

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2014

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

The Episcopal Church in the Diocese of California

Independent Auditors' Report and Financial Statements

Independent Auditors' Report	1 - 2
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Financial Statements:

Statement of Financial Position	3
Statement of Activities	4
Statement of Cash Flows	5
Notes to Financial Statements	6 - 19

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of **THE EPISCOPAL CHURCH IN THE DIOCESE OF CALIFORNIA (the Diocese)** which comprise the statement of financial position as of December 31, 2014, and the related statement of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2014, and the statement of activities and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the Diocese's December 31, 2013 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated June 25, 2014. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
July 14, 2015

The Episcopal Church in the Diocese of California

Statement of Financial Position

December 31, 2014 (with comparative totals for 2013)

	2014					2013
	Operating	Custodial and Unexpended Income	Endowment	Deferred Gifts	Total All Funds	Total
Assets:						
Cash and cash equivalents	\$ 2,070,390		\$ 558,214		\$ 2,628,604	\$ 2,933,488
Receivables, net	1,865,215				1,865,215	2,325,929
Investments			18,648,079	\$ 15,331,479	33,979,558	37,707,869
Notes receivable	3,429,281				3,429,281	2,779,896
Notes receivable held for investment, net	309,909	\$ 2,300			312,209	2,300
Equity interests in real property	43,949	100,000	1,087,500		1,231,449	1,231,449
Property and equipment, net	4,499,279				4,499,279	4,495,881
Due to/from other funds	(1,368,046)	582,988	785,155	(97)		
Total assets	\$ 10,849,977	\$ 685,288	\$ 21,078,948	\$ 15,331,382	\$ 47,945,595	\$ 51,476,812
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	\$ 1,031,178				\$ 1,031,178	\$ 1,118,798
Deferred revenue	20,560				20,560	30,057
Line of credit	3,477,975				3,477,975	3,061,590
Funds held in trusts for beneficiaries				\$ 11,625,536	11,625,536	15,587,822
Total liabilities	4,529,713			11,625,536	16,155,249	19,798,267
Net Assets:						
Unrestricted	6,320,264		\$ (382,583)		5,937,681	6,111,015
Temporarily restricted		\$ 685,288	12,126,890	599,252	13,411,430	13,442,174
Permanently restricted			9,334,641	3,106,594	12,441,235	12,125,356
Total net assets	6,320,264	685,288	21,078,948	3,705,846	31,790,346	31,678,545
Total liabilities and net assets	\$ 10,849,977	\$ 685,288	\$ 21,078,948	\$ 15,331,382	\$ 47,945,595	\$ 51,476,812

The accompanying notes are an integral part of this statement.

The Episcopal Church in the Diocese of California

Statement of Activities

Year Ended December 31, 2014 (with comparative totals for 2013)

