2008
Cash flows from operating activities		
Cash received from contributions and sales	\$ 6,122,157	\$ 4,981,159
Cash paid for expenses	(4,731,124)	(4,550,286)
Interest received	3,011	36,451
Interest paid	(403,351)	(795,151)
	<u>990,693</u>	<u>(327,827)</u>
Cash flows from investing activities		
Purchase of fixed assets	(499,649)	(798,927)
Proceeds from the sale of property held for sale	51,261	1,494,971
	<u>(448,388)</u>	<u>696,044</u>
Cash flows from financing activities		
Contributions restricted for purchase of building and land	-	429,288
Principal payments on notes payable	(186,845)	(8,865,336)
Proceeds from refinancing notes payable	18,245	8,500,000
	<u>(168,600)</u>	<u>63,952</u>
Net increase in cash and cash equivalents	373,705	432,169
Cash and cash equivalents, Beginning of year	<u>787,715</u>	<u>355,546</u>
Cash and cash equivalents, End of year	<u>\$ 1,161,420</u>	<u>\$ 787,715</u>

The accompanying notes are an integral part of these financial statements.

Bay Area Fellowship

Statements of Cash Flows - Continued

Years Ended August 31,

	<u>2009</u>	<u>2008</u>
Cash and cash equivalents inflow (outflow) from operating activities:		
Change in net assets	\$ 162,171	\$ (156,773)
Adjustments to reconcile changes in net assets to net cash and cash equivalents from operating activities:		
Depreciation expense	600,099	275,847
Amortization expense	11,873	5,488
(Gain) loss on sale of property held for sale	8,639	(93,888)
Contributions restricted for purchase of building and land	-	(429,288)
Write-down of property held for sale	22,105	60,000
Write-off of debt issue cost	-	419,469
Unrealized (gain) loss on derivative financial instruments	184,661	(17,577)
Changes in assets and liabilities:		
Due from vendor	-	10,232
Prepaid expenses and other assets	(51,938)	10,581
Accounts payable	(14,482)	(41,279)
Accrued wages and compensated absences	61,782	(372,928)
Accrued interest	5,783	2,289
Total adjustments	<u>828,522</u>	<u>(171,054)</u>
Net cash provided by (used in) operating activities	<u>\$ 990,693</u>	<u>\$ (327,827)</u>

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

August 31, 2009 and 2008

Note A – Nature of Activities and Summary of Significant Accounting Policies

1. Nature of Activities

Bay Area Fellowship (the “Church”) is incorporated under the laws of the state of Texas as a not-for-profit corporation and is located in Corpus Christi, Texas. The Church is classified as a tax-exempt Church under Internal Revenue Code Section 501(c)(3) and accordingly, no provision for federal income taxes is required in the Church’s financial statements.

The Church’s operations are supported by the members of the congregation. The Church’s primary activities are worship services and related events. The mission statement of the Church is “To Reach up (worship), Reach out (evangelism and ministry), and Reach in (discipleship and fellowship).” The purpose of the Church reads as follows, “We believe a great commitment to the great commandment and the great commission will grow a great church.”

2. Contributions

The Church reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All contributions are considered available for the Church’s general programs unless specifically restricted by the donor. Amounts received that are restricted by the donor are reported as temporarily or permanently restricted support and increase the respective class of net assets. Contributions received with temporary restrictions that are met in the same reporting period are reported as unrestricted support and increase unrestricted net assets.

3. Contributed Services and Materials

In addition to receiving cash contributions, the Church occasionally receives in-kind contributions from various donors. It is the policy of the Church to record the fair value of qualifying in-kind donations as assets in its financial statements, and similarly to increase contributions by a like amount.

In the past, a number of volunteers donated significant amounts of time to the Church’s programs and supporting services. Contributions of donated services that create or enhance nonfinancial assets or that require specialized skills, are provided by individuals possessing these skills, and would typically need to be purchased if not provided by donation, are recorded at their fair values in the period received. For the years ended August 31, 2009 and 2008, there were no amounts recorded for contributed services and materials.

4. Estimates

Management utilizes estimates to record certain transactions in accordance with generally accepted accounting principles. Actual results may differ from those estimates.

Notes to Financial Statements

August 31, 2009 and 2008

Note A – Nature of Activities and Summary of Significant Accounting Policies - Continued

5. *Functional Expenses*

Functional expenses have been allocated between program services and supporting services based on management's analysis of personnel time and space utilized for the related activities.

