

FINANCIAL STATEMENTS
KEYSTONE CONFERENCE OF
THE FREE METHODIST CHURCH OF
NORTH AMERICA, INC.

JUNE 30, 2010
with
INDEPENDENT AUDITOR'S REPORT

KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.

CONTENTS

| | <u>Page</u> |
|--|-------------|
| Independent Auditor's Report | 1 |
| Financial Statements: | |
| Statements of Financial Position | 2 |
| Statements of Activities | 3 |
| Statements of Cash Flows | 4 |
| Notes to the Financial Statements | 5 - 17 |



INDEPENDENT AUDITOR'S REPORT

Conference Administrative Committee
Keystone Conference of the Free Methodist Church of North America, Inc.

We have audited the accompanying statements of financial position of the Keystone Conference of the Free Methodist Church of North America, Inc. (Conference) as of June 30, 2010 and June 30, 2009, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Conference'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 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 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 the Keystone Conference of the Free Methodist Church of North America, Inc. as of June 30, 2010 and 2009, 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.

Freed Maxick & Battaglia, CPAs, PC

Buffalo, New York
October 12, 2010

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

**STATEMENTS OF FINANCIAL POSITION
June 30,**

| ASSETS | <u>2010</u> | <u>2009</u> |
|--|----------------------------|----------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 1,075,872 | \$ 799,304 |
| Investments | 1,238,604 | 143,507 |
| Prepaid expenses and other assets - net | 29,896 | 35,302 |
| Short term loans receivable - net | 442,643 | 111,485 |
| Total current assets | <u>2,787,015</u> | <u>1,089,598</u> |
| Long term loans receivable - net | 1,659,468 | 2,094,871 |
| Equipment - net | 12,759 | 15,002 |
| Property held for sale | 469,000 | 403,000 |
| Total assets | <u><u>\$ 4,928,242</u></u> | <u><u>\$ 3,602,471</u></u> |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 7,738 | \$ 26,317 |
| Debt securities - current portion | 3,542,733 | 2,028,916 |
| Total current liabilities | <u>3,550,471</u> | <u>2,055,233</u> |
| Long-term debt securities | 730,995 | 648,896 |
| Net assets: | | |
| Unrestricted | | |
| Undesignated | 59,758 | 366,266 |
| Designated | 574,259 | 517,074 |
| Invested in land, buildings, and equipment | 12,759 | 15,002 |
| Total net assets | <u>646,776</u> | <u>898,342</u> |
| Total liabilities and net assets | <u><u>\$ 4,928,242</u></u> | <u><u>\$ 3,602,471</u></u> |

See accompanying notes.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

**STATEMENTS OF ACTIVITIES
For the Years Ended June 30, 2010 and 2009**

| | <u>2010</u> | <u>2009</u> |
|---|--------------------------|--------------------------|
| Support and revenue: | | |
| Designated contributions | \$ 71,442 | \$ 75,657 |
| Property reversions | 130,000 | 299,000 |
| Interest income | 175,135 | 171,523 |
| Unrealized and realized loss on investments | (67,674) | (36,715) |
| Other income | 18,787 | 21,712 |
| Total support and revenue | <u>327,690</u> | <u>531,177</u> |
| Expenses: | | |
| Interest on debt securities | 177,486 | 96,904 |
| Professional fees | 67,602 | 41,316 |
| Office | 193,282 | 119,479 |
| Annual conference | 26,534 | 7,758 |
| Bad debt expense | 27,136 | 37,000 |
| Evangelism and world missions | - | 2,952 |
| Christian education | 326 | 19,706 |
| Property impairment loss | 54,000 | - |
| Other | 28,890 | 18,343 |
| Loss on sale of property | 4,000 | - |
| Total expenses | <u>579,256</u> | <u>343,458</u> |
| Change in net assets | (251,566) | 187,719 |
| Unrestricted net assets, beginning of year | <u>898,342</u> | <u>710,623</u> |
| Unrestricted net assets, end of year | <u><u>\$ 646,776</u></u> | <u><u>\$ 898,342</u></u> |

