

**TEEN CHALLENGE OF TEXAS, INC.**

Financial Statements  
Year Ended December 31, 2010

(With Independent Auditors' Report Thereon)

## Independent Auditors' Report

To the Board of Directors  
of Teen Challenge of Texas, Inc.:

We have audited the accompanying statement of financial position of Teen Challenge of Texas, Inc. (the "Organization") as of December 31, 2010, and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit. The statement of financial position as of December 31, 2009, and the related statements of activities and cash flows for the year then ended were audited by other auditors whose report dated November 18, 2010, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Teen Challenge of Texas, Inc. as of December 31, 2010, and the changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**PMB HELIN DONOVAN, LLP**

*PMB Helin Donovan, LLP*

October 7, 2011  
Austin, Texas

**TEEN CHALLENGE TEXAS, INC.**  
**Statements of Financial Position**  
**Years Ended December 31, 2010 and 2009**

|  | <b>2010</b>  | <b>2009</b>  |
|--|--------------|--------------|
| <b>Assets</b>                                      |              |              |
| Current assets:                                    |              |              |
| Cash and cash equivalents                          | \$ 23,501    | \$ 21,261    |
| Notes receivable                                   | 286,081      | -            |
| Inventory  | 70,778       | 115,123      |
| Other assets                                       | 3            | 3            |
| Total current assets                               | 380,363      | 136,387      |
| Investments  | 13,892       | 10,693       |
| Land, buildings and equipment, net                 | 4,203,881    | 4,986,595    |
| Total assets                                       | \$ 4,598,136 | \$ 5,133,675 |
| <b>Liabilities and Net Assets</b>                  |              |              |
| Current liabilities:                               |              |              |
| Accounts payable and accrued liabilities           | \$ 656,840   | \$ 492,912   |
| Lines of credit                                    | 399,201      | 535,654      |
| Current maturities of long-term debt               | 2,197,246    | 107,486      |
| Current portion of capitalized lease obligations   | 12,666       | 11,889       |
| Total current liabilities                          | 3,265,953    | 1,147,941    |
| Long-term debt, less current portion               | 224,859      | 2,229,033    |
| Long-term portion of capitalized lease obligations | 32,140       | 49,085       |
| Total liabilities                                  | 3,522,952    | 3,426,059    |
| Net assets:  |              |              |
| Unrestricted                                       | 1,061,292    | 1,696,923    |
| Temporarily restricted                             | 13,892       | 10,693       |
| Permanently restricted                             | -            | -            |
| Total net assets                                   | 1,075,184    | 1,707,616    |
| Total liabilities and net assets                   | \$ 4,598,136 | \$ 5,133,675 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**

Statement of Activities

Year Ended December 31, 2010

|                                       | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Permanently<br/>Restricted</u> | <u>2010</u>         |
|---------------------------------------|---------------------|-----------------------------------|-----------------------------------|---------------------|
| <b>Support and Revenues</b>           |                     |                                   |                                   |                     |
| Individuals contributions             | \$ 121,545          | -                                 | -                                 | \$ 121,545          |
| Church contributions                  | 221,621             | -                                 | -                                 | 221,621             |
| Other contributions                   | 188,212             | -                                 | -                                 | 188,212             |
| Special events                        | 910,471             | -                                 | -                                 | 910,471             |
| Crafts and services                   | 1,129,215           | -                                 | -                                 | 1,129,215           |
| Investment income                     | -                   | 3,199                             | -                                 | 3,199               |
| Other income                          | 701,161             | -                                 | -                                 | 701,161             |
| Loss of sale of assets                | (318,392)           | -                                 | -                                 | (318,392)           |
| Net assets released from restrictions | -                   | -                                 | -                                 | -                   |
| Total support and revenues            | <u>2,953,833</u>    | <u>3,199</u>                      | <u>-</u>                          | <u>2,957,032</u>    |
| <b>Expenses</b>                       |                     |                                   |                                   |                     |
| Program services:                     |                     |                                   |                                   |                     |
| Rehabilitation                        | 3,102,922           | -                                 | -                                 | 3,102,922           |
| Total program services                | <u>3,102,922</u>    | <u>-</u>                          | <u>-</u>                          | <u>3,102,922</u>    |
| Supporting services:                  |                     |                                   |                                   |                     |
| Management and general                | 148,508             | -                                 | -                                 | 148,508             |
| Fundraising                           | 338,034             | -                                 | -                                 | 338,034             |
| Total supporting services             | <u>486,542</u>      | <u>-</u>                          | <u>-</u>                          | <u>486,542</u>      |
| Total expenses                        | <u>3,589,464</u>    | <u>-</u>                          | <u>-</u>                          | <u>3,589,464</u>    |
| Decrease in net assets                | (635,631)           | 3,199                             | -                                 | (632,432)           |
| Net assets at beginning of year       | 1,696,923           | 10,693                            | -                                 | 1,707,616           |
| Net assets at end of year             | <u>\$ 1,061,292</u> | <u>13,892</u>                     | <u>-</u>                          | <u>\$ 1,075,184</u> |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**