6. *Fixed Assets and Depreciation*

Fixed asset additions that are purchased are recorded at cost and donations of fixed assets are recorded as unrestricted support at fair value. Additions exceeding \$5,000 are capitalized. Property and equipment is depreciated over the estimated useful lives of the assets using the straight-line method. Donations of property and equipment are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, the Church reports expirations of donor restrictions when the donated or acquired assets are placed in service.

Below is a description of depreciation periods used:

Furniture, fixtures and equipment	5 - 10 years
Land improvements	15 - 20 years
Buildings and improvements	36 - 40 years

7. *Derivative Financial Instruments*

The Church makes limited use of derivative instruments for the purpose of managing interest rate risk. Two interest rate swap agreements are being used to convert the Church's variable rate debt to a fixed rate (see notes G and H). Generally accepted accounting principles require a derivative instrument, such as an interest rate swap agreement, to be recognized at fair value as either an asset or a liability in the statement of financial position. The corresponding increase or decrease in value is reported in the statement of activities as a separate component of revenue and other support.

8. *Reclassifications*

Certain 2008 amounts have been reclassified to conform to the current year presentation.

Notes to Financial Statements

August 31, 2009 and 2008

Note B – Statement of Cash Flows

Cash Equivalents

For purposes of the statement of cash flows, the Church considers all highly liquid debt instruments purchased within maturity of three months or less to be cash equivalents.

Additional Cash Flow Information

No taxes were paid during 2009 or 2008.

Note C – Concentration of Credit Risk

The Church maintains its cash balances in banks. These balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At various times during 2009 and 2008, there were balances in those banks that were over the FDIC limit. The Church maintains its cash and cash equivalents with high quality banks which the Church believes limits these risks.

Note D – Property Held for Sale

Assets that are to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell. At August 31, property held for sale included the following:

	2009	2008
Donated land - Parcel #1	\$ -	\$ 59,900
Donated land - Parcel #2	-	10,000
Donated jewelry	-	12,105
	<u>\$ -</u>	<u>\$ 82,005</u>

In May 2009, Parcel #1 was sold to an unrelated third party. Pursuant to the sale of the property, the Church recorded a realized loss of approximately \$8,600.

Parcel #2 was donated in 2007 from a third party donor and was not needed nor used for the Church's operations. Marketing the property produced no viable bids and therefore, during 2009, the Church decided to fully impair the remaining carrying value of Parcel #2.

During 2009, the Church decided to fully impair the remaining carrying value of donated jewelry based on the Church's inability to sell the items over a period of approximately 3 years.

Bay Area Fellowship

Notes to Financial Statements

August 31, 2009 and 2008

Note E – Debt Origination Fees

Following is a summary of debt origination fees and related accumulated amortization as of August 31:

	2009	2008
Debt origination fees	\$ 157,945	\$ 94,084
Less accumulated amortization	<u>(17,362)</u>	<u>(5,488)</u>
Debt origination fees, net	<u>\$ 140,583</u>	<u>\$ 88,596</u>

Note F – Fair Value Disclosures

Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS No. 157 characterizes inputs used in determining fair value according to a hierarchy that prioritizes inputs based upon the degree to which they are observable. The three levels of the fair value hierarchy are as follows:

- Level 1 Inputs represent quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 Inputs that are not observable from objective sources, internally developed assumptions used in pricing an asset or liability.

In determining fair value, the Church utilizes calculations provided by their lending institution, and the interest rate swap agreements, therefore, are considered to be based upon Level 2 inputs as defined above. For the Church, recurring fair value measurements consist only of the interest rate swap agreements described in note H.

Note G – Notes Payable

In December 2007, the Church obtained a bank loan for \$8,500,000 which was used to liquidate existing mortgage bonds and other debt. The note had an initial fixed rate of 5.62 percent and is payable in monthly installments of principal and interest through January 1, 2018. From the note's inception, it allowed the Church an option to swap interest rates on a portion (subject to a 50 percent ceiling) of the then outstanding and unpaid principal within the first 5 years of the note's origination. The Church elected to swap the interest rate on April 1, 2008 on half of

Notes to Financial Statements

August 31, 2009 and 2008

Note G – Notes Payable - Continued

the then unpaid principal amount, thereby subjecting that portion of the loan to a variable rate, as described in note H. The remaining portion of the balance on this note remained subject to the initial fixed rate of 5.62 percent. The outstanding balance of the entire note, including the swapped and un-swapped portions, on August 31, 2008 was \$8,374,761.