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

**STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2010 and 2009**

| | <u>2010</u> | <u>2009</u> |
|--|---------------------|-------------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ (251,566) | \$ 187,719 |
| Adjustments to reconcile changes in net assets to net cash used by operations: | | |
| Allowance for doubtful accounts | (9,601) | 33,990 |
| Interest added to debt securities | 121,056 | 76,470 |
| Depreciation | 2,243 | 2,243 |
| Noncash reversion of property | (130,000) | (299,000) |
| Property impairment loss | 54,000 | - |
| Realized gain on investments | (20,047) | - |
| Unrealized loss on investments | 87,721 | 36,715 |
| Change in: | | |
| Prepaid expenses and other assets | 5,406 | (11,159) |
| Accounts payable and accrued expenses | (18,579) | (23,012) |
| Net cash used by operating activities | <u>(159,367)</u> | <u>3,966</u> |
| Cash flows from investing activities: | | |
| Loans receivable granted | (155,500) | (485,135) |
| Collections on loans receivable | 269,346 | 201,870 |
| Purchase of investments | (3,099,229) | (7,126) |
| Purchase of fixed assets | - | (5,897) |
| Proceeds from sale of reverted property | 10,000 | - |
| Proceeds from sale of investments | 1,936,458 | 27,000 |
| Net cash used by investing activities | <u>(1,038,925)</u> | <u>(269,288)</u> |
| Cash flows from financing activities: | | |
| Sale of debt securities | 2,465,593 | 1,388,989 |
| Redemptions of debt securities | (990,733) | (489,935) |
| Net cash provided by financing activities | <u>1,474,860</u> | <u>899,054</u> |
| Net change in cash and cash equivalents | 276,568 | 633,732 |
| Cash and cash equivalents, beginning of year | 799,304 | 165,572 |
| Cash and cash equivalents, end of year | <u>\$ 1,075,872</u> | <u>\$ 799,304</u> |
| Supplemental cash flow information: | | |
| Cash paid for interest | <u>\$ 50,836</u> | <u>\$ 11,684</u> |

See accompanying notes.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. - NATURE OF ORGANIZATION

The Keystone Conference of the Free Methodist Church of North America, Inc. (Conference) is a nonprofit corporation associated with the Free Methodist Church of North America, Inc. (Free Methodist Church). As an association of churches, the Conference is exempt from federal and state income tax under Section 501(c)(3) of the Internal Revenue Code, and contributions made by the public are deductible for income tax purposes. The Conference changed its year end from December 31st to June 30th effective June 30, 2008. This has been done to better align the Conference's fiscal year with its operations.

The purpose of the Conference is to carry out the work of the Free Methodist Church within and through its member churches and thereby to spread the Gospel of Jesus Christ. This is accomplished by the operations of the Conference and the operations of the Keystone Conference Loan Fund (Loan Fund). The Loan Fund provides loans to Free Methodist churches for the construction and renovation of church buildings. The Loan Fund also provides loans to Free Methodist ministers within the Conference to assist them in purchasing their homes.

Seven other Conferences, in addition to the Keystone Conference, are being serviced by one office located in Rochester, New York. This office, WAVE administration, is responsible for the activities related to the United Ministries for Christ Home Ministries, pastor pensions, and WAVE operations, which are included in the local church tithes that are sent to the central location. The Keystone Conference is a distinct legal entity; however, the Keystone Conference and the seven other Conferences with which it shares administrative operations are served by a combined administrative office and the same personnel. Local churches no longer routinely make contributions to the Keystone Conference, as such contributions are now made directly to the combined administrative unit. The Keystone Conference supports various programs, including camping and Christian education, but on a limited basis.

Beginning in 2002, churches within the Conference were requested to increase their contributions from 10% to 12.5% to the combined administrative office in Rochester, New York. Two and a half percent of annual church income is sent to the Keystone Conference to help support operations.

