

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2007

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

**The Episcopal Church in the
Diocese of California**

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

THE BOARD OF DIRECTORS
THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA
San Francisco, California

We have audited the accompanying statement of financial position of **THE EPISCOPAL CHURCH IN THE DIOCESE OF CALIFORNIA (the Diocese)** as of December 31, 2007 and 2006, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Diocese's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year's summarized comparative information has been derived from the Diocese's 2006 financial statements and, in our report dated August 29, 2007, we expressed an unqualified opinion on these 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 The Episcopal Church in the Diocese of California as of December 31, 2007, 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.

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May 28, 2008

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**The Episcopal Church in the
Diocese of California**

Statement of Financial Position

December 31,

	2007					2006
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	Total
Asset:						
Cash and cash equivalents	\$ 1,902,736				\$ 1,902,736	\$ 667,525
Receivables, net	1,423,682		\$ 53,499		1,477,181	1,710,907
Investments			18,272,515		18,272,515	18,473,186
Other investment			90,000		90,000	100,000
Notes receivable held for investment, net		\$ 51,750	168,506		220,256	256,167
Pledge receivable			31,329		31,329	306,640
Equity interests in real property		100,000	4,009,451		4,109,451	4,160,951
Property and equipment, net	730,627				730,627	754,092
Investments - charitable remainder unitrusts				\$ 16,308,515	16,308,515	16,120,604
Due to/from other funds	(1,158,378)	1,035,813	145,758	(23,193)		
Total assets	\$ 2,898,667	\$ 1,187,563	\$ 22,771,058	\$ 16,285,322	\$ 43,142,610	\$ 42,550,072
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	\$ 738,706		\$ 25,124		\$ 763,830	\$ 704,755
Accounts payable, related parties		\$ 190,000	4,985,477	\$ 185,270	5,360,747	5,724,185
Deferred revenue	171,245				171,245	135,107
Funds held in trusts for beneficiaries				13,204,687	13,204,687	13,124,324
Total liabilities	909,951	190,000	5,010,601	13,389,957	19,500,509	19,688,371
Net Assets:						
Unrestricted	1,854,031		1,333,249		3,187,280	2,963,725
Unrestricted-board designated	134,685				134,685	122,675
Total unrestricted	1,988,716		1,333,249		3,321,965	3,086,400
Temporarily restricted		997,563	12,339,250	522,511	13,859,324	13,472,056
Permanently restricted			4,087,958	2,372,854	6,460,812	6,303,245
Total net assets	1,988,716	997,563	17,760,457	2,895,365	23,642,101	22,861,701
Total liabilities and net assets	\$ 2,898,667	\$ 1,187,563	\$ 22,771,058	\$ 16,285,322	\$ 43,142,610	\$ 42,550,072

The Episcopal Church in the Diocese of California

Statement of Activities

Years Ended December 31, 2007 (with comparative totals for 2006)

	2007					2006 Total
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	
Support and Revenue:						
Parish and mission assessments	\$ 3,598,002				\$ 3,598,002	\$ 3,525,939
Gifts, grants and other	275,427				275,427	455,382
Investment income, net	179,935		\$ 86,505		266,440	275,010
Interfund transfer	67,825		(67,825)			
Total support and revenue	4,121,189		18,680		4,139,869	4,256,331
Expenses:						
Episcopate	371,593				371,593	417,742
Diocesan finance	484,370				484,370	376,913
Diocesan administration	426,294				426,294	828,022
Clerical	232,341				232,341	206,636
Support services-Diocese	88,169				88,169	173,393
Support services-outside Diocese	751,100				751,100	809,358
Planned giving office	150,111				150,111	183,262
Congregational development	732,636				732,636	369,896
Ordained ministry development	94,064				94,064	88,262
Congregation and lay ministries development	332,460				332,460	388,574
Social ministries	20,945				20,945	74,254
Community Ministries	137,638				137,638	405,709
Jubilate Deo						265,298
Communications	237,933				237,933	
Payments to beneficiaries and other custodial fund disbursements	869,262				869,262	929,992
Total expenses	4,928,916				4,928,916	5,517,311
Changes in Unrestricted Net Assets	(807,727)		18,680		(789,047)	(1,260,980)
Changes in Temporarily Restricted Net Assets:						
Gifts, grants and other		\$ 434,805	\$ 205,406	\$ 215,775	855,986	285,875
Investment income, net		57,950	497,943		555,893	1,699,506
Interfund transfer		158,771	(158,771)			
Change in temporarily restricted net assets		651,526	544,578	215,775	1,411,879	1,985,381
Change in Permanently Restricted Net Assets:						
Gifts, grants, and other			104,910	52,658	157,568	492,089
Interfund transfer			124,118	(124,118)		
Change in permanently restricted net assets			229,028	(71,460)	157,568	492,089
Net Assets Released from Restrictions	1,024,612	(575,349)	(449,263)			
Change in Net Assets	216,885	76,177	343,023	144,315	780,400	1,216,490
Net Assets, beginning of year						22,400,776
Prior period adjustment						(755,565)
Net Assets, beginning of year	1,771,831	921,386	17,417,434	2,751,050	22,861,701	21,645,211
Net Assets, end of year	\$ 1,988,716	\$ 997,563	\$ 17,760,457	\$ 2,895,365	\$ 23,642,101	\$ 22,861,701