	2014				2013	
	Operating	Custodial and Unexpended Income	Endowment	Deferred Gifts	Total All Funds	Total
Support and Revenue:						
Parish and mission assessments	\$ 3,244,207				\$ 3,244,207	\$ 3,195,231
Gifts, grants and other	639,452	\$ 1,211,837	\$ 193,166		2,044,455	1,102,307
Change in value of charitable remainder trusts				\$ 27,146	27,146	387,209
Investment income, net			276,367		276,367	2,394,515
Total support and revenue	3,883,659	1,211,837	469,533	27,146	5,592,175	7,079,262
Expenses:						
Episcopate	586,843				586,843	533,331
Diocesan communications	150,229				150,229	216,263
Congregational development	647,462				647,462	572,974
Youth, young adult, and camps	300,971				300,971	264,616
Ministry development	172,703				172,703	160,066
Multicultural and other ministries	59,582				59,582	57,477
Development & planned giving	297,767				297,767	187,816
National church & international support	717,065				717,065	717,053
Finance	336,093				336,093	491,368
Administration & support staff	961,781				961,781	741,258
Total expenses	4,230,496				4,230,496	3,942,222
Changes in Net Assets Before Transfers & Reclasses						
	(346,837)	1,211,837	469,533	27,146	1,361,679	3,137,040
Interfund Transfers						
Transfers from Endowment to Custodial Fund		119,835	(119,835)			
Transfers from Endowment to Operating Fund	827,035		(827,035)			
Transfers from Custodial Funds to Operating Fund	945,420	(945,420)				
Payments to beneficiaries:						
Payments to endowment beneficiaries	(304,458)				(304,458)	(305,635)
Payments to custodial fund beneficiaries	(945,420)				(945,420)	(741,863)
Reclassification of unrestricted and restricted fund to endowment	(144,566)	(262,831)	407,397			
Change in Net Assets	31,174	123,421	(69,940)	27,146	111,801	2,089,542
Net Assets, beginning of year	6,289,090	561,867	21,148,888	3,678,700	31,678,545	29,589,003
Net Assets, end of year	\$ 6,320,264	\$ 685,288	\$ 21,078,948	\$ 3,705,846	\$ 31,790,346	\$ 31,678,545
Fund Balances by Classification						
Net Assets, beginning of year						
Unrestricted Net Assets	\$ 6,289,090		\$ (178,075)		\$ 6,111,015	\$ 5,700,337
Temporarily Restricted Net Assets		\$ 561,867	12,185,286	\$ 695,021	13,442,174	12,425,125
Permanently Restricted Net Assets			9,141,677	2,983,679	12,125,356	11,463,541
Net Assets, beginning of year	\$ 6,289,090	\$ 561,867	\$ 21,148,888	\$ 3,678,700	\$ 31,678,545	\$ 29,589,003
Changes in Net Assets:						
Unrestricted Net Assets	\$ 31,174		\$ (204,508)		\$ (173,334)	\$ 410,678
Temporarily Restricted Net Assets		\$ 123,421	(58,396)	\$ (95,769)	(30,744)	1,017,049
Permanently Restricted Net Assets			192,964	122,915	315,879	661,815
Changes in Net Assets	\$ 31,174	\$ 123,421	\$ (69,940)	\$ 27,146	\$ 111,801	\$ 2,089,542
Net Assets, end of year						
Unrestricted Net Assets	\$ 6,320,264		\$ (382,583)		\$ 5,937,681	\$ 6,111,015
Temporarily Restricted Net Assets		\$ 685,288	12,126,890	\$ 599,252	13,411,430	13,442,174
Permanently Restricted Net Assets			9,334,641	3,106,594	12,441,235	12,125,356
Net Assets, end of year	\$ 6,320,264	\$ 685,288	\$ 21,078,948	\$ 3,705,846	\$ 31,790,346	\$ 31,678,545

The accompanying notes are an integral part of this statement.

The Episcopal Church in the Diocese of California

Statement of Cash Flows

<i>Year Ended December 31, 2014 (with comparative totals for 2013)</i>	2014	2013
Cash Flows from Operating Activities:		
Changes in net assets	\$ 111,801	\$ 2,089,542
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	80,232	79,845
Net realized and unrealized gain on investments	(137,724)	(2,211,853)
Loss (gain) on disposal of fixed assets	808	(558)
Change in value of charitable remainder trusts	(27,146)	(387,306)
Increase (decrease) in operating assets and liabilities:		
Receivables	460,714	106,964
Notes receivable	(309,909)	
Accounts payable and accrued expenses	(87,620)	135,297
Deferred revenue	(9,497)	(23,864)
Net cash provided by (used in) operating activities	81,659	(211,933)
Cash Flows from Investing Activities:		
Purchases of investments	(1,524,334)	(808,914)
Proceeds from sale of investments	322,447	
Proceeds from capital gains distributions	1,132,782	1,711,577
Purchases of property and equipment	(84,438)	(70,460)
Net cash (used in) provided by investing activities	(153,543)	832,203
Cash Flows from Financing Activities:		
Borrowings from line of credit - net	(233,000)	(44,000)
Net cash used in financing activities	(233,000)	(44,000)
Cash and Cash Equivalents, beginning of year	2,933,488	2,357,218
Cash and Cash Equivalents, end of year	\$ 2,628,604	\$ 2,933,488

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 corporation that administratively supports Episcopal congregations and affiliated 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 in accordance with U.S. generally accepted accounting principles, 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 accounting for the monies entrusted to the Diocese.

c. Basis of Presentation

Financial statement presentation follows the recommendations of the Accounting Standards Codification (ASC) 958-205-05, *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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

e. Receivables

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

f. Fair Value Measurements

The Diocese carries certain assets and liabilities at fair value. Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Diocese classifies its financial assets and liabilities according to three levels, and maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

Level 1 – Quoted market prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 – Observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly.

