

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2010

INDEPENDENT AUDITORS' REPORT

FINANCIAL STATEMENTS,

AND

SUPPLEMENTAL INFORMATION

The Episcopal Church in the Diocese of California

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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, 2010, 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 2009 financial statements and, in our report dated July 13, 2010, 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, 2010, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information on page 21 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

Hood & Strong LLP

June 21, 2011

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The Episcopal Church in the Diocese of California

Statement of Financial Position

Years Ended December 31, 2010 (with comparative totals for 2009)

	2010					2009 Total
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	
Assets:						
Cash and cash equivalents	\$ 1,819,306	\$ 1,833	\$ 38,629		\$ 1,859,768	\$ 1,959,819
Receivables, net	1,764,200				1,764,200	1,810,363
Investments	117,932		17,341,837	\$ 18,558,783	36,018,552	32,581,978
Notes receivable	3,107,795				3,107,795	2,110,030
Notes receivable held for investment, net		30,750	89,674		120,424	141,862
Equity interests in real property	43,949	100,000	1,087,500		1,231,449	1,481,110
Property and equipment, net	3,027,537		1,211,797		4,239,334	4,311,778
Due to/from other funds	(264,711)	336,719	241,831	(313,839)		
Total assets	\$ 9,616,008	\$ 469,302	\$ 20,011,268	\$ 18,244,944	\$ 48,341,522	\$ 44,396,940
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	\$ 842,604				\$ 842,604	\$ 812,184
Accounts payable, related parties			\$ 203,237		203,237	59,701
Deferred revenue	163,936				163,936	167,469
Line of credit	3,107,795				3,107,795	2,110,030
Funds held in trusts for beneficiaries				\$ 15,132,564	15,132,564	14,969,516
Total liabilities	4,114,335		203,237	15,132,564	19,450,136	18,118,900
Net Assets:						
Unrestricted	4,595,363		(573,741)		4,021,622	2,459,152
Unrestricted - board designated	906,310				906,310	884,074
Total unrestricted	5,501,673		(573,741)		4,927,932	3,343,226
Temporarily restricted		469,302	11,978,282	678,487	13,126,071	12,620,083
Permanently restricted			8,403,490	2,433,893	10,837,383	10,314,731
Total net assets	5,501,673	469,302	19,808,031	3,112,380	28,891,386	26,278,040
Total liabilities and net assets	\$ 9,616,008	\$ 469,302	\$ 20,011,268	\$ 18,244,944	\$ 48,341,522	\$ 44,396,940

The accompanying notes are an integral part of this statement.

The Episcopal Church in the Diocese of California

Statement of Activities

Years Ended December 31, 2010 (with comparative totals for 2009)