Support and revenue are derived primarily from Conference churches and from interest and investment income from investments in church loans and other investments.

NOTE 2. - SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The financial statements of the Conference are prepared on the accrual basis of accounting. The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The functional allocation of expenses, described below, is displayed and represents allocation of the Conference expenses in accordance with the program services or supporting activities benefited.

Effective for interim and annual periods ending after September 15, 2009, the Financial Accounting Standards Board ("FASB") has codified all sources of authoritative accounting literature pertaining to all non-governmental entities into a single set of authoritative literature, known as the FASB Accounting Standards Codification ("FASC"). The FASC includes all authoritative literature previously issued by recognized standard-setting bodies pertaining to accounting principles generally accepted in the United States, thereby superseding all previously issued authoritative pronouncements relating to non-governmental entities.

KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2. - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

All references to relevant authoritative literature issued by the FASB with which the Conference must comply are hereinafter referred to generally as "U.S. GAAP".

Accounting Estimates - The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Accordingly, actual results may differ from estimated amounts but management believes any such differences will not have a material effect on the financial position or result of operations of the Conference. Significant estimates in these financial statements include the allocation of expenses on a functional basis and reserves for loan losses.

Cash and Cash Equivalents - Cash and cash equivalents consist of checking and demand deposits with maturities of three months or less. The carrying amount of cash and cash equivalents approximates fair value. Financial instruments that potentially subject the Conference to a concentration of credit risk consist principally of cash and cash equivalent accounts in financial institutions. Although deposits exceeded the federally insured deposit amount at June 30, 2010 and 2009, management does not anticipate nonperformance by the financial institutions. Management reviews the financial viability of these institutions on a periodic basis.

Investments and Property Held for Sale - Investments in equity securities with readily determinable fair values and debt securities are reported at fair value. Donated stocks, bonds, mutual funds, government securities, and property are reported at quoted value or fair value at the date of donation, in accordance with the policy stated above. Other investments, such as property held for sale, are reported at fair market value as determined by an independent market analysis.

Loans Receivable - Loans receivable are made primarily to churches for construction and renovation of church buildings and to ministers within the Conference, bearing interest at various rates. Interest income is accrued on the outstanding balances and recognized as income when earned. Management considers the collectability of each receivable on an individual basis. Management considers loans that are three months delinquent and beyond to be in default.

Equipment and Depreciation - Items capitalized as equipment are reported at historical cost. Certain items that were purchased prior to the initiation of the formal accounting records are reported at their estimated value. Donated items are reported at their fair market value on the date of the gift.

Depreciation is computed on the straight-line method over the estimated useful lives of the related assets which are all 5 years. Church buildings that in the future will be granted to a conference church are depreciated over the estimated period of time until the church is granted full society status by the Free Methodist Church.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2. - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Support, Revenue and Expenses - Revenue is reported when earned and support is reported when contributions are made, which may be when cash is received, unconditional promises are made, or ownership of other assets are transferred to the Conference. The Conference reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated amounts. When a stipulated time restriction ends or a purpose restriction is satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. The Conference reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. When explicit donor stipulations about how long those long-lived assets must be maintained are absent, the Conference reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Expenses are reported when costs are incurred.

Functional Allocation of Expenses - The expenses have been allocated between program services and supporting activities. Program services consist of Christian education, church growth, Evangelism, and missions. Supporting activities consist of general and administrative costs. Because the scope of operations and partnership with the combined administrative office does not require the Conference to engage in fund-raising activities, there are no fund-raising costs recognized. The functional allocation of expenses for the years ended June 30, 2010 and June 30, 2009 is as follows:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|-----------------------|--------------------------|--------------------------|
| Program services | \$ 414,946 | \$ 241,344 |
| Supporting activities | <u>164,310</u> | <u>102,114</u> |
| Total expenses | <u>\$ 579,256</u> | <u>\$ 343,458</u> |

Display of Net Assets by Class - The accompanying financial statements have been prepared in conformity with the disclosure and display requirements of U.S. GAAP. U.S. GAAP requires that resources be classified for reporting purposes into three net asset categories (temporarily restricted, permanently restricted and unrestricted) according to the existence or absence of donor-imposed restrictions. Temporarily restricted net assets are those whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those for which donors require the principal of the gift to be maintained in perpetuity. Temporarily restricted net assets whose restrictions are satisfied in the year of the gift are reported as temporarily restricted and included in the amount released from restrictions in the accompanying Statements of Activities.

