PMB Helin Donovan
CONSULTANTS & CERTIFIED PUBLIC ACCOUNTANTS

# Independent Auditors' Report

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

We have audited the accompanying statements of financial position of Teen Challenge of Texas, Inc. (the "Organization") as of December 31, 2011 and 2010, and the related statements of activities, functional expenses and cash flows for the years 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 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 Teen Challenge of Texas, Inc. as of December 31, 2011 and 2010, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**PMB HELIN DONOVAN, LLP**

PMB Helin Donovan, LLP

November 2, 2012
Austin, Texas

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**TEEN CHALLENGE TEXAS, INC.**
Statements of Financial Position
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 33,583 | $ 23,501 |
| Notes receivable | 68,500 | 286,081 |
| Inventory | 80,556 | 70,781 |
| Total current assets | 182,639 | 380,363 |
| Investments | 13,892 | 13,892 |
| Land, buildings and equipment, net | 5,536,119 | 4,203,881 |
| Other long-term assets | 20,399 | - |
| Total assets | $ 5,753,049 | $ 4,598,136 |
| **Liabilities and Net Assets** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 405,513 | $ 656,840 |
| Lines of credit | - | 399,201 |
| Current portion of long-term debt | 61,242 | 2,197,246 |
| Current portion of capitalized lease obligations | 14,072 | 12,666 |
| Total current liabilities | 480,827 | 3,265,953 |
| Long-term debt, less current portion | 2,014,790 | 224,859 |
| Long-term portion of capitalized lease obligations | 215 | 32,140 |
| Total liabilities | 2,495,832 | 3,522,952 |
| Net assets: | | |
| Unrestricted | 3,243,325 | 1,061,292 |
| Temporarily restricted | 13,892 | 13,892 |
| Permanently restricted | - | - |
| Total net assets | 3,257,217 | 1,075,184 |
| Total liabilities and net assets | $ 5,753,049 | $ 4,598,136 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**
Statement of Activities
Year Ended December 31, 2011

| | Unrestricted | Temporarily Restricted | Permanently Restricted | 2011 |
|---|---|---|---|---|
| **Support and Revenues** | | | | |
| Individuals' contributions | $ 1,962,406 | - | - | $ 1,962,406 |
| Church contributions | 130,404 | - | - | 130,404 |
| Other contributions | 263,599 | - | - | 263,599 |
| Special events | 798,047 | - | - | 798,047 |
| Crafts and services | 736,415 | - | - | 736,415 |
| In-kind contributions | 525,000 | - | - | 525,000 |
| Other income | 817,065 | - | - | 817,065 |
| Gain on extinguishment of debt | 1,035,634 | - | - | 1,035,634 |
| Loss on disposal of assets | (471,959) | - | - | (471,959) |
| Total support and revenues | 5,796,611 | - | - | 5,796,611 |
| **Expenses** | | | | |
| Program services: | | | | |
| Rehabilitation | 2,786,946 | - | - | 2,786,946 |
| Total program services | 2,786,946 | - | - | 2,786,946 |
| Supporting services: | | | | |
| Management and general | 488,759 | - | - | 488,759 |
| Fundraising | 338,873 | - | - | 338,873 |
| Total supporting services | 827,632 | - | - | 827,632 |
| Total expenses | 3,614,578 | - | - | 3,614,578 |
| Increase in net assets | 2,182,033 | - | - | 2,182,033 |
| Net assets at beginning of year | 1,061,292 | 13,892 | - | 1,075,184 |
| Net assets at end of year | $ 3,243,325 | 13,892 | - | $ 3,257,217 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**
Statement of Activities
Year Ended December 31, 2010