Statement of Activities

Year Ended December 31, 2009

|                                       | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Permanently<br/>Restricted</u> | <u>2009</u>         |
|---------------------------------------|---------------------|-----------------------------------|-----------------------------------|---------------------|
| <b>Support and Revenues</b>           |                     |                                   |                                   |                     |
| Individuals contributions             | \$ 119,907          | -                                 | -                                 | \$ 119,907          |
| Church contributions                  | 157,863             | -                                 | -                                 | 157,863             |
| Other contributions                   | 285,726             | -                                 | -                                 | 285,726             |
| Special events                        | 1,575,103           | -                                 | -                                 | 1,575,103           |
| Crafts and services                   | 2,090,820           | -                                 | -                                 | 2,090,820           |
| Investment income                     | 5                   | -                                 | -                                 | 5                   |
| Other income                          | 476,731             | -                                 | -                                 | 476,731             |
| Loss of sale of assets                | (78,190)            | -                                 | -                                 | (78,190)            |
| Net assets released from restrictions | -                   | -                                 | -                                 | -                   |
| Total support and revenues            | <u>4,627,965</u>    | <u>-</u>                          | <u>-</u>                          | <u>4,627,965</u>    |
| <b>Expenses</b>                       |                     |                                   |                                   |                     |
| Program services:                     |                     |                                   |                                   |                     |
| Rehabilitation                        | 3,880,289           | -                                 | -                                 | 3,880,289           |
| Total program services                | <u>3,880,289</u>    | <u>-</u>                          | <u>-</u>                          | <u>3,880,289</u>    |
| Supporting services:                  |                     |                                   |                                   |                     |
| Management and general                | 842,875             | -                                 | -                                 | 842,875             |
| Fundraising                           | 1,046,910           | -                                 | -                                 | 1,046,910           |
| Total supporting services             | <u>1,889,785</u>    | <u>-</u>                          | <u>-</u>                          | <u>1,889,785</u>    |
| Total expenses                        | <u>5,770,074</u>    | <u>-</u>                          | <u>-</u>                          | <u>5,770,074</u>    |
| Decrease in net assets                | (1,142,109)         | -                                 | -                                 | (1,142,109)         |
| Net assets at beginning of year       | 2,839,032           | 10,693                            | -                                 | 2,849,725           |
| Net assets at end of year             | <u>\$ 1,696,923</u> | <u>10,693</u>                     | <u>-</u>                          | <u>\$ 1,707,616</u> |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**