Unrestricted Net Assets - Are those currently available for ministry purposes under the direction of the board, which are comprised of resources invested in land, buildings, and equipment, and board designated accounts. There are no temporarily restricted or permanently restricted net assets. Within the unrestricted net assets the Conference maintains an operating fund and a loan fund as follows:

KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2. - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Fund - Funds established for the operations of the Conference.

Loan Fund - Funds established primarily for making loans to churches and ministers within the Conference for church constructions, renovation, and housing.

Reclassifications – Certain elements of the financial statements for the year ended June 30, 2009 have been reclassified to conform with the 2010 presentation.

NOTE 3. - NEW ACCOUNTING PRONOUNCEMENTS

In September 2009, the FASB issued *Accounting Standards Update ("ASU") 2009-12, Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*. ASU 2009-12 provides amendments to the Fair Value Measurements and Disclosures required under U.S. GAAP, relating to the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The amendments in this update permit, as a practical expedient, a reporting entity to measure the fair value of an investment that is within its scope on the basis of the net asset value per share of the investment (or its equivalent) in certain instances. This update also requires disclosures by major category of investment about the attributes of investments within its scope, such as the nature of any restrictions on the investor's ability to redeem its investments at the measurement date, any unfunded commitments (for example, a contractual commitment by the investor to invest a specified amount of additional capital at a future date to fund investments that will be made by the investee), and the investment strategies of the investees.

ASU 2009-12 was effective for the Conference fiscal year ended June 30, 2010. The adoption of AUS 2009-12 does not have a material impact on the Conference's financial statements.

In January 2010, the FASB issued *ASU 2010-6, Improving Disclosures about Fair Value Measurements*, to amend U.S. GAAP to require certain new disclosures pertaining to an entity's fair value disclosures. The ASU requires, in particular, disclosure about transfers between levels within the fair value hierarchy, as well as disclosure of the gross activity for assets classified as Level III within the hierarchy. The ASU is effective for interim and annual reporting periods beginning after December 15, 2009. The Conference is currently evaluating the impact ASU 2010-6 will have on its financial statements.

In January 2010, the FASB issued *ASU 2010-7*, to amend U.S. GAAP to incorporate the provisions of *SFAS 164, Not-for Profit Entities: Mergers and Acquisitions*. ASU 2010-7 establishes principles and requirements on how a not-for-profit entity should account for a business combination, including determining whether the combination is a merger or an acquisition. The ASU also provides guidance on the accounting and disclosure for goodwill generated in a combination. ASU 2010-7 is effective for combinations for which date of merger or acquisition date is on or after the beginning of an initial reporting period beginning on or after December 15, 2009. The adoption of ASU 2010-7 is not expected to have a material impact on the Conference financial statements.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 3. - NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In July 2010, the FASB issued ASU 2010-20, Receivables, to amend U.S. GAAP to require enhanced disclosures about the credit quality of financing receivables and the allowance for credit losses. The ASU is effective for annual reporting periods ending on or after December 15, 2011. The Conference is currently evaluating the impact ASU 2010-20 will have on its financial statements.