	2010					2009 Total
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	
Support and Revenue:						
Parish and mission assessments	\$ 3,247,823				\$ 3,247,823	\$ 3,578,977
Gifts, grants and other	2,012,920	\$ 172,144	\$ 345,605	\$ 3,201	2,533,870	1,390,432
Change in value				304,133	304,133	530,703
Investment income, net			1,511,821		1,511,821	3,008,377
Total support and revenue	5,260,743	172,144	1,857,426	307,334	7,597,647	8,508,489
Expenses:						
Episcopate	602,546				602,546	531,534
Finance	450,368				450,368	562,416
Administration	850,719				850,719	735,808
Planned giving	177,282				177,282	147,286
Congregational development	383,633				383,633	309,195
Ministry development	145,094				145,094	155,467
Youth & young adult	123,412				123,412	100,106
Multicultural ministry	402,229				402,229	562,914
Communications	245,378				245,378	265,567
Support services-outside Diocese	770,402				770,402	800,960
Other ministry	148,373				148,373	150,640
Justice, peace, and integrity	24,281				24,281	33,639
Payments to beneficiaries and other custodial fund disbursements	660,584				660,584	660,620
Total expenses	4,984,301				4,984,301	5,016,152
Changes in Net Assets before Transfers & Reclasses						
	276,442	172,144	1,857,426	307,334	2,613,346	3,492,337
Interfund transfer		124,711	168,280	(292,991)		
Releases from Restriction	1,278,108	(279,479)	(998,629)			
Transfer from Corporation Sole						3,633,971
Change in Net Assets	1,554,550	17,376	1,027,077	14,343	2,613,346	7,126,308
Net Assets, beginning of year	3,947,123	451,926	18,780,954	3,098,037	26,278,040	19,151,732
Net Assets, end of year	\$ 5,501,673	\$ 469,302	\$ 19,808,031	\$ 3,112,380	\$ 28,891,386	\$ 26,278,040
Fund Balances by Classification						
Net Assets, beginning of year:						
Unrestricted net assets	\$ 3,947,123		\$ (603,897)		\$ 3,343,226	\$ 2,819,051
Temporarily restricted net assets		\$ 451,926	11,493,898	\$ 674,259	12,620,083	10,213,154
Permanently restricted net assets			7,890,953	2,423,778	10,314,731	6,119,527
Net assets, beginning of year	\$ 3,947,123	\$ 451,926	\$ 18,780,954	\$ 3,098,037	\$ 26,278,040	\$ 19,151,732
Changes in Net Assets						
Unrestricted net assets	\$ 1,554,550		\$ 30,156		\$ 1,584,706	\$ 524,175
Temporarily restricted net assets		\$ 17,376	484,383	\$ 4,228	505,987	2,406,929
Permanently restricted net assets			512,538	10,115	522,653	4,195,204
Changes in net assets	\$ 1,554,550	\$ 17,376	\$ 1,027,077	\$ 14,343	\$ 2,613,346	\$ 7,126,308
Net Assets, end of year:						
Unrestricted net assets	\$ 5,501,673		\$ (573,741)		\$ 4,927,932	\$ 3,343,226
Temporarily restricted net assets		\$ 469,302	11,978,281	\$ 678,487	13,126,071	12,620,083
Permanently restricted net assets			8,403,491	2,433,893	10,837,383	10,314,731
Net assets, end of year	\$ 5,501,673	\$ 469,302	\$ 19,808,031	\$ 3,112,380	\$ 28,891,386	\$ 26,278,040

The accompanying notes are an integral part of this statement.

The Episcopal Church in the Diocese of California

Statement of Cash Flows

Years Ended December 31, 2010 (with comparative totals for 2009)

	2010	2009
Cash Flows from Operating Activities:		
Changes in net assets	\$ 2,613,346	\$ 7,126,308
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Transfer of net assets from the Corporation Sole		(3,633,971)
Depreciation	77,660	86,979
Net realized and unrealized gain on investments	(1,080,849)	(2,615,313)
Donation of stock	(219,761)	(123,492)
Change in charitable remainder unitrusts	(576,432)	(393,896)
Reclass of note receivable to investment		(194,654)
Increase in operating assets		
Receivables	46,163	138,919
Pledge receivable		20,934
Increase (decrease) in operating liabilities		
Accounts payable and accrued expenses	30,420	(99,068)
Accounts payable, related party	143,536	(3,530,761)
Deferred revenue	(3,533)	(25,330)
Net cash provided (used) by operating activities	1,030,550	(3,243,345)
Cash Flows from Investing Activities:		
Purchases of investments	(6,334,432)	(5,911,727)
Proceeds from sale of investments	4,937,951	6,042,079
Principal payments received on notes receivable held for investments	21,438	20,953
Purchases of property and equipment	(5,219)	(273,431)
Sale of equity interest	249,661	
Transfer of assets from the Corporation Sole		3,633,971
Transfer of equity interest from Corporation Sole		(43,949)
Net cash (used) provided by investing activities	(1,130,601)	3,467,896
Net (Decrease) Increase in Cash and Cash Equivalents	(100,051)	224,551
Cash and Cash Equivalents, beginning of year	1,959,819	1,735,268
Cash and Cash Equivalents, end of year	\$ 1,859,768	\$ 1,959,819

The accompanying notes are an integral part of this statement.

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. The Diocese is governed by the Executive Council which is the legal board of directors of the Diocesan Corporation.

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

Financial statement presentation follows the recommendations of the Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. Under ASC 958, the Diocese is required to report information regarding its financial position and activities according to 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 Diocese.

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 Diocese.

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.