Statement of Functional Expenses

Year Ended December 31, 2010

|                         | <b>Program<br/>Services</b> | <b>Supporting Services</b>        |                    |                |                     |
|-------------------------|-----------------------------|-----------------------------------|--------------------|----------------|---------------------|
|                         | <b>Rehabilitation</b>       | <b>Management<br/>and General</b> | <b>Fundraising</b> | <b>Total</b>   |                     |
| Salaries and benefits   | \$ 1,318,452                | 8,505                             | -                  | 8,505          | \$ 1,326,957        |
| Crafts and services     | -                           | -                                 | 110,989            | 110,989        | 110,989             |
| Curriculum              | 6,211                       | -                                 | -                  | -              | 6,211               |
| Depreciation            | 225,826                     | -                                 | -                  | -              | 225,826             |
| Events                  | -                           | -                                 | 222,323            | 222,323        | 222,323             |
| Housing                 | 306,044                     | -                                 | -                  | -              | 306,044             |
| In-kind rent            | 349,992                     | -                                 | -                  | -              | 349,992             |
| Insurance               | 175,243                     | 11,346                            | -                  | 11,346         | 186,589             |
| Bank fees               | 39,341                      | -                                 | -                  | -              | 39,341              |
| Interest expense        | 197,892                     | -                                 | -                  | -              | 197,892             |
| Maintenance and repairs | 131,659                     | -                                 | -                  | -              | 131,659             |
| Office expense          | -                           | 56,168                            | -                  | 56,168         | 56,168              |
| Professional fees       | -                           | 72,489                            | -                  | 72,489         | 72,489              |
| Public relations        | -                           | -                                 | 4,722              | 4,722          | 4,722               |
| Transportation          | 12,565                      | -                                 | -                  | -              | 12,565              |
| Utilities               | 337,500                     | -                                 | -                  | -              | 337,500             |
| Other                   | 2,197                       | -                                 | -                  | -              | 2,197               |
| <b>Total expenses</b>   | <b>\$ 3,102,922</b>         | <b>148,508</b>                    | <b>338,034</b>     | <b>486,542</b> | <b>\$ 3,589,464</b> |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**

Statement of Functional Expenses

Year Ended December 31, 2009

|                         | <b>Program<br/>Services</b> | <b>Supporting Services</b>        |                    |                  |                     |
|-------------------------|-----------------------------|-----------------------------------|--------------------|------------------|---------------------|
|                         | <b>Rehabilitation</b>       | <b>Management<br/>and General</b> | <b>Fundraising</b> | <b>Total</b>     |                     |
| Salaries and benefits   | \$ 1,881,172                | 441,937                           |                    | 441,937          | \$ 2,323,109        |
| Crafts and services     | -                           | -                                 | 380,599            | 380,599          | 380,599             |
| Curriculum              | 25,028                      | -                                 | -                  | -                | 25,028              |
| Depreciation            | 321,162                     | -                                 | -                  | -                | 321,162             |
| Events                  | -                           | -                                 | 597,527            | 597,527          | 597,527             |
| Housing                 | 396,219                     | -                                 | -                  | -                | 396,219             |
| In-kind rent            | -                           | -                                 | -                  | -                | -                   |
| Insurance               | 162,124                     | 15,146                            | -                  | 15,146           | 177,270             |
| Bank fees               | 16,998                      | -                                 | -                  | -                | 16,998              |
| Interest expense        | 185,326                     | -                                 | -                  | -                | 185,326             |
| Maintenance and repairs | 354,433                     | 114,705                           | -                  | 114,705          | 469,138             |
| Office expense          | -                           | 154,842                           | -                  | 154,842          | 154,842             |
| Professional fees       | -                           | 116,245                           | -                  | 116,245          | 116,245             |
| Public relations        | -                           | -                                 | 68,784             | 68,784           | 68,784              |
| Transportation          | 118,634                     | -                                 | -                  | -                | 118,634             |
| Utilities               | 412,558                     | -                                 | -                  | -                | 412,558             |
| Other                   | 6,635                       | -                                 | -                  | -                | 6,635               |
| Total expenses          | \$ <u>3,880,289</u>         | <u>842,875</u>                    | <u>1,046,910</u>   | <u>1,889,785</u> | \$ <u>5,770,074</u> |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**