**The Episcopal Church in the
Diocese of California**

Statement of Cash Flows

<i>Years Ended December 31,</i>	2007	2006
Cash Flows from Operating Activities:		
Changes in net assets	\$ 780,400	\$ 1,216,490
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	70,320	59,956
Net realized and unrealized loss (gain) on investments	327,180	(1,501,473)
Change in charitable remainder unitrusts	(107,548)	(87,005)
Change in allowance for doubtful accounts		(3,115)
(Increase) decrease in operating assets		
Receivables	233,726	(255,305)
Pledge receivable	275,311	
Increase (decrease) in operating liabilities		
Accounts payable and accrued expenses	59,075	221,218
Accounts payable, related party	(363,438)	744,746
Deferred revenue	36,138	(66,000)
Net cash provided (used) by operating activities	1,311,164	(886,978)
Cash Flows from Investing Activities:		
Purchases of investments	(4,258,199)	(4,095,010)
Proceeds from sale of investments	4,141,690	5,548,783
Principal payments received on notes receivable held for investments	35,911	212,813
Purchases of property and equipment	(46,855)	(126,233)
Issuance of new notes receivable held for investment		(58,000)
(Purchase) sale of investment in equity interest in real property	51,500	(3,286,688)
Net cash provided (used) by investing activities	(75,953)	(1,804,335)
Net Increase (Decrease) in Cash and Cash Equivalents	1,235,211	(1,474,823)
Cash and Cash Equivalents, beginning of year	667,525	2,142,348
Cash and Cash Equivalents, end of year	\$ 1,902,736	\$ 667,525

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies:

a. Organization

The Episcopal Church in the Diocese of California (the Diocese) is a nonprofit entity that administratively supports Episcopal parishes and other ancillary institutions throughout the San Francisco Bay Area in the State of California.

b. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables, and other liabilities, including deferred revenue. The principles of “fund accounting” are utilized in order to provide a more detailed accountability for the funds entrusted to the Diocese.

c. Basis of Presentation

The Diocese reports information regarding its financial position and activities according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of balances and transactions into three classes of net assets:

Unrestricted Net Assets. The portion of net assets that is neither temporarily restricted nor permanently restricted by donor-imposed stipulations.

Temporarily Restricted Net Assets. The portion of net assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the organization.

Permanently Restricted Net Assets. The portion of net assets whose use by the organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the organization.

d. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, cash and cash equivalents include time deposits and all highly liquid debt instruments with original maturities of three months or less.

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

e. Receivables

Receivables consist of amounts due to the Diocese from parishes that are within the Diocese of California and represent assessments, reimbursable expenses, and other receivables. The Diocese records bad debts using the allowance method.

f. Investments

Investments are carried at fair value, with realized and unrealized gains and losses reflected in the statement of activities. The fair value of investments is based on quoted market price and such investments are subject to market fluctuations.

g. Notes Receivable Held for Investment

Notes receivable held for investment consists of notes to several churches and an individual. The notes bear interest at rates ranging from 0% - 8% and are due through 2016. The notes are secured by property or unsecured and are recorded net of an allowance related to interest accruals.

h. Equity Interest in Real Property

Equity interest in real property consists of amounts funded by the Diocese for the purchase of property by related parties. The Diocese has an equity interest in the property for the amount of the purchase price funded by the Diocese. This interest is recorded at cost.