NOTE 4. - FAIR VALUE MEASUREMENTS

Assets and liabilities recorded at fair value in the Statements of Financial Position are categorized based upon the level of judgment associated with the inputs used to measure their fair value. An asset or a liability's categorization within the fair value hierarchy is based on the lowest level of judgment input to its valuation. Hierarchical levels, defined by U.S. GAAP, are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities as follows:

- Level I: Valuations based on quoted prices in active markets for identical assets or liabilities that the Conference has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment. Level I assets include money market funds and mutual funds that are traded in active exchange markets.
- Level II: Valuations based on quoted prices in active markets for similar assets or liabilities quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. Level II assets include real estate properties whose value is determined using a property appraisal of the fair market value conducted by an appraisal service.
- Level III: Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These are generally company generated inputs and are not market based inputs. Level III assets would include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques as well as instruments for which the determination of fair value requires significant investment management judgment or estimation.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2010 and 2009.

- Cash and cash equivalents: valued at the balance of the cash account at year end or the value of the investment certificate at year end.
- Equities and stock options: valued at the closing price reported on the active market on which the individual securities are traded.
- Mutual funds and other fixed income: valued at the net asset value (NAV) of shares held at year end.
- Property held for sale: valued at the appraised amount provided by third party real estate professionals or the amount of a pending purchase agreement.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4. - FAIR VALUE MEASUREMENTS (CONTINUED)

The following table presents information about assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2010 and June 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

| | Assets at Fair Value as of June 30, 2010 | | | |
|---------------------------|---|-------------------------|--------------------------|----------------------------|
| | <u>(Level 1)</u> | <u>(Level 2)</u> | <u>(Level 3)</u> | <u>Total</u> |
| Cash and cash equivalents | \$ 217,711 | \$ - | \$ - | \$ 217,711 |
| Equities: | | | | |
| Basic materials | 9,500 | - | - | 9,500 |
| Consumer goods | 9,053 | - | - | 9,053 |
| Financial | 22,990 | - | - | 22,990 |
| Healthcare | 8,770 | - | - | 8,770 |
| Industrial goods | 33,910 | - | - | 33,910 |
| Services | 15,850 | - | - | 15,850 |
| Technology | <u>12,087</u> | <u>-</u> | <u>-</u> | <u>12,087</u> |
| Total equities | 112,160 | | | 112,160 |
| Mutual funds: | | | | |
| Bond Fund | 364,031 | - | - | 364,031 |
| Equity Fund | 80,498 | - | - | 80,498 |
| Large Blend | 113,547 | - | - | 113,547 |
| Large Growth | 42,987 | - | - | 42,987 |
| Large Value | 93,553 | - | - | 93,553 |
| Medium Blend | 50,642 | - | - | 50,642 |
| Medium Growth | 23,894 | - | - | 23,894 |
| Small Value | <u>51,750</u> | <u>-</u> | <u>-</u> | <u>51,750</u> |
| Total mutual funds | 820,902 | - | - | 820,902 |
| Stock options | 67,923 | - | - | 67,923 |
| Other fixed income | - | 19,908 | - | 19,908 |
| Property held for sale | <u>-</u> | <u>-</u> | <u>469,000</u> | <u>469,000</u> |
| Total | <u>\$ 1,218,696</u> | <u>\$ 19,908</u> | <u>\$ 469,000</u> | <u>\$ 1,707,604</u> |

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4. - FAIR VALUE MEASUREMENTS (CONTINUED)

| | Assets at Fair Value as of June 30, 2009 | | | |
|---------------------------|---|------------------|-------------------|-------------------|
| | (Level 1) | (Level 2) | (Level 3) | Total |
| Cash and cash equivalents | \$ 8,983 | \$ - | \$ - | \$ 8,983 |
| Mutual funds: | | | | |
| Bond Fund | 36,013 | - | - | 36,013 |
| Equity Fund | 16,890 | - | - | 16,890 |
| Large Blend | 9,822 | - | - | 9,822 |
| Large Growth | 5,534 | - | - | 5,534 |
| Large Value | 51,034 | - | - | 51,034 |
| Medium Blend | 15,231 | - | - | 15,231 |
| Total mutual funds | 134,524 | - | - | 134,524 |
| Property held for sale | - | - | 403,000 | 403,000 |
| Total | \$ 143,507 | \$ - | \$ 403,000 | \$ 546,507 |