Statements of Cash Flows

Years Ended December 31, 2010 and 2009

|   | <u>2010</u>       | <u>2009</u>       |
|---|-------------------|-------------------|
| <b>Cash flows from operating activities</b>   |                   |                   |
| Changes in net assets   | \$ (632,432)      | \$ (1,142,109)    |
| Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities |                   |                   |
| Depreciation and amortization   | 225,826           | 321,162           |
| Loss of sale of assets  | 318,392           | 78,190            |
| Appreciation of investment  | (3,199)           | -                 |
| Write-off of construction projects  | -                 | 88,562            |
| Changes in operating assets and liabilities:  |                   |                   |
| Inventory   | 44,345            | (49,024)          |
| Other assets  | -                 | 23,971            |
| Accounts payable and accrued liabilities  | 163,928           | 372,279           |
| Net cash provided by (used in) operating activities   | <u>116,860</u>    | <u>(306,969)</u>  |
| <b>Cash flows from investing activities</b>   |                   |                   |
| Purchase of land, buildings and equipment   | (272,013)         | (646,397)         |
| Proceeds from sale of assets  | 99,428            | 82,866            |
| Repayments from notes receivable  | 125,000           | -                 |
| Net cash used in investing activities   | <u>(47,585)</u>   | <u>(563,531)</u>  |
| <b>Cash flows from financing activities</b>   |                   |                   |
| Proceeds (payments) on line of credit, net  | (136,453)         | 410,654           |
| Proceeds from notes payable   | 85,586            | -                 |
| Payment of notes payable  | -                 | (89,490)          |
| Payment on capital lease obligations  | (16,168)          | (5,083)           |
| Net cash provided by (used in) financing activities   | <u>(67,035)</u>   | <u>316,081</u>    |
| Increase (decrease) in cash and cash equivalents  | 2,240             | (554,419)         |
| Cash and cash equivalents at beginning of year  | 21,261            | 575,680           |
| Cash and cash equivalents at end of year  | <u>\$ 23,501</u>  | <u>\$ 21,261</u>  |
| <b>Supplemental disclosures of Cash Flow Information:</b>   |                   |                   |
| In-kind contributions   | <u>\$ 349,992</u> | <u>\$ 106,245</u> |
| Interest paid   | <u>\$ 184,373</u> | <u>\$ 176,253</u> |
| <b>Supplemental disclosures of Noncash Flow Information:</b>  |                   |                   |
| Property, plant and equipment acquired through notes payable and capital leases                       | <u>\$ 411,081</u> | <u>\$ 216,057</u> |

See accompanying notes to financial statements.

## TEEN CHALLENGE OF TEXAS, INC.

Notes to the Financial Statements

December 31, 2010 and 2009

### (1) Organization and Summary of Significant Accounting Policies

#### Organization

Teen Challenge of Texas, Inc. ("Teen Challenge") operates alcohol and drug rehabilitation facilities. Teen Challenge was founded in 1958 and provides services in San Antonio, Pasadena, Magnolia and Azle, Texas. The program's purpose is to evangelize people who have life controlling problems, and to initiate the discipleship process to the point where the student can function as a Christian in society, applying spiritually motivated biblical principles to relationships in the family, local church, vocation, and community. Teen Challenge endeavors to help people become mentally sound, emotionally balanced, socially adjusted, physically well and spiritually alive.

**Liquidity** - During the year ending December 31, 2010, the Company reported revenue of approximately \$2.6 million, a net operating loss of \$635,631, and future debt repayments of approximately \$2.4 million. Management believes that it has enough cash to operate through December 31, 2011 with its cash on hand, anticipated 2011 operating results, and debt restructurings.

#### Summary of Significant Accounting Policies

- (a) **Basis of Presentation** - Teen Challenge's financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America (GAAP).
- (b) **Net Asset Classifications** - In accordance with GAAP, Teen Challenge classifies its net assets into three categories as follows:

*Permanently Restricted* - Net assets subject to donor-imposed stipulations that they be maintained permanently by Teen Challenge.

*Temporarily Restricted* - Net assets the use of which is subject to donor-imposed stipulations that can be fulfilled by actions of Teen Challenge pursuant to those stipulations or that expire by the passage of time. Temporarily restricted net assets include the portion of donor-restricted endowment funds that have not been appropriated for expenditure by Teen Challenge.

*Unrestricted* - Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be used for any purpose or designated for specific purposes by action of the Board of Directors.