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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

f. Fair Value Measurements

The Diocese classifies its financial assets and liabilities measured at fair value on a recurring basis based on a fair value hierarchy with three levels of inputs. Level 1 values are based on unadjusted quoted prices in active markets for identical securities. Level 2 values are based on significant observable market inputs, such as quoted prices for similar securities and quoted prices in inactive markets. Level 3 values are based on significant unobservable inputs that reflect the Diocese's determination of assumptions that market participants might reasonably use in valuing the securities. The valuation levels are not necessarily an indication of the risk or liquidity associated with the assets and liabilities measured at fair value.

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to limited market activity of the instrument.

g. Notes Receivable Held for Investment

Notes receivable held for investment consists of notes to several churches. The notes bear interest at rates ranging from 0% - 4% 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 property owned by the Diocese, and 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

k. Recognition of Support and Revenue

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

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.

The Financial Accounting Standards Board issued new guidance on accounting for uncertainty in income taxes. The Diocese adopted this new guidance for the year ended December 31, 2009. Management evaluated the Diocese's tax positions and concluded that the Diocese had maintained its tax exempt status and had taken no uncertain tax positions that required adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the 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. Subsequent Events

The Diocese has reviewed the changes in net assets for the period of time from December 31, 2010 through June 21, 2011, the date the financial statements are available to be issued, and have determined that no adjustments are necessary to the amounts reported in the accompanying financial statements nor subsequent events have occurred, the nature of which would require disclosure.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

o. Reclassifications

Certain amounts in the 2009 financial statements have been reclassified to conform to 2010 presentation. These reclassifications have no effect on changes in net assets.

p. Comparative Financial Information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the Diocese's financial statements for the year ended December 31, 2009, from which the summarized information was derived.

q. New Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This update provided amendments that require new disclosures of (a) transfers in and out of Levels 1 and 2 to include reasons for the transfers as well and (b) reconciliation for fair value measurements using significant unobservable inputs (Level 3) should be presented separately on a gross basis, rather than as one net number. This update also provided amendments that clarify existing disclosures such as the level of disaggregation for each class of assets and liabilities as well as disclosures about inputs and valuation techniques. The Diocese does not believe that the adoption of this update will have a material impact on its financial statements.

Note 2 - Description of Funds:

a. Operating Fund

This fund is used to account for all expenditures related to unrestricted support and revenue. 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.

b. Custodial and Unexpended Income Fund

This fund is used to account for gifts and grants designated for specific projects or programs by donors. The fund balance is classified as temporarily restricted on the statement of financial position.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

c. Endowment and Trust Fund

This fund is used to account for assets contributed by donors that are subject to various restrictions, both temporary and permanent. The Diocese is responsible to assure that distributions be made in accordance with the provisions of each trust. When the market value of permanently restricted funds fall below the historical value, the deficiency is reflected as unrestricted net assets. At the end of 2010, this deficiency decreased to \$573,741 as the market continued to improve from the 2008 and 2009 declines. The permanently restricted net assets represent the historic value of additions to the endowment, and the temporarily restricted net assets represent appreciation of the endowment and the trust fund balances.

d. 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 fund balances are a combination of permanently restricted net assets and temporarily restricted net assets on the statement of financial position.

Note 3 - Receivables:

Receivables consist of the following at December 31, 2010 and 2009:

	2010	2009
Assessments	\$ 267,459	\$ 220,297
Reimbursable expenses from related entities, net of allowance	1,187,786	1,083,770
Other receivables	308,955	506,296
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	\$ 1,764,200	\$ 1,810,363

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 4 - Investments:

The fair value of investments at December 31, 2010 and 2009 is as follows:

	2010	2009
Corporate stocks	\$ 6,147,090	\$ 5,214,632
Mutual funds	11,312,679	9,548,043
Charitable trusts	18,558,783	17,819,303
	<hr/>	<hr/>
	\$ 36,018,552	\$ 32,581,978

Investment income for the year ended December 31, 2010 and 2009 consists of the following:

	2010	2009
Interest and dividends, net of management fees of \$57,410 and \$50,873, respectively	\$ 436,856	\$ 401,888
Realized gains and losses	366,858	(2,193,612)
Unrealized gains and losses	708,107	4,800,101
	<hr/>	<hr/>
	\$ 1,511,821	\$ 3,008,377