| | Unrestricted | Temporarily Restricted | Permanently Restricted | 2010 |
|---|---|---|---|---|
| **Support and Revenues** | | | | |
| 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 |
| In-kind contributions | 349,992 | - | - | 349,992 |
| Other income | 351,169 | - | - | 351,169 |
| Loss on disposal of assets | (318,392) | - | - | (318,392) |
| Total support and revenues | 2,953,833 | 3,199 | - | 2,957,032 |
| **Expenses** | | | | |
| Program services: | | | | |
| Rehabilitation | 3,102,922 | - | - | 3,102,922 |
| Total program services | 3,102,922 | - | - | 3,102,922 |
| Supporting services: | | | | |
| Management and general | 148,508 | - | - | 148,508 |
| Fundraising | 338,034 | - | - | 338,034 |
| Total supporting services | 486,542 | - | - | 486,542 |
| Total expenses | 3,589,464 | - | - | 3,589,464 |
| Increase (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 | $ 1,061,292 | 13,892 | - | $ 1,075,184 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**
Statement of Functional Expenses
Year Ended December 31, 2011

| | Program Services | Supporting Services | | | |
|---|---|---|---|---|---|
| | **Rehabilitation** | **Management and General** | **Fundraising** | **Total Supporting Services** | **Total 2011** |
| Salaries and benefits | $ 1,053,902 | $ 38,355 | $ - | $ 38,355 | $ 1,092,257 |
| Crafts and services | - | - | 43,309 | 43,309 | 43,309 |
| Curriculum | 29,635 | - | - | - | 29,635 |
| Depreciation | 220,000 | - | - | - | 220,000 |
| Events | - | - | 227,524 | 227,524 | 227,524 |
| Housing | 227,893 | - | - | - | 227,893 |
| In-kind rent | 525,000 | - | - | - | 525,000 |
| Insurance | 157,587 | - | - | - | 157,587 |
| Bank fees | 25,632 | - | - | - | 25,632 |
| Interest expense | 112,095 | - | - | - | 112,095 |
| Maintenance and repairs | 63,342 | - | 62,534 | 62,534 | 125,876 |
| Office expense | - | 29,732 | - | 29,732 | 29,732 |
| Professional fees | - | 68,871 | - | 68,871 | 68,871 |
| Public relations | - | - | 5,506 | 5,506 | 5,506 |
| Transportation | 14,167 | - | - | - | 14,167 |
| Utilities | 241,062 | - | - | - | 241,062 |
| Other | 116,631 | 351,801 | - | 351,801 | 468,432 |
| Total expenses | $ 2,786,946 | $ 488,759 | $ 338,873 | $ 827,632 | $ 3,614,578 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**
Statement of Functional Expenses
Year Ended December 31, 2010

| | Program Services | Supporting Services | | | |
|---|---|---|---|---|---|
| | Rehabilitation | Management and General | Fundraising | Total Supporting Services | Total 2010 |
| 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 |
| Total expenses | $ 3,102,922 | $ 148,508 | $ 338,034 | $ 486,542 | $ 3,589,464 |

See accompanying notes to financial statements.

**TEEN CHALLENGE OF TEXAS, INC.**
Statements of Cash Flows
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Changes in net assets | $ 2,182,033 | $ (632,432) |
| Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities | | |
| Depreciation and amortization | 220,000 | 225,826 |
| Loss on disposal of assets | 471,959 | 318,392 |
| Appreciation of investments | - | (3,199) |
| Donation of land and buildings | (1,857,347) | - |
| Gain on extinguishment of debt | (1,035,634) | - |
| Changes in operating assets and liabilities: | | |
| Inventory | (9,775) | 44,345 |
| Other long-term assets | (20,399) | - |
| Accounts payable and accrued liabilities | (172,521) | 163,928 |
| Net cash provided by (used in) operating activities | (221,684) | 116,860 |
| **Cash flows from investing activities** | | |
| Purchase of land, buildings and equipment | (166,850) | (272,013) |
| Proceeds from sale of assets | - | 99,428 |
| Repayments from notes receivable | 217,581 | 125,000 |
| Net cash provided by (used in) investing activities | 50,731 | (47,585) |
| **Cash flows from financing activities** | | |
| Payments on lines of credit, net | - | (136,453) |
| Proceeds from notes payable | 1,859,250 | 85,586 |
| Payment of notes payable | (1,647,696) | - |
| Payments on capitalized lease obligations | (30,519) | (16,168) |
| Net cash provided by (used in) financing activities | 181,035 | (67,035) |
| Increase in cash and cash equivalents | 10,082 | 2,240 |
| Cash and cash equivalents at beginning of year | 23,501 | 21,261 |
| Cash and cash equivalents at end of year | $ 33,583 | $ 23,501 |
| **Supplemental disclosures of cash flow information:** | | |
| In-kind contributions | $ 525,000 | $ 349,992 |
| Interest paid | $ 112,095 | $ 184,373 |
| **Supplemental disclosure of non-cash investing and financing activities:** | | |
| Land, buildings and equipment acquired through notes payable and capital leases | $ - | $ 411,081 |
| Non-cash donation of land and buildings | $ 1,857,347 | $ - |