In August 2008, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) Topic 958-205 (formerly FASB Staff Position (FSP) 117-1, Endowments of Not-For-Profit Organizations Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for all Endowment Funds). ASC Topic 958-205 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). ASC Topic 958-205 also improved disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

The state of Texas adopted UPMIFA effective September 2007. Teen Challenge has determined that the majority of its net assets do not meet the definition of endowments under UPMIFA. While not UPMIFA-defined endowments, Teen Challenge intends many of its funds to be permanent and manages them accordingly. Further references to “endowment”, “endowment fund”, or “endowed assets” in these notes relate to those intentions of Teen Challenge.

- (c) **Contributions** - Contributions received (including unconditional promises to give) are recorded as unrestricted, temporarily restricted, or permanently restricted support in the period received depending on the existence and/or nature of any donor restrictions. Contributions received which are part of Teen Challenge’s ongoing major or central activities are recognized as revenue, while contributions which are peripheral or incidental are recognized as gains. Conditional promises to give (grants) are recognized as the conditions upon which they depend are substantially met. Promises to give are recognized as revenue only if sufficient evidence exists in the form of verifiable documentation that a promise was made and received.

Teen Challenge reports contributions as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, if a restriction is fulfilled in the same period in which the contribution is received, Teen Challenge reports the support as unrestricted. Donated assets are recorded at their estimated fair market values at the date of receipt.

Teen Challenge reports contributions of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets or other assets with explicit restrictions that specify how the assets are to be used are recorded as restricted net assets. Teen Challenge reports expirations of donor restrictions when the donated or acquired long-lived assets or other assets are placed in service.

During the years ended December 31, 2010 and 2009, the value of contributed services meeting the requirements for recognition in the financial statements was not material and has not been recorded. In addition, individuals volunteer their time and perform a variety of tasks that assist Teen Challenge, but these services do not meet the criteria for recognition as contributed services.

- (d) **Cash and Cash Equivalents** - For purposes of the statement of cash flows, cash and cash equivalents include cash on hand and demand deposits.

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

- (e) **Investments** - Teen Challenge initially records investments at their acquisition cost if they are purchased and at fair value if they are received as a contribution. Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets. Investment income and gains restricted by a donor are reported as increases in unrestricted net assets if the restrictions are met (either by passage of time or by use) in the reporting period in which the income and gains are recognized.

Teen Challenge uses the equity method of accounting for other types of investments such as investments in limited partnerships. Under the equity method, Teen Challenge initially records an investment at cost if purchased and at fair market value if received as a contribution. Subsequently, the carrying amount of other investments is increased to reflect the investor's share of income of the investee and is reduced to reflect the investor's share of losses or dividends. Teen Challenge's share of income or losses is included in Teen Challenge's investment income.

- (f) **Fair Value of Financial Instruments** - The carrying value of the financial instruments classified as current assets or liabilities, including cash and cash equivalents, notes receivable, other assets, and, accounts payable and accrued liabilities, approximate their fair values due to their short maturities. The fair value of debt approximates the carrying amount because the rates and terms currently available to Teen Challenge approximate the rate and terms on the existing debt.

The fair value of Teen Challenge's financial instruments reflects the amounts that Teen Challenge estimates to receive in connection with the sale of an asset or paid in connection with the transfer of a liability in an orderly transaction between market participants at the measurement date (exit price). Teen Challenge established a fair value hierarchy that prioritizes the use of inputs used in valuation techniques into the following three levels:

Level 1 – quoted prices in active markets for identical assets and liabilities.

Level 2 – observable inputs other than quoted prices in active markets for identical assets and liabilities.

Level 3 – unobservable inputs.

Much of the disclosure is focused on the inputs used to measure fair value, particularly in instances where the measurement uses significant unobservable (Level 3) inputs. As of December 31, 2010 and 2009, Teen Challenge evaluated the fair value of its investments on a recurring basis. Teen Challenge's investments are recorded at fair value at December 31, 2010 and 2009.

- (g) **Inventory** - Inventory consists of raw materials and finished goods and is stated at the lower of cost or market using the first-in, first-out method.
- (h) **Property and Equipment** - Property and equipment greater than \$500 are recorded at cost and capitalized. Betterments and renewals, which add significantly to the utility or useful lives of the assets, are capitalized. Repairs and maintenance are charged to expenses. Gains and losses from normal retirements or dispositions are credited or charged to revenue.