i. Property and Equipment

Purchased property and equipment is recorded at cost. Donated property is valued at fair value at time of donation. Depreciation is provided on a straight-line basis over the estimated useful lives (five to thirty years) of the related assets. Maintenance and repairs are charged to expense as incurred. Significant betterments and renewals are capitalized.

j. Deferred Revenue

Deferred revenue consists of assessments, payroll, and benefits received from parishes in advance of the period to which they relate.

k. Recognition of Support and Revenue

Current year parish and mission assessments have been prepared on the accrual basis of accounting.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Gifts and grants are recognized when the donor makes an unconditional promise to give to the Diocese. Donor-restricted gifts and grants are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Investment income is recognized as revenue when earned. Investment income earned on permanently restricted net assets is recorded as an increase or decrease in temporarily restricted net assets unless specifically restricted as permanent by the donor.

l. Income Taxes

The Diocese is a tax exempt organization under the provision of the Internal Revenue Code, Section 501(c)(3), and the related state provisions. Accordingly, no provision for income taxes has been reflected in these financial statements.

m. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

n. Prior Year Summarized Comparative Information

The financial statements include certain prior year summarized information in total but not by net asset class. Accordingly, such information should be read in conjunction with the Diocese's financial statements for the year ended December 31, 2006, from which the summarized information was derived.

o. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements* (SFAS No. 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and nonfinancial liabilities of which the effective date has been delayed for one year.

The Diocese is currently evaluating the impact SFAS No. 157 will have on its financial statements, but does not believe that its adoption of SFAS No. 157 will have a material impact on its financial position and changes in net assets.

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Note 2 - Description of Funds:

Operating Fund

This fund is used to account for all expenditures related to unrestricted support and revenue. It also accounts for all assets and liabilities of the Diocese which have not been restricted. However, the Board of Directors of the Diocese has set aside certain donor unrestricted funds for certain designated uses. These funds are included in the operating fund as board designated.

Custodial and Unexpended Income Fund

This fund is used to account for gifts and grants designated for specific projects or programs by donors.

Endowment and Trust Fund

This fund is used to account for assets contributed by donors which are subject to various restrictions. The Diocese is responsible to assure that distributions be made in accordance with the provisions of each trust.

Deferred Gifts Fund

This fund is used to account for funds held in trust and administered by the Diocese, the income of which is payable to individual beneficiaries. Income earned but not paid to beneficiaries is treated as a liability, which is included with "Funds Held in Trust for Beneficiaries". Upon the expiration of the income beneficiaries' interest, the principal will be distributed in accordance with the conditions prescribed by the Charitable Remainder Unitrust agreements. Any principal that will ultimately be distributed to third party beneficiaries has been recorded as a liability, "Funds Held in Trust for Beneficiaries." The remainder is distributable to the Diocese and is stated at the estimated present value, which is calculated based on the actuarial life expectancy of the donor or designees. The discount rate used, ranging between 5% and 6.5%, approximates the 30 year U.S. Treasury Bond rate in the year of origination.

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Note 3 - Receivables:

Receivables consist of the following at December 31, 2007 and 2006:

	2007	2006
Assessments	\$ 173,303	\$ 256,012
Reimbursable expenses from related entities net of allowance (\$0 and \$19,000)	1,142,126	1,039,947
Endowment receivables	53,499	351,597
Other receivables	108,253	63,351
	\$ 1,477,181	\$ 1,710,907

Note 4 - Pledge Receivable:

The pledge receivable at December 31, 2007 is from one donor for \$31,329, with no defined payment date.

The pledge receivable at December 31, 2006 is from one donor in the amount of \$306,640 and was paid in full subsequent to year-end.