See accompanying notes to financial statements.

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

### Organization

Teen Challenge of Texas, Inc. (the "Organization") operates alcohol and drug rehabilitation facilities. The Organization 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. The Organization endeavors to help people become mentally sound, emotionally balanced, socially adjusted, physically well and spiritually alive.

### Summary of Significant Accounting Policies

(a) **Basis of Presentation -** The Organization'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, the Organization classifies its net assets into three categories as follows:

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

*Temporarily Restricted* - Net assets the use of which is subject to donor-imposed stipulations that can be fulfilled by actions of the Organization 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 the Organization.

*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.

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

(d) **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.

(e) **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. 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.

The Organization 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, the Organization reports the support as unrestricted. Donated assets are recorded at their estimated fair market values at the date of receipt.

The Organization reports in-kind 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. The Organization 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, 2011 and 2010, the Organization recorded $525,000 and $349,992 of in-kind rent contributions, respectively.

(f) **Contributed Services** - During the years ended December 31, 2011 and 2010, 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 the Organization, but these services do not meet the criteria for recognition as contributed services.

(g) **Investments** - The Organization 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.

The Organization uses the equity method of accounting for other types of investments such as investments in limited partnerships. Under the equity method, the Organization 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. The Organization's share of income or losses is included in the Organization's investment income.

(h) **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 long-term assets, and, accounts payable and accrued liabilities, approximate their fair values due to their short maturities. The fair value of fixed-rate debt approximates the carrying amount because the rates and terms currently available to the Organization approximate the rate and terms on the existing debt.

For investments that are remeasured at fair value on a recurring basis, the Foundation discloses the hierarchy of the valuation based on the inputs used to determine the valuation. 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 ("Level 1"). 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 ("Level 2"). The Organization carried no Level 1 or 2 investments, as defined above, as of or during the years ended December 31, 2011 and 2010.

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"). Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

(i) **Inventory** - Inventory consists of raw materials for crafts and finished goods and is stated at the lower of cost or market using the first-in, first-out method.

(j) **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.

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:

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

The Organization reviews long-lived assets for impairment, based on the estimated undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. No impairment charges were recorded in 2011 and 2010.

(k) **Income Taxes** - The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Unrelated business income, of which the Organization had none for the years ended December 31, 2011 and 2010, 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, 2011 and 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, 2007.

(l) **Compensated Absences** - The Organization does not accrue for compensated absences as management believes that the impact of compensated absences is not material.

(m) **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 in not readily available.

(n) **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.

(o) **Concentrations of Credit Risk** - Certain financial instruments potentially subject the Organization to concentrations of credit risk. These financial instruments consist primarily of cash deposits. The cash policy of the Organization limits the amount of credit exposure, and requires that cash be placed with high credit quality financial institutions. At December 31, 2011, the Organization held no cash balances in financial institutions that exceeded the FDIC insurance coverage.