Investment income is included in:

Unrestricted net assets	\$ 30,156	\$ 655,690
Temporarily restricted net assets	1,481,665	2,352,687
	<hr/>	<hr/>
	\$ 1,511,821	\$ 3,008,377

The Episcopal Church in the Diocese of California

Notes to Financial Statements

The table below presents the balances of assets measured at fair value at December 31, 2010 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments:				
Corporate Stocks:				
Strategic Value	\$ 3,061,984	\$ 3,061,984		
Strategic Growth	3,085,106	3,085,106		
Mutual Funds:				
Intermediate Duration				
Institutional	6,528,621	6,528,621		
International Portfolio	2,991,588	2,991,588		
Emerging Markets Fund	903,683	903,683		
Global Real Estate Fund	888,787	888,787		
Charitable Trusts:				
Cash & Equivalents	605,434		\$ 605,434	
Domestic REIT	1,517,739		1,517,739	
Emerging Markets Stocks	519,907		519,907	
High Quality Bond Funds	1,993,506		1,993,506	
High Quality Bonds	189,928		189,928	
High Yield Bond Funds	372,720		372,720	
Int'l Bond Funds	772,984		772,984	
Int'l REIT	923,981		923,981	
Int'l Stocks	2,494,398		2,494,398	
Int'l Small Co. Stocks	443,990		443,990	
Investm't Grade Bond				
Funds	1,795,327		1,795,327	
Large Co. Stocks	5,471,370		5,471,370	
Small Co. Stocks	1,457,499		1,457,499	
Total assets measured at fair value	\$ 36,018,552	\$ 17,459,769	\$ 18,558,783	

Financial Investments not Measured at Fair Value

Some of the Diocese's financial instruments are not measured at fair value on a recurring basis but nevertheless are recorded at amounts that approximate fair value due to their liquid or short-term nature. Such assets and liabilities include: Cash and cash equivalents, receivables, other investments, notes receivable, equity interest in real property, payables, deferred revenue and line of credit.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 5 - 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% (as of gift receipt date) and is classified as funds held in trust for beneficiary.

The investments in charitable remainder unitrusts consist of the following at December 31, 2010 and 2009:

	2010	2009
Funds	\$ 18,558,783	\$ 17,819,003
Less funds held in trust for beneficiaries	(15,132,564)	(14,969,516)
Less accounts payable to related party	(313,839)	
	<hr/>	<hr/>
	\$ 3,112,380	\$ 2,849,487

The contribution revenue and changes in value of charitable remainder trusts recognized under such agreements for the year ended December 31, 2010 and 2009 are the following:

	2010	2009
Contributions	\$ 3,201	\$ 111,443
Change in value	304,133	530,703
Interfund transfer	(292,991)	140,560
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Net change in unitrusts	\$ 14,343	\$ 782,706

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 6 - Notes Receivable Held for Investment:

Notes receivable held for investment consists of the following at December 31, 2010 and 2009:

	2010	2009
Note receivable from Episcopal Church of the Redeemer and Redeemer Pre-School; bearing interest at 4%; principal and interest due through August 2014; secured by Episcopal Bishop of California property.	\$ 89,674	\$ 105,012
Note Receivable from St. James Episcopal Church, Oakland; bearing interest at 0% and due in 2016.	30,750	36,850
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	\$ 120,424	\$ 141,862

Note 7 - Equity Interests in Real Property:

Equity interests in real property, which are recorded at cost, consist of the following at December 31, 2010 and 2009:

	2010	2009
45% equity interest in real property owned by the Executive Officer of the Diocese		\$ 249,661
24% equity interest in real property owned by Bayani Rico	\$ 43,949	43,949
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 Person, Sue Thompson	100,000	100,000
50% equity interest in real property owned by the former Bishop, William Swing	927,500	927,500
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	\$ 1,231,449	\$ 1,481,110

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 8 - Property and Equipment:

At December 31, 2010 and 2009, property and equipment consisted of the following:

	2010	2009
Diocesan House	\$ 1,027,752	\$ 1,027,752
S. F. Campus Center partial interest	30,000	30,000
Computers/server	99,667	96,547
Other furniture and equipment	79,039	76,943
Automobile	27,108	27,108
Hearst Street, Berkeley	906,197	906,197
Bishop's Residence	2,672,290	2,672,290
<u>Bishop's Residence Improvements</u>	<u>72,707</u>	<u>72,707</u>
	4,914,760	4,909,544
<u>Less accumulated depreciation</u>	<u>(675,426)</u>	<u>(597,766)</u>
	<u>\$ 4,239,334</u>	<u>\$ 4,311,778</u>

Depreciation expense for the year ended December 31, 2010 and 2009 was \$77,660 and \$86,979, respectively.

Note 9 - Line of Credit:

The Diocese has an unsecured line of credit agreement with Union Bank of California under which the Diocese may borrow up to \$9,500,000; bearing interest at the prime rate (3.25%); interest payable monthly; principal due on October 2, 2011; unsecured.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Total principal payments due to Union Bank on the line of credit are \$3,107,795 at December 31, 2010. This debt is incurred by the Diocese on behalf of various parishes and missions as follows:

<i>December 31, 2010</i>	Line of Credit and Other Notes Payable	Corresponding Receivable
Parishes:		
Lafayette, St. Anselm's	\$ 72,240	\$ 72,240
Belvedere, St. Stephen's	369,150	369,150
Orinda, St. Stephens	421,000	421,000
Pleasanton, St. Clare's	597,661	597,661
San Francisco, St. Aidan's	46,500	46,500
San Leandro, All Saints'	40,187	40,187
Pleasant Hill, Resurrection	35,200	35,200
Danville, St. Timothy's	176,415	176,415
Concord, St. Michael and All Angels	59,500	59,500
<hr/>		
Total parishes	1,817,853	1,817,853
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Total parish and missions	1,817,853	1,817,853
<hr/>		
Other Properties:		
Berkeley Emergency Food and Housing	144,195	144,195
Bishop's Ranch	68,875	68,875
Episcopal Community Services	900,000	900,000
Ohloff House	97,500	97,500
St. Dorothy's Rest	79,372	79,372
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Total other properties	1,289,942	1,289,942
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Total	\$ 3,107,795	\$ 3,107,795

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 10 - Endowment Funds:

The Diocese's endowments consist of 102 individual funds, all established to generate general operating support to the organization. Its endowment includes donor-restricted endowment funds and funds designated by the Executive Council to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Executive Council to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

In 2008, the Diocese implemented ASC 958-205 *Reporting Endowment Funds* which was effective for fiscal years ending after December 15, 2008. The state of California adopted a version of the Uniform Prudent Management of Institutional Funds Act as its State Prudent Management of Institutional Funds Act (SPMIFA) which is applicable to funds established on or after January 1, 2009 and funds established prior to January 1, 2009 only with respect to actions taken after January 1, 2009.

SPMIFA moves away from the concept of corpus with its "historical dollar value" in an endowment. Charities are encouraged to develop spending policies that are responsive to short term fluctuations in the value of the fund, preserve the value of the fund for future use, and honor the charitable purpose of the fund. The Diocese will continue to balance the endurance of its funds and the needs of the community in its granting policy and practices.

Interpretation of Relevant Law

The Diocese considers the fair value of its endowment funds to be the value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

The Diocese classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA.

In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) The duration and preservation of the fund, (2) The purposes of the organization and the donor-restricted endowment fund, (3) General economic conditions, (4) The possible effect of inflation and deflation, (5) The expected total return from income and the appreciation of investments, (6) Other resources of the organization, (7) The investment policies of the organization.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or SPMIFA requires the Diocese to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$573,741 and \$603,897 as of December 31, 2010 and 2009, respectively.