Level 3 – Unobservable inputs for the asset or liability that are not corroborated by market data.

g. Notes Receivable

Notes receivable held for investment consists of notes to several churches. The notes bear interest at the prime rate and are due through 2019. The notes are secured by property or unsecured and are recorded net of an allowance related to interest accruals.

h. Equity Interests in Real Property

Equity interests in real property comprises properties 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. The Diocese has elected not to depreciate its real property and has determined that the effect on the financial statements is not material as of December 31, 2014.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

j. Deferred Revenue

Deferred revenue consists of assessments, payroll, and benefits received from congregations 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.

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 Section 501(c)(3) of the Internal Revenue Code and the related state provisions. Accordingly, no provision for income taxes has been made in these financial statements.

The Diocese follows the guidelines of the Financial Accounting Standards Board (FASB) for accounting for uncertainty in income taxes. As of December 31, 2014, management evaluated the Diocese's tax positions and concluded that the Diocese had maintained its tax exempt status and has taken no uncertain tax positions that require 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 as well as reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

n. 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 Generally Accepted Accounting Principles. Accordingly, such information should be read in conjunction with the Diocese's financial statements for the year ended December 31, 2013, from which the summarized information was derived.

Certain items as reported for December 31, 2013 have been reclassified to conform with the December 31, 2014 financial statement presentation. Such classification had no effect on the Diocese's financial position or activities.

o. Subsequent Events

The Diocese has reviewed the changes in net assets for the period of time from December 31, 2014 through July 14, 2015, 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 have subsequent events occurred the nature of which would require disclosure.

Note 2 - Description of Funds:

a. Operating Fund

This fund is used to account for all expenditures related to unrestricted support and revenue. The Diocese provides programming and staff support to its 80 congregations, numerous ministries, and diocesan institutions such as its university centers, St. Dorothy's Rest, and Bishop's Ranch. The Diocese also pays an apportionment for the support of The Episcopal Church and dedicates a small portion of its revenue to international projects and relief. The Diocese manages both an endowment and a planned giving portfolio, of which congregations and others are the primary beneficiaries. The Diocese employs a planned giving officer as a resource to its congregations and institutions, and also provides a centralized payroll and benefits administration service to its congregations, schools, and institutions.

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 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 for assuring that distributions are made in accordance with the provisions of each trust. When the market value of permanently restricted funds falls below the historical value, the deficiency is reflected as unrestricted net assets. At the end of 2014, this deficiency increased to \$382,583. 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 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' interests, the principal will be distributed in accordance with the conditions prescribed by the deferred gift agreements. Any principal that will ultimately be distributed to third party beneficiaries has been recorded as a liability, "Funds Held in Trusts 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 rates used, ranging between 5% and 6.5%, approximate 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, 2014 and 2013:

	2014	2013
Assessments	\$ 152,003	\$ 145,759
Reimbursable expenses of related entities, net of allowance	1,554,559	1,716,750
Other receivables	158,653	463,420
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	\$ 1,865,215	\$ 2,325,929

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 4 - Investments:

The fair value of investments at December 31, 2014 and 2013 is as follows:

	2014	2013
Mutual funds	\$ 1,388,556	\$ 526,902
TIFF Multi-Asset Fund	17,259,523	17,914,348
Charitable trusts	15,331,479	19,266,619
	<hr/>	<hr/>
	\$ 33,979,558	\$ 37,707,869

Investment income for the years ended December 31, 2014 and 2013 consists of the following:

Interest and dividends, net of management fees	\$ 138,643	\$ 182,662
Realized gains	1,134,892	1,711,574
Unrealized (losses) gains	(997,168)	500,279
	<hr/>	<hr/>
	\$ 276,367	\$ 2,394,515