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

Depreciation of property and equipment is provided at rates intended to distribute the cost of the assets over their estimated useful lives using the straight-line method. Major categories or depreciable assets and their estimated useful lives are:

| <u>Asset Category</u>     | <u>Estimated Useful Lives</u> |
|---------------------------|-------------------------------|
| Building and improvements | 25 – 40 years                 |
| Furniture and equipment   | 3 – 7 years                   |
| Vehicles                  | 5 years                       |

- (i) **Income Taxes** - Teen Challenge is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Unrelated business income, of which the Teen Challenge had none for the years ended December 31, 2010 and 2009, would be subject to federal income taxes. Accordingly, there is no provision or liability for federal income taxes in the accompanying financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Organization and recognize a tax liability (or asset) if the Organization has taken an uncertain position that more likely than not would not be sustained upon examination by Internal Revenue Service. Management has analyzed the tax positions taken by the plan, and has concluded that as of December 31, 2010, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Organization is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes it is no longer subject to income tax examinations for years prior to its fiscal year beginning January 1, 2006.

- (j) **Compensated Absences** - Teen Challenge does not accrue for compensated absences as Teen Challenge's management believes that the impact of compensated absences is not material.
- (k) **Functional Allocation of Expenses** - The costs of providing the program and other activities have been summarized on a functional basis in the statement of activities and changes in net assets. Accordingly, costs are allocated to the rehabilitation program, fundraising and management and general expenses based on actual use or estimated use based on management's estimates if actual use is not readily available.
- (l) **Use of Estimates** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount 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 estimated. Significant estimates include valuation of investments and depreciation.

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

**(m) Revenue Recognition** - Revenues from special events consist of fundraising events such as auctions, choir services, a golf tournament, banquets, and pancake breakfasts. Revenues from crafts and services are sales from wood crafts, clothing, cookbooks, and jewelry. Revenues from the sale of these items are recognized upon acceptance of the goods by the customer.

**(n) Subsequent Events** - Teen Challenge evaluates events that occur subsequent to the statement of financial position date of periodic reports, but before financial statements are issued for periods ending on such dates, for possible adjustment to such financial statements or other disclosure. This evaluation generally occurs through the date at which Teen Challenge's financial statements are issued. For the financial statements as of and for the year ending December 31, 2010, this date was October 7, 2011.

**(2) Inventory**

Inventory at December 31, 2010 and 2009 consisted of the following:

|                         | <u>2010</u>      |    | <u>2009</u>    |
|-------------------------|------------------|----|----------------|
| Raw materials - crafts  | \$ 33,962        | \$ | 41,600         |
| Finished goods - crafts | 31,678           |    | 35,125         |
| Jewelry                 | 4,607            |    | 21,160         |
| Clothing                | 531              |    | 12,955         |
| Cookbooks               | -                |    | 4,283          |
| Total inventory         | \$ <u>70,778</u> | \$ | <u>115,123</u> |

**(3) Investments**

Investments are stated at fair market value and consist of the following as of December 31, 2010 and 2009:

|                                   | <u>2010</u>      |    | <u>2009</u>   |
|-----------------------------------|------------------|----|---------------|
| Investment in limited partnership | \$ 13,892        | \$ | 10,693        |
|                                   | \$ <u>13,892</u> | \$ | <u>10,693</u> |

The following schedule summarizes the investment return and its classification in the Statement of Activities for the year ended December 31, 2010 and 2009:

|                            | <u>2010</u>     |    | <u>2009</u> |
|----------------------------|-----------------|----|-------------|
| Appreciation of investment | \$ 3,199        | \$ | -           |
|                            | \$ <u>3,199</u> | \$ | <u>-</u>    |

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

**(4) Fair Value of Financial Instruments**

Teen Challenge has estimated fair value of financial instruments using available market information and appropriate valuation methodologies.

Financial instruments are considered Level 1 when their values are determined using quoted prices in active markets for identical assets that the reporting entity has the ability to access at the measurement date. In 2010 and 2009, there were no Level 1 investments.