Return Objectives and Risk Parameters

The Diocese has adopted investment and spending policies for endowment assets that will ultimately provide a predictable stream of funding to provide support for the various programs and ministries of the Diocese of California. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity as well as board-designated funds. Under this policy, as approved by the Executive Council, the endowment assets are invested in a manner that is intended to realize a competitive rate of return comparable to index benchmarks.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Diocese relies on a diversified asset investment strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Diocese targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Diocese is expecting to provide annual distributions of 5% of the market value of the portfolio as calculated on a 3 year rolling average. The investment managers are required to invest funds so as to ensure that required distributions of income or principal are met. In order to avoid untimely sales of securities, the Investment Committee will forward to the managers estimates of needed payouts well in advance.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Net changes in endowment funds for the year ended December 31 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net assets, December 31, 2009	\$ (603,897)	\$ 11,493,898	\$ 7,890,953	\$ 18,780,954
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Investment Return:				
Income		436,857		436,857
Net appreciation	30,156	1,044,808		1,074,964
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Total investment return	30,156	1,481,665		1,511,821
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Contributions		126,058	219,547	345,605
Corp Sole Transfer			292,991	292,991
Appropriation of endowment assets		(1,123,340)		(1,123,340)
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Endowment Net Assets, December 31, 2010	\$ (573,741)	\$ 11,978,281	\$ 8,403,491	\$ 19,808,031

Note 11 - Net Assets:

Temporarily restricted net assets are restricted for specific purposes as of December 31, 2010.

	Custodial	Endowment	Deferred Gifts	Total
Support Diocese	\$ 119,055	\$ 4,676,131	\$ 458,511	\$ 5,253,697
Education		50,997	52,241	103,238
Congregational Support		1,880,706	124,797	2,005,503
Congregational Development	122,831	1,353,636		1,476,467
Social Ministry	88,809	2,183,837	42,938	2,315,584
Scholarships	138,607	1,832,975		1,971,582
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	\$ 469,302	\$ 11,978,282	\$ 678,487	\$ 13,126,071

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2010 and 2009.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Permanently restricted net assets are invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2010 are as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 5,903,160	\$ 762,090	\$ 6,665,250
Education	183,863	265,170	449,033
Congregational Support	1,424,173	600,303	2,024,476
Congregational Development	318,951	153,075	472,026
Social Ministry	492,527	653,255	1,145,782
Scholarships	80,816		80,816
	\$ 8,403,490	\$ 2,433,893	\$ 10,837,383

Note 12 - Related Parties:

Included in accounts payable, related party is funds held for others. Two churches gave funds to the Diocese to invest and hold for them. The funds as of December 31, 2010 are as follows:

	2010	2009
Incarnation	\$ 60,995	\$ 59,701
True Sunshine	142,242	
	\$ 203,237	\$ 59,701

Note 13 - 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 2010 and 2009 contribution by the Diocese to the defined contribution pension plans approximated \$51,830 and \$54,300, 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 2010 and 2009, the Diocese contributed approximately \$169,829 and \$154,517, (18% of compensation), respectively, to the clergy defined benefit pension plan.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 14 - 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, \$0 and \$1,785,000 were not federally insured at December 31, 2010 and 2009, 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 6, consist of notes secured by property and unsecured notes.

The Diocese bills and collects assessment revenue from the various parishes. Assessment revenues comprised 57% of all non investment revenue the Diocese received in 2010.

The Episcopal Church in the Diocese of California

Changes in Fund Asset Balance

Years Ended December 31, 2010 (with comparative totals for 2009)

	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds
Beginning Balance - December 31, 2009	\$ 3,947,123	\$ 451,926	\$ 18,780,954	\$ 3,098,037	\$ 26,278,040
Income:					
Assessment income	3,247,823				3,247,823
Gifts and grants	2,012,920	172,144	345,605	307,334	2,838,003
Investment income, net			436,856		436,856
Realized and unrealized gains			1,074,965		1,074,965
Expenses:					
Operating departments (exclude payments to beneficiaries and other custodial)	(4,323,717)				(4,323,717)
Interfund Transfer:					
Endowments Fund to Operating Fund	998,629		(998,629)		
Less: payments to beneficiaries	(381,105)				(381,105)
Custodial Funds to Operating Fund	279,479	(279,479)			
Less: payments to beneficiaries	(279,479)				(279,479)
Endowment Fund to Custodial Fund		124,711	(124,711)		
Deferred Gifts to Endowment Fund			292,991	(292,991)	
Ending Balance - December 31, 2010	\$ 5,501,673	\$ 469,302	\$ 19,808,031	\$ 3,112,380	\$ 28,891,386