The table below sets forth a summary of changes in the fair value of the Conference's Level 3 assets for the year ended June 30, 2010:

| | Level 3 Asset Property Held For Sale |
|-----------------------------|---|
| Balance as of July 1, 2009 | \$ 403,000 |
| Reversions and sales, net | 120,000 |
| Impairment of assets | (54,000) |
| Balance as of June 30, 2010 | \$ 469,000 |

The table below sets forth a summary of changes in the fair value of the Conference's Level 3 assets for the year ended June 30, 2009:

| | Level 3 Asset Property Held For Sale |
|-----------------------------|---|
| Balance as of July 1, 2008 | \$ 104,000 |
| Reversions and sales, net | 299,000 |
| Impairment of assets | - |
| Balance as of June 30, 2009 | \$ 403,000 |

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5. - INVESTMENTS

The realized and unrealized gains and losses on investments reported at fair value for the years ended June 30, 2010 and 2009 are as follows:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|---|--------------------------|--------------------------|
| Unrealized losses | \$ (87,721) | \$ (36,715) |
| Realized gains | <u>20,047</u> | <u>-</u> |
| Total unrealized and realized losses on investments | <u>\$ (67,674)</u> | <u>\$ (36,715)</u> |

NOTE 6. - LOANS RECEIVABLE

Loans receivable consist primarily of secured church notes and loans and ministers' loans for home purchases with interest rates of 3.5% to 7.0% and terms from 60 days to 30 years. These notes are secured by the underlying properties.

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|---|--------------------------|--------------------------|
| Church loans | \$ 1,487,440 | \$ 1,665,249 |
| Ministers' loans | 655,912 | 591,949 |
| Allowance for doubtful accounts | <u>(41,241)</u> | <u>(50,842)</u> |
| | <u>2,102,111</u> | <u>2,206,356</u> |
| Short term portion of loans receivable, net | <u>(442,643)</u> | <u>(111,485)</u> |
| Long term portion of loans receivable, net | <u>\$ 1,659,468</u> | <u>\$ 2,094,871</u> |

Bad debt expense is recognized when a loan is considered uncollectible. Management has reviewed the loan portfolio and has established a reserve for bad debts in the amount of \$41,241 and \$50,842 at June 30, 2010 and June 30, 2009, respectively.

At June 30, 2010, the principal maturities to be received during the periods indicated are as follows:

| | |
|---------------------|---------------------|
| 2011 | \$ 442,643 |
| 2012 | 94,341 |
| 2013 | 101,161 |
| 2014 | 80,526 |
| 2015 and thereafter | <u>1,383,440</u> |
| | <u>\$ 2,102,111</u> |

As of June 30, 2010, almost all of the Conference's loans and the majority of the Conference's outstanding debt securities were to borrowers and investors located in the geographical area encompassed by the Keystone Conference.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7. - LAND, BUILDINGS, AND EQUIPMENT

Land, buildings, and equipment consist of the following at June 30, 2010 and June 30, 2009:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|-------------------------------|--------------------------|--------------------------|
| Office equipment | \$ 44,493 | \$ 44,493 |
| Less accumulated depreciation | <u>(31,734)</u> | <u>(29,491)</u> |
| | <u>12,759</u> | <u>15,002</u> |
| Depreciation expense | \$ <u>2,243</u> | \$ <u>2,243</u> |

NOTE 8. - PROPERTY HELD FOR SALE

Property held for sale consists of property that has reverted to the Conference at the date of closure of local congregations. This property is reported at fair market value as determined by an independent market analysis. At June 30, 2010 and June 30, 2009 property held for sale is comprised of the following:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|--|--------------------------|--------------------------|
| Conneaut Free Methodist Church | \$ 69,000 | \$ 94,000 |
| Gilson Ridge Free Methodist Church | - | 10,000 |
| Huntington Free Methodist Church, Fellowship Hall, and Shady Side Parsonage | 270,000 | 299,000 |
| Clarion Free Methodist Church and Parsonage | <u>130,000</u> | <u>-</u> |
| | <u>\$ 469,000</u> | <u>\$ 403,000</u> |

During the year ended June 30, 2010, the Conference recorded a property impairment loss of \$54,000 to reflect the decline in the fair market value of certain properties. The impairment was recorded based either on appraised amounts provided by third party real estate professionals or the amount of a pending purchase agreement.