Level 2 inputs are inputs other than quoted prices included within Level 1, such as quoted prices for similar assets in active or inactive markets, inputs other than quoted prices that are observable for the asset, or inputs that are derived principally from or corroborated by observable market data by correlation or other means. In 2010 and 2009, there were no Level 2 investments.

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

Teen Challenge had an investment in a limited partnership that is classified as Level 3 during the years ended December 31, 2010 and 2009 and is carried at fair value.

The following table sets forth the changes in fair value of Teen Challenge's investments measured using significant unobservable inputs (Level 3) during the year ended December 31, 2010 and 2009:

|  | <u>Level 3</u>   |
|--|------------------|
| Balance at December 31, 2008                           | \$ 10,693        |
| Interest, dividends or unrealized gains or losses, net | -                |
| Balance at December 31, 2009                           | \$ 10,693        |
| Interest, dividends or unrealized gains or losses, net | 3,199            |
| Balance at December 31, 2010                           | \$ <u>13,892</u> |

**(5) Notes Receivable**

In June 2010, Teen Challenge sold, in accordance with an interest-free note agreement, its Channelview property for \$457,500, with a down payment of \$60,000. A principal payment of \$125,000 was due and paid on November 20, 2010 and subsequent principal payments are payable in five equal semi-annual installments of \$54,500 each, with the first installment due and payable on May 19, 2011. The last installment is due and payable on May 19, 2013. As of December 31, 2010, the balance of the note was \$272,500.

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

In February 2010, Teen Challenge sold property through a seller-financed real estate lien note for \$13,581. The interest rate of the note is 8% and the note and related interest is due in full on June 12, 2011. As of December 31, 2010, the balance of the note was \$13,581. Subsequent to year end, the property was donated back to Teen Challenge and the note was cancelled. This property is currently listed for sale.

**(6) Land, Buildings and Equipment**

Balances of major categories of land, buildings, and equipment as of December 31, 2010 and 2009 are as follows:

|                                     | <u>2010</u>         |    | <u>2009</u>        |
|-------------------------------------|---------------------|----|--------------------|
| Land                                | \$ 419,622          | \$ | 1,054,065          |
| Buildings and improvements          | 3,765,682           |    | 3,668,536          |
| Furniture and equipment             | 558,906             |    | 651,807            |
| Vehicles                            | <u>726,154</u>      |    | <u>777,075</u>     |
| Total land, buildings and equipment | 5,470,364           |    | 6,151,483          |
| Less accumulated depreciation       | <u>(1,266,483)</u>  |    | <u>(1,164,888)</u> |
| Net land, buildings and equipment   | \$ <u>4,203,881</u> | \$ | <u>4,986,595</u>   |

Depreciation expense was \$225,826 and \$321,162 for the years ended December 31, 2010 and 2009, respectively.

**(7) Debt**

Long-term debt consisted of the following at December 31, 2010 and 2009:

|  | <u>2010</u>       |    | <u>2009</u>      |
|--|-------------------|----|------------------|
| Note payable to a bank, due in monthly installments of \$17,278, including interest; final balloon payment due in September 2011, interest at 6.95%, and collateralized by the assets of Teen Challenge. | \$ 2,156,582      | \$ | 2,028,768        |
| Note payable to an investment company, due in monthly installments of \$1,582, including interest; final payment due June 2022, interest at 5.00% and collateralized by property of Teen Challenge       | 164,862           |    | 176,162          |
| Note payable to a church, due in monthly installments of \$2,746, including interest; final payment due April 2014, interest at 3.75% and collateralized by property of Teen Challenge                   | <u>100,661</u>    |    | <u>131,589</u>   |
| Total debt   | 2,422,105         |    | 2,336,519        |
| Less: current portion of note payable  | <u>2,197,246</u>  |    | <u>107,486</u>   |
| Long-term portion of note payable  | \$ <u>224,859</u> | \$ | <u>2,229,033</u> |

**TEEN CHALLENGE OF TEXAS, INC.**

Notes to the Financial Statements

December 31, 2010 and 2009

(Continued)