On April 1, 2009, the Church and the lender agreed to refinance the un-swapped portion of the original note described above. The new note agreement carried an initial principal sum of \$4,125,000, provides for a variable rate of interest (as described in note H) and is payable in monthly installments of principal and interest through April 1, 2019. Similar to the initial note described above, this note agreement also gave the Church the option to elect an interest rate swap (subject to a 100 percent ceiling of the note's outstanding balance), which the Church immediately exercised, as described in note H. As of August 31, 2009, the combined outstanding loan balance under both notes was \$8,270,021.

Certain real estate has been pledged as collateral for both notes.

The loan agreements described above contain various covenants, which among other things, place restrictions on the Church's ability to incur additional indebtedness, require the Church to maintain certain accounts exclusively with the lending bank, and require the Church's financial statements to be delivered to the bank within 120 days from the Church's fiscal year-end. The Church was in default on the last two covenants noted above as of the August 31, 2009 measurement date. However, the Church was granted an extension to open the operating accounts without penalty and has since cured such default. In addition, an extension for the issuance of the financial statements was granted and also cured by the Church in a manner considered timely by the lending institution. Accordingly, management has classified the debt balance as long-term in the statement of financial position as of August 31, 2009.

Aggregate maturities of the notes payable balance outstanding as of August 31, 2009 are as follows: \$131,150 for the year ending August 31, 2010, \$131,150 in 2011, \$131,150 in 2012, \$131,150 in 2013, \$131,150 in 2014 and \$7,614,271 thereafter.

Note H – Interest Rate Swap Agreements

The Church has entered into two interest rate swap agreements as provided for in the bank loan agreements described at note G. The swap agreements effectively fix the interest rate the Church pays on the swapped portion of the bank notes to a fixed rate of 5.7 percent for the terms of the swap agreements, thereby limiting the Church's exposure to cash flow variability created by variable interest rates.

Notes to Financial Statements

August 31, 2009 and 2008

Note H – Interest Rate Swap Agreements - Continued

Under the terms of the initial note agreement described in note G, upon the Church's election to swap interest rates on 50 percent of the note balance, the interest rate applicable to the swapped portion of the note balance became a variable rate equal to one and forty-five one-hundredths (1.45 percent) above the rate as shown in Dow Jones Markets as of the end of each month. The first swap agreement's term began on April 1, 2008 and extends to January 1, 2018. During such term, monthly settlements will occur between the Church and the bank based on the bank paying the variable rate described above and the Church paying a fixed rate of 5.70 percent.

The terms of the second note agreement described in note G above provide for a variable rate of interest equal to two and seventy-five one-hundredths percentage points (2.75 percent) above the rate as shown in the Dow Jones Markets as of the end of each month. The second swap agreement's term began April 1, 2009 and extends to April 1, 2019. During such term, monthly settlements will occur between the Church and the bank based on the bank paying the variable rate described above and the Church paying a fixed rate of 5.71 percent.

In accordance with the agreements described above, an accrual equal to the Church's monthly net settlement position as of August 31, 2009 is recorded in the amount of \$38,535 in the statement of financial position. In addition, a liability for the current fair value of the combined remainder portion of both swap agreements is also reported in the statement of financial position as a liability in the amount of \$167,084. The change in the fair value of the remainder portion reflects a decrease in value of \$184,661 from the Church's recorded asset position of \$17,577 as of August 31, 2008. This decrease in value is reported as an unrealized loss on derivative financial instruments in the statements of activities as a separate component of revenue and other support. Fair value has been measured based on estimates of the future amounts needed to settle the agreements as calculated by the counterparty to the swap agreements and as described in the paragraphs above, based on existing market conditions.

The Church could be exposed to credit loss in the event of nonperformance by the other party to the interest rate swap agreements. However, the Church does not anticipate nonperformance by the counterparty.

Note I – Operating Leases

The Church leases buildings, storage units and office equipment under operating leases expiring in various years through 2013. Lease expense for these facilities and equipment for the years ended August 31, 2009 and 2008 was approximately \$218,000 and \$139,000, respectively

Notes to Financial Statements

August 31, 2009 and 2008

Note I – Operating Leases - Continued

Minimum future lease payments under non-cancellable operating leases having original terms in excess of one year for each of the next four years as of August 31, 2009 are:

2010	\$ 166,892
2011	128,287
2012	103,450
2013	<u>93,600</u>
Total minimum future lease payments	<u>\$ 492,229</u>

Note J – Advertising

The Church charges advertising costs to operations in the year the expense is incurred. Advertising expense recorded in Church activities for the years ended August 31, 2009 and 2008 was approximately \$199,000 and \$156,000, respectively.

Note K – Subsequent Events

In preparing these financial statements, the Church has evaluated events and transactions for potential recognition or disclosure through February 3, 2010, the date the financial statements were available to be issued.