See Notes 15 and 16 regarding the pending sale of the Huntington Free Methodist Church, Fellowship Hall, and Shady Side Parsonage.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9. - DEBT SECURITIES

The Keystone Conference Loan Fund offers two types of debt securities to investors through its Offering Circular. The debt securities offered are 30-day demand notes and 1, 2 and 5 year term notes. The principal terms of these instruments are as follows:

Demand Note

| | |
|--|-----------------------------------|
| Minimum initial investment in security | \$ 500 |
| Interest payable semi-annually | Variable: 4.0%* at June 30, 2010. |

Term Note

| | |
|--|---|
| Minimum initial investment in security | \$ 1,000 |
| Interest payable at end of term* | 1 Year Note: 4.4% 2 Year Note: 4.6% 5 Year Note: 4.9% |

*Rates as of 6/30/10

The Conference had outstanding debt securities payable with the following terms at June 30, 2010 and June 30, 2009:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|------------------------|--------------------------|--------------------------|
| Demand Notes (30 days) | \$ 2,368,996 | \$ 1,359,496 |
| 1 Year Notes | 500,192 | 431,649 |
| 2 Year Notes | 1,246,049 | 878,587 |
| 5 Year Notes | <u>158,491</u> | <u>8,080</u> |
| | <u>\$ 4,273,728</u> | <u>\$ 2,677,812</u> |

The five year maturity schedule at June 30, 2010 is as follows:

| | |
|------|---------------------|
| 2011 | \$ 3,542,733 |
| 2012 | 572,505 |
| 2013 | - |
| 2014 | 8,501 |
| 2015 | <u>149,989</u> |
| | <u>\$ 4,273,728</u> |

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 10. - LINE OF CREDIT

The Conference has available a \$50,000 working capital demand line of credit which bears interest at the bank's prime rate plus 1% (4.25% at June 30, 2010 and at June 30, 2009). There were no outstanding borrowings under this agreement at June 30, 2010 or June 30, 2009. The line is collateralized by substantially all assets of the Conference.

NOTE 11. - RELATED PARTY TRANSACTIONS

The Conference offers its debt securities to member churches as well as parishioners. In addition, members of the Board of Administration and the Conference itself also hold these debt securities.

The Conference had outstanding loans receivable from officers and directors amounting to \$358,842 and \$379,908 at June 30, 2010 and June 30, 2009, respectively, which were included within loans receivable (see Note 6). These loans were issued in compliance with the Conference's policies and procedures.

NOTE 12. - NET ASSETS

Unrestricted net assets consist of the following at June 30, 2010 and June 30, 2009:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|---|--------------------------|--------------------------|
| Operating fund: | | |
| Undesignated (deficit) | \$ 4,136 | \$ (46,160) |
| Invested in land, buildings, and equipment | 12,759 | 15,002 |
| Designated for Evangelism—property in use and held for sale—net of debt | 469,000 | 403,000 |
| Designated—invested in loan fund: | | |
| Ministers' benefit fund | 39,512 | 41,343 |
| Church planting fund | 25,770 | 32,034 |
| Evangelism | 13,470 | 12,934 |
| Scholarship fund | 20,352 | 21,853 |
| Pastor benevolence fund | <u>6,155</u> | <u>5,910</u> |
| Total operating fund | 591,154 | 485,916 |
| Loan fund: | | |
| Undesignated | <u>55,622</u> | <u>412,426</u> |
| Total unrestricted net assets | <u>\$ 646,776</u> | <u>\$ 898,342</u> |