Note 5 - Investments :

The fair value of investments at December 31, 2007 and 2006 is as follows:

	Fair Value 2007	Fair Value 2006
Government obligations		\$ 3,050,972
Money market funds	\$ 3,812,959	
Corporate equity	\$ 14,459,556	15,422,214
	\$ 18,272,515	\$ 18,473,186

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Investment income for the years ended December 31, 2007 and 2006 consists of the following:

	2007	2006
Interest and dividends, net of management fees of \$ 38,634 and \$41,638, respectively	\$ 1,074,160	\$ 680,520
Realized gains and losses	1,134,282	1,159,102
Unrealized gains and losses	(1,386,109)	134,894
	\$ 822,333	\$ 1,974,516

Investment income is included in:

Unrestricted net assets	\$ 266,440	\$ 275,010
Temporarily restricted net assets	555,893	1,699,506
	\$ 822,333	\$ 1,974,516

Note 6 - Charitable Remainder Unitrusts:

The Diocese is the trustee for various charitable remainder unitrusts, which have been invested. These investments represent gifts received subject to certain restrictions on the distribution of income and the assets of the unitrust. The unitrust agreements specify the beneficiaries of the income and the assets.

The charitable remainder unitrust agreements provide for annuity payments to donors of 5% to 10%. The Diocese records this investment at fair market value. The estimated liability is based upon the annuity payments and donor life expectancy using a discount rate of 5% to 6.5% and is classified as funds held in trust for beneficiary.

The investments in charitable remainder unitrusts consist of the following at December 31, 2007 and 2006:

	Fair Value 2007	Fair Value 2006
Funds, including notes receivable of \$0 and \$131,250	\$ 16,308,515	\$ 16,120,604
Less funds held in trust for beneficiaries	(13,204,687)	(13,124,324)
Less accounts payable to related party	(185,270)	(245,230)
	\$ 2,918,558	\$ 2,751,050

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Note 7 - Notes Receivable Held for Investment:

Notes receivable held for investment consists of the following at December 31, 2007 and 2006:

	2007	2006
Note receivable from Episcopal Church of the Redeemer and Redeemer Pre-School; bearing interest at 6%; principal and interest due through January 2014; secured by Episcopal Bishop of California property.	\$ 158,294	179,581
Note receivable from St. Augustine Episcopal Church; bearing interest at 6%; principal and interest due through December 2008; secured by a Deed of Trust.	10,308	18,683
Note receivable from individual; bearing interest at 8%; principal and interest due when certain secured property is sold.	51,408	51,408
Note Receivable from St. James Episcopal Church, Oakland; bearing interest at 0% and due in 2016.	51,750	58,000
Less valuation allowance relating to interest accruals	(51,504)	(51,505)
	\$ 220,256	\$ 256,167

Note 8 - Equity Interests in Real Property:

Equity interests in real property, which are recorded at cost, consist of the following at December 31, 2007 and 2006:

	2007	2006
45% equity interest in real property owned by the Executive Officer of the Diocese	\$ 249,661	\$ 249,661
31% equity interest in real property owned by the Culmers	160,000	160,000
22% equity interest in real property owned by the Mission Clergy	100,000	100,000
23% equity interest in real property owned by the Mission Clergy		51,500

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

50% equity interest in real property owned by the former Bishop	927,500	927,500
100% equity interest in real property for current Bishop	2,672,290	2,672,290
	\$4,109,451	\$4,160,951

Note 9 - Property and Equipment:

At December 31, 2007 and 2006, property and equipment consisted of the following:

	2007	2006
Diocesan House	\$ 998,194	\$ 998,194
S. F. Campus Center partial interest	30,000	30,000
Computers/servers	61,824	14,969
Other furniture and equipment	46,209	46,209
Automobile	27,108	27,108
	1,163,335	1,116,480
Less accumulated depreciation	(432,708)	(362,388)
	\$ 730,627	\$ 754,092

Depreciation expense for the years ended December 31, 2007 and 2006 was \$70,320 and \$59,956, respectively.

Note 10 – Net Assets:

Temporarily restricted net assets are restricted for specific purposes as of December 31, 2007.

	Custodial	Endowment	Deferred Gifts	Total
Support Diocese	\$ 129,108	\$ 2,814,173	\$ 317,758	\$ 3,261,039
Education		103,607	95,821	199,428
Congregational Support		2,745,555	61,843	2,807,398

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Congregational Development	718,471	1,840,766		2,559,237
Social Ministry	57,056	2,279,864	47,089	2,384,009
Scholarships	92,928	2,555,285		2,648,213
	\$ 997,563	\$ 12,339,250	\$ 522,511	\$ 13,859,324

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the years ended December 31, 2007 and 2006.