(p) **Notes Receivable** - The Organization periodically enters into note receivable arrangements which are typically associated with sales of property. Notes receivable are considered impaired when it is probable that the Organization will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the agreement. The difference between the net value of the amounts expected to be received and the note balance is recognized as an impairment of the note. No impairments were recognized on notes receivable during the years ended December 31, 2011 and 2010, respectively.

(q) **Subsequent Events** - The Organization 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 the Organization's financial statements are issued. For the financial statements as of and for the year ending December 31, 2011, this date was November 2, 2012.

(r) **New Accounting Standards** - In May 2011, the FASB issued Update No. 2011-04, "Fair Value Measurement (Topic 820). It establishes and clarifies certain requirements for measuring fair value and for disclosing information about fair value measurements. This standard is effective for fiscal years beginning after December 15, 2011. The Organization will adopt this standard beginning January 1, 2012 and does not expect it to have a material impact on its consolidated financial statements.

## (2) Inventory

Inventory at December 31, 2011 and 2010 consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Raw materials - crafts | $ 53,662 | $ 33,962 |
| Finished goods - crafts | 24,868 | 31,678 |
| Jewelry, clothing, and other | 2,026 | 5,141 |
| Total inventory | $ 80,556 | $ 70,781 |

## (3) Fair Value of Financial Instruments

The Organization has an investment in a limited partnership that is classified as Level 3 during the years ended December 31, 2011 and 2010 and is carried at fair value. This investment was valued at $13,892 as of December 31, 2011 and 2010. Estimated fair value is determined by the Organization based on a number of factors, including the cost of the investment to the Organization, as well as the current and projected operating performance.

The following table sets forth the changes in fair value of the Organization's investment measured using significant unobservable inputs during the years ended December 31, 2011 and 2010:

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |
|---|---|
| Balance at December 31, 2009 | $ 10,693 |
| Interest, dividends or unrealized gains or losses, net | 3,199 |
| Balance at December 31, 2010 | 13,892 |
| Interest, dividends or unrealized gains or losses, net | - |
| Balance at December 31, 2011 | $ 13,892 |

On April 30, 2012, the Organization entered into an agreement to sell the Organization's 1% investment in this limited partnership for $21,000.

### (4) Notes Receivable

In June 2010, the Organization 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, 2011 and 2010, the balance of the note was $68,500 and $272,500, respectively. The remaining balance of the note was paid in full in February 2012.

In February 2010, the Organization sold property through a seller-financed real estate lien note for $13,581. The interest rate of the note is 8%. As of December 31, 2010, the balance of the note was $13,581. During 2011 the holder of the note entered into an agreement to contribute proceeds from the sale of the property to the Organization, and the note was cancelled. This property was sold in October 2011.

### (5) Land, Buildings and Equipment

Balances of major categories of land, buildings, and equipment as of December 31, 2011 and 2010 are as follows:

| | 2011 | 2010 |
|---|---|---|
| Land | $ 737,842 | $ 419,622 |
| Buildings and improvements | 4,946,825 | 3,765,682 |
| Furniture and equipment | 563,079 | 558,906 |
| Vehicles | 716,323 | 726,154 |
| Total land, buildings and equipment | 6,964,069 | 5,470,364 |
| Less accumulated depreciation | (1,427,950) | (1,266,483) |
| Net land, buildings and equipment | $ 5,536,119 | $ 4,203,881 |

Depreciation expense was $220,000 and $225,826 for the years ended December 31, 2011 and 2010, respectively.

During September 2011, the Organization sustained fire damages to their wood shop of $186,515. As of December 31, 2011, the Organization had received $164,948 in reimbursements from its insurance company.

In December 2011, the Organization received a donation of $1,857,347 of land and buildings in Pasadena, Texas. This property had previously been used by the Organization since 2010 under an in-kind rent contribution agreement. The property was capitalized at its estimated fair value at the time of the donation.