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 13. - DESIGNATED CONTRIBUTIONS/REVENUE

Contributions consist of the following for the year ended June 30, 2010 and June 30, 2009:

| | <u>June 30, 2010</u> | <u>June 30, 2009</u> |
|--|--------------------------|--------------------------|
| Operating fund: | | |
| WAVE Fair Share (Office Contributions of 2.0% and 2.5% at June 30, 2010 and 2009, respectively) | \$ 52,989 | \$ 46,607 |
| Retired Ministers | 2,073 | 2,533 |
| World Missions | - | 2,952 |
| Other | <u>16,380</u> | <u>23,565</u> |
| | <u>\$ 71,442</u> | <u>\$ 75,657</u> |

NOTE 14. - CONCENTRATION OF CREDIT RISK

Cash and cash equivalents – Financial instruments that potentially subject the Conference to concentrations of credit risk consist principally of cash accounts in a financial institution and cash equivalent accounts with a related party. The Conference has concentrated its credit risk for cash by maintaining deposits in a bank in excess of federally insured limits in the amount of \$209,689 at June 30, 2010 (\$542,754 – 2009) and by maintaining Investment Certificates from a related party which are uninsured in the amount of \$616,183 at June 30, 2010 (\$6,550 – 2009).

The Investment Certificates that the Conference holds are Flexible Certificates which can be invested in or redeemed from at any time and in any increment. The redemption amount will generally be paid within 30 days of the request.

Although the cash accounts exceed federally insured deposit amounts and the cash equivalents are uninsured, the Conference does not anticipate nonperformance by the financial institution or related party.

Loans receivable – The loans receivable (see Note 6) are substantially all made to entities and people related to the Conference in the states of Pennsylvania and New York.

In the normal course of business, the Conference makes commitments to extend mortgage loans to meet the financing needs of the Free Methodist pastors and churches in the northeast. The Conference's exposure to credit loss, in the event of nonperformance by the churches to which it has extended commitments, is limited to the amount of the commitment. The Conference controls the credit risk of its commitments through collateral, limits, and monitoring procedures.

The Conference is subject to a concentration of credit risk relating to the notes and loans made to Conference churches and pastors since the Conference primarily grants notes and loans to these entities.

The timing differences between the repayment terms of the Conference notes and loans receivable and the debt securities could impact the Conference's liquidity.

**KEYSTONE CONFERENCE OF THE FREE METHODIST
CHURCH OF NORTH AMERICA, INC.**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 15. – COMMITMENT

During the final quarter of the year ended June 30, 2010, the Conference received a purchase offer of \$270,000 for the Huntingdon Free Methodist Church, Fellowship Hall, and Shady Side Parsonage. Due to contingencies on behalf of the purchasing party the sale was not completed as of the date these financial statements were available to be issued.

During the final quarter of the year ended June 30, 2010, the Conference received a purchase offer of \$48,500 for the Clarion Free Methodist Church portion of the Clarion Church and Parsonage property. Due to contingencies on behalf of the purchasing party no closing date has been set as of the date these financial statements were available to be issued.

NOTE 16. - SUBSEQUENT EVENT

Subsequent to the year ended June 30, 2010, the Conference made the decision to perform a deed transfer in lieu of foreclosure on a delinquent pastor loan. The mortgagor was nine payments behind and the loan amounted to \$61,879 at June 30, 2010. The transfer of the deed has not occurred as of the date these financial statements were available to be issued.

Subsequent to the year ended June 30, 2010, the Conference entered into a one-year lease agreement with the purchaser of the Huntingdon Free Methodist Church, Fellowship Hall, and Shady Side Parsonage. The lease is for the Church and Fellowship Hall portions of the property. The lease has a termination clause that can be exercised upon the purchase of the leased premises, effective on the date of the closing of the transaction.

These financial statements have not been updated for subsequent events occurring after October 12, 2010 which is the date these financial statements were available to be issued.