The aggregate future maturities of the notes payable are as follows:

|            |    |                  |
|------------|----|------------------|
| 2011       | \$ | 2,197,246        |
| 2012       |    | 42,359           |
| 2013       |    | 44,125           |
| 2014       |    | 20,946           |
| 2015       |    | 13,413           |
| Thereafter |    | 104,016          |
| Total      | \$ | <u>2,422,105</u> |

**(8) Lines of Credit**

Teen Challenge has established two revolving lines of credit with a financial institution. The first line of credit provides for maximum borrowings of \$400,000 at a 3.25% interest rate. For this line, Teen Challenge has pledged as collateral its inventory, chattel paper, accounts receivable, and general intangibles. The line of credit is due on demand. As of December 31, 2010 and 2009, the outstanding balance on this line of credit was \$399,201.

The second line of credit provides for maximum borrowings of \$200,000 at a 6.25% interest rate and is due in November 2012. At December 31, 2009, the outstanding balance on this line of credit was \$136,453. During 2010, this line of credit was paid off with borrowings on the note payable to the bank.

**(9) Restrictions on Net Assets**

As of December 31, 2010 and 2009, temporarily restricted net assets consist of \$13,892 and \$10,693, respectively, on an investment in a limited partnership. This investment has a time restriction.

**(10) Related Party Transactions**

Teen Challenge is a chapter of Teen Challenge USA. Teen Challenge is required to pay Teen Challenge USA an accreditation fee of \$150 per center per month. During the years ended December 31, 2010 and 2009, Teen Challenge paid \$7,800 and \$14,654, respectively, to Teen Challenge USA.

During the years ended December 31, 2010 and 2009, various members of the Board of Directors and their affiliated organizations, made contributions to Teen Challenge in the amount of \$52,000 and \$8,450, respectively.

**(11) Concentrations of Credit Risk**

Certain financial instruments potentially subject Teen Challenge to concentrations of credit risk. These financial instruments consist primarily of cash deposits. The cash policy of Teen Challenge limits the amount of credit exposure, and requires that cash be placed with high credit quality financial institutions. At December 31, 2010 Teen Challenge held no cash balances in financial institutions that exceeded the FDIC insurance coverage.

**TEEN CHALLENGE OF TEXAS, INC.**

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December 31, 2010 and 2009

(Continued)

**(12) Leases**

Teen Challenge has various equipment leases and leases a portion of its facilities pursuant to noncancellable operating lease agreements expiring in 2012. Lease expense was approximately \$48,000 and 41,000 for the years ended December 31, 2010 and 2009, respectively.

Minimum future rentals for the office space lease and equipment leases as of December 31, 2010 are as follows:

| <b>Year Ending December 31,</b>                    | <b>Capital<br/>Leases</b> | <b>Operating<br/>Leases</b> |
|--|---------------------------|-----------------------------|
| 2011   | \$ 15,419                 | \$ 20,808                   |
| 2012   | 15,419                    | 6,936                       |
| 2013   | 23,642                    | -                           |
| Future minimum lease payments                      | \$ 54,480                 | \$ 27,744                   |
| Less discount for present value (6.35%)            | 9,674                     |                             |
| Present value of net minimum lease obligations     | 44,806                    |                             |
| Current portion of capitalized lease obligations   | 12,666                    |                             |
| Long-term portion of capitalized lease obligations | \$ 32,140                 |                             |

Amortization of assets held under capital leases is included with depreciation expense.

**(13) Subsequent Events**

On March 11, 2011, Teen Challenge entered into an agreement with Wells Fargo Bank to repay the outstanding note and line of credit. Under the agreement, Wells Fargo accepted \$1,600,000 to relieve the note and line of credit which had a principal balance of \$2,157,626 and \$399,201, respectively as of March 11, 2011. The \$1,600,000 was paid on March 30, 2011, utilizing the new funding obtained on March 17, 2011.

On March 17, 2011, Teen Challenge entered into a note agreement with a lender for a \$1,859,250 note, due in monthly installments of \$12,683, including interest, based on the minimum 5% certificate base (\$92,500 at funding) at the 7.25% adjustable interest rate and 30 year term. This note was used to pay back \$1,600,000 of an existing loan and \$250,000 for reducing accounts payable.

In June 2011, Teen Challenge sold the Celina property for \$56,000.