## (6) Long-Term Debt

Long-term debt consisted of the following at December 31, 2011 and 2010:

| | 2011 | 2010 |
|---|---|---|
| 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 the Organization; this note was paid in full during 2011 | $ - | $ 2,156,582 |
| 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 the Organization | 154,812 | 164,862 |
| 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 the Organization | 73,501 | 100,661 |
| Note payable to a lender, 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, and collateralized by the assets of the Organization | 1,847,719 | - |
| Total long-term debt | 2,076,032 | 2,422,105 |
| Less: current portion of long-term debt | 61,242 | 2,197,246 |
| Long-term debt, less current portion | $ 2,014,790 | $ 224,859 |

On March 17, 2011, the Organization entered into a note agreement with a lender for a $1,859,250 note, of which $1,600,000 was used to pay back the existing loan and line of credit to Wells Fargo Bank and $250,000 was used to reduce outstanding accounts payable. The Organization recorded a gain on extinguishment of debt of $956,828, consisting of $557,627 from the Wells Fargo Bank note and $399,201 from the line of credit (see Note 7). The remaining $78,806 in gain from debt extinguishment recognized was the result of the forgiveness of certain outstanding credit card liabilities during 2011. This note had a balance of $1,847,719 as of December 31, 2011.

On March 11, 2011, the Organization entered into an agreement with Wells Fargo Bank to repay the outstanding note and line of credit (see Note 7). 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.

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

| | | |
|---|---|---|
| 2012 | $ | 61,242 |
| 2013 | | 64,424 |
| 2014 | | 45,284 |
| 2015 | | 36,869 |
| 2016 | | 39,314 |
| Thereafter | | 1,828,899 |
| Total | $ | 2,076,032 |

## (7) Lines of Credit

The Organization 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, the Organization pledged as collateral its inventory, chattel paper, accounts receivable, and general intangibles. The line of credit is due on demand. As of December 31, 2011 and 2010, the outstanding balance on this line of credit was $0 and $399,201, respectively. This line of credit was forgiven by Wells Fargo Bank during 2011 (see Note 6).

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

## (8) Restrictions on Net Assets

As of December 31, 2011 and 2010, temporarily restricted net assets consisted of $13,892 in an investment in a limited partnership. This investment has a time restriction.

## (9) Related Party Transactions

The Organization is a chapter of Teen Challenge USA. The Organization is required to pay Teen Challenge USA an accreditation fee of $150 per center per month. During the years ended December 31, 2011 and 2010, the Organization paid approximately $9,500 and $7,800, respectively, to Teen Challenge USA.

During the years ended December 31, 2011 and 2010, various members of the Board of Directors and their affiliated organizations, made contributions to the Organization in the amount of $22,418 and $52,000, respectively.

## (10) Leases

The Organization has various equipment leases and leases a portion of its facilities pursuant to noncancellable operating lease agreements. Lease expense was approximately $34,000 and $48,000 for the years ended December 31, 2011 and 2010, respectively.

Minimum future rentals for the office space lease and equipment leases as of December 31, 2011 are as follows:

| **Year Ending December 31,** | Capital Leases | Operating Leases |
|---|---|---|
| 2012 | $ 14,072 | $ 13,056 |
| 2013 | 215 | 6,120 |
| 2014 | - | 6,120 |
| 2015 | - | 6,120 |
| 2016 | - | 3,570 |
| Future minimum lease payments | $ 14,287 | $ 34,986 |
| Current portion of capitalized lease obligations | 14,072 | |
| Long-term portion of capitalized lease obligations | $ 215 | |

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

## (11) Subsequent Events

In August 2012, the Organization sold its property in Driscoll, Texas for $650,000 to an outside buyer. In conjunction with this sale, the buyer entered into a $625,000 note receivable agreement, which bears interest at 7.5% and matures in 5 years.

In April 2012, the Organization received a $150,000 grant to pay for the first phase of a new sprinkler system to be installed at the San Antonio location.