Permanently restricted net assets are invested in perpetuity, with the income available to support the programs of the Diocese as of December 31, 2007 are as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 1,921,929	\$1,218,184	\$ 3,140,113
Education	183,863	269,072	452,935
Congregational Support	1,088,723	740,527	1,829,250
Congregational Development	318,951	20,594	339,545
Social Ministry	493,676	124,477	618,153
Scholarships	80,816		80,816
	\$ 4,087,958	\$2,372,854	\$ 6,460,812

Note 11 - Related Parties :

The Diocese and The Episcopal Bishop of California (The Bishop), a Corporation Sole, are related parties in that the Bishop administers and oversees the operations of the Diocese.

**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Included in accounts payable, related parties are the following funds due to the Bishop (a Corporation Sole) at December 31, 2007 and 2006:

	2007	2006
Funds investment in the Diocese pooled endowment	\$4,902,553	\$4,942,520
Short-term loan		215,205
Charitable remainder trusts for the benefit of the Bishop	185,270	245,230
	\$5,087,823	\$5,402,955

Also included in accounts payable, related parties are funds held for others. Several years ago, the Church of Incarnation, a church within the Diocese, gave funds to the Diocese to invest and hold for them. At December 31, 2007 and 2006, the balance due to the Church of Incarnation was \$82,924 and \$86,230, respectively.

	Amounts owed 12/31/07	Amounts owed 12/31/06
The Diocese has made several promises to give to related parties:		
Church Divinity School of the Pacific due over five years	\$ 20,000	\$ 40,000
Grace Cathedral \$25,000 due over five years	10,000	15,000
Bay School \$200,000 due over 10 years	160,000	180,000
	\$ 190,000	\$ 235,000

The Diocese was the guarantor of notes payable of one parish in the approximate amount of \$26,152 at December 31, 2006. The note was paid in full in 2007.

**The Episcopal Church in the
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Notes to Financial Statements

These amounts are payable as follows:

Less than one year	\$ 45,000
One to five years	85,000
More than five years	60,000
	<hr/>
	\$ 190,000

Note 12 - Retirement Plans:

The Diocese funds defined contribution pension plans covering lay employees. The Diocese contributes between 5% and 9% of employee compensation depending upon the employee contribution. The 2007 and 2006 contribution by the Diocese to the defined contribution pension plans approximated \$68,500 and \$67,000, respectively.

The Diocese also provides pension benefits for the clergy through a national plan. The plan is a defined benefit pension plan funded by specific assessments charged to the Diocese based on a specified percentage of compensation. In 2007 and 2006, the Diocese contributed approximately \$130,316 and \$96,000, (18% of compensation), respectively, to the clergy defined benefit pension plan.

Note 13 - Concentrations of Credit Risk:

The Diocese has identified its financial instruments which are potentially subject to credit risk. These financial instruments consist principally of cash and cash equivalents, investments in securities, and notes receivable held for investment.

The Diocese invests its cash deposits with three financial institutions. Of these deposits, \$5,485,711 and \$567,525 was not federally insured at December 31, 2007 and 2006, respectively.

Investments in securities are diversified into various equity instruments and other investment securities in order to limit the concentration of market risk.

The notes receivable held for investments, as described in Note 5, consist of notes secured by property and unsecured notes.

The Diocese bills and collects assessment revenue from the various parishes. Assessment revenues comprised 61% and 52% of total revenue the Diocese received in 2007 and 2006, respectively.

**The Episcopal Church in the
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Notes to Financial Statements

Note 14 - Prior Period Adjustments:

During the year ended December 31, 2006, it was discovered that a charitable remainder trust (the trust) had been improperly recorded. The trust had been recorded with the Diocese as the remainder beneficiary, when the remainder actually belongs to a third party. An adjustment to properly reflect the trust has been recorded. That adjustment decreased permanently restricted net assets in the deferred gifts fund by \$755,565 and increased funds held in trust for beneficiaries by the same amount as of December 31, 2005. Of that amount, \$24,446 was included in net income for 2005 and the remainder was net income of prior periods.

Also during the year ended December 31, 2006, it was discovered that certain funds within the endowment fund were improperly recorded with respect to net asset classification. An adjustment to properly reflect net assets as of December 31, 2005 has been recorded. That adjustment increased permanently restricted net assets by \$600,582 and decreased unrestricted and temporarily restricted net assets by \$269,533 and \$331,049, respectively. The adjustment had no impact on net income.