Investment income is included in:

Unrestricted net assets	\$ (204,508)	\$ 475,096
Temporarily restricted net assets	480,875	1,919,419
	<hr/>	<hr/>
	\$ 276,367	\$ 2,394,515

Investment Securities

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 the limited market activity of the instrument.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

As of December 31, 2014, a substantial portion of the Diocese's investments are deposited in a no-load mutual fund, The Investment Fund for Foundation's (TIFF) Multi Asset Fund (MAF). The MAF investments are valued using their net asset value. At December 31, 2014, the MAF was invested approximately 57% in total return assets (primarily global equities and high yield bonds) and 43% in hedging assets (commodities, REITS, inflation-linked bonds, cash equivalents and other hedging assets). The fund's performance objective is to achieve a total return (price appreciation plus dividends and interest income) net of expenses that, over a majority of market cycles, exceeds inflation, as measured by the Consumer Price Index, plus 5% per annum.

The table below presents the assets at fair value as of December 31, 2014 on a recurring basis.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Investments:			
Mutual Funds:			
Exchange traded funds	\$ 1,155,226	\$ 1,155,226	
Emerging Markets Fund	233,330	233,330	
TIFF Multi-Asset Fund	17,259,523		\$ 17,259,523
Charitable Trusts:			
Cash & Equivalents	610,566		610,566
Domestic REIT	1,381,779		1,381,779
Emerging Markets Stocks	433,441		433,441
High Quality Bond Funds	1,469,275		1,469,275
High Quality Bonds	253,633		253,633
High Yield Bond Funds	255,667		255,667
International Bond Funds	664,760		664,760
International REIT	745,483		745,483
International Stocks	1,909,263		1,909,263
International Small Co. Stocks	333,627		333,627
Investment Grade Bond Funds	1,632,987		1,632,987
Large Co. Stocks	4,435,929		4,435,929
Small Co. Stocks	1,205,069		1,205,069
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Total assets measured at fair value	\$ 33,979,558	\$ 1,388,556	\$ 32,591,002

There are no investments measured at Level 3.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 interests in real property, payables, deferred revenue and line of credit.

Note 5 - Charitable Remainder Trusts:

The Diocese is the trustee for various charitable remainder unitrusts and charitable remainder annuity trusts. These investments represent gifts received subject to certain restrictions on the distribution of income and the assets of the trusts.

The charitable remainder unitrusts provide payments to the donor or other beneficiaries for their lifetime or a set period of years based on a fixed percentage of between 5% to 7% of the trust principal as it is revalued annually. The charitable remainder annuity trusts provide a fixed annual dollar payment to the donor or other beneficiaries. Upon the expiration of the trusts, their remaining principal is distributed to the charitable organization designated by the donor, typically a congregation or institution of the Diocese or the Diocese itself.

The Diocese records the investments at fair market value. The estimated liability of future payments to beneficiaries is based upon the annual payment multiplied by the beneficiary's 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 the beneficiary.

The investments in charitable remainder unitrusts consist of the following at December 31, 2014 and 2013:

	2014	2013
Funds (See Note 4)	\$ 15,331,479	\$ 19,266,619
Due to other funds	(97)	(97)
Less funds held in trust for beneficiaries	(11,625,536)	(15,587,822)
	<u>\$ 3,705,846</u>	<u>\$ 3,678,700</u>

Change in value represents the net effect of contributions, distributions, and change in market value of investments under such agreements and for the years ended December 31, 2014 and 2013 is \$27,146 and \$387,209, respectively.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 6 - Equity Interests in Real Property:

Equity interests in real property, which are recorded at cost, comprise the following at December 31, 2014 and 2013:

	2014	2013
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 Sue Thompson	100,000	100,000
50% equity interest in real property owned by the former Bishop	927,500	927,500
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	\$1,231,449	\$ 1,231,449

Note 7 - Property and Equipment:

At December 31, 2014 and 2013, property and equipment comprised the following:

	2014	2013
Diocesan House	\$ 1,071,447	\$ 1,071,447
S. F. Campus Center partial interest	30,000	30,000
Computers/servers	70,601	60,549
Other furniture and equipment	123,491	114,334
Automobile	42,481	27,108
Hearst Street, Berkeley	649,669	649,669
Bishop's residence	1,112,605	1,112,605
Bishop's residence improvements	434,458	434,458
	<hr/>	<hr/>
	3,534,752	3,500,170
Less accumulated depreciation	(851,686)	(820,502)
	<hr/>	<hr/>
	2,683,066	2,679,668
Land	1,816,213	1,816,213
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	\$ 4,499,279	\$ 4,495,881

Depreciation expense for the years ended December 31, 2014 and 2013 was \$80,232 and \$79,845, respectively.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 8 - 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 at the prime rate (currently 3.25%). The line of credit is subject to renewal every two years, and the next renewal date is October 1, 2016.

Total principal payments due to Union Bank on the line of credit are \$3,477,975 at December 31, 2014. This debt is incurred by the Diocese on behalf of various congregations and ministries as follows:

<i>December 31, 2014</i>	Line of Credit and Other Notes Payable	Corresponding Receivable
Congregations:		
St. Clare's, Pleasanton	\$ 553,397	\$ 553,397
Christ Church, Los Altos	401,875	401,875
St. Mark's, Berkeley	124,487	124,487
St. Michael and All Angels, Concord	59,100	59,100
All Saints, San Leandro	27,921	27,921
St. Aidan's, San Francisco	7,300	7,300
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Total congregations	1,174,080	1,174,080
Other:		
Berkeley Emergency Food and Housing	108,194	108,194
Episcopal Community Services	1,250,000	1,250,000
Episcopal Diocese	48,694	
St. Dorothy's Rest	897,007	897,007
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Total other	2,303,895	2,255,201
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Total	\$ 3,477,975	\$ 3,429,281

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 9 - Endowments:

The Diocese's endowment comprises 120 individual funds established to support general operations of the Diocese or specific congregations and programs in the Diocese. The endowment includes donor-restricted endowment funds and funds designated by the Executive Council to function as endowments. As required by accounting principles generally accepted in the United States of America (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.

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 State Prudent Management of Institutional Funds Act (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.

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 \$382,583 and \$178,075 as of December 31, 2014 and 2013, respectively.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 expects 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.

Net changes in endowment funds for the year ended December 31, 2014 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2013	\$ (178,075)	\$ 12,185,286	\$ 9,141,677	\$ 21,148,888
Investment Return:				
Income		1,273,535		1,273,535
Net depreciation	(204,508)	(792,660)		(997,168)
Total investment return	(204,508)	480,875		276,367
Contributions			192,964	192,964
Appropriations		(946,871)		(946,871)
Interfund transfer		407,397		407,397
Other Income		203		203
Endowment Net Assets, December 31, 2014	\$ (382,583)	\$ 12,126,890	\$ 9,334,641	\$ 21,078,948

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 10 - Net Assets:

Temporarily restricted net assets are restricted for specific purposes as of December 31, 2014:

	Custodial	Endowment	Deferred Gifts	Total
Support Diocese	\$ 209,526	\$ 3,813,669	\$ 444,548	\$ 4,467,743
Education		59,732	19,640	79,372
Congregational Support		2,693,945	129,916	2,823,861
Congregational Development	288,378	1,403,992		1,692,370
Social Ministry	8,638	2,261,417	5,148	2,275,203
Scholarships	178,746	1,894,135		2,072,881
	\$ 685,288	\$ 12,126,890	\$ 599,252	\$ 13,411,430

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2014 and 2013.

Permanently restricted net assets are invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2014 are as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 6,393,445	\$ 926,627	\$ 7,320,072
Education	217,197	252,038	469,235
Congregational Support	1,678,372	742,006	2,420,378
Congregational Development	318,951	200,601	519,552
Social Ministry	525,860	985,322	1,511,182
Scholarships	200,816		200,816
	\$ 9,334,641	\$ 3,106,594	\$ 12,441,235

Note 11 - Retirement Plans:

The Diocese funds defined contribution pension plans covering lay employees. The Diocese contributes between 5% and 9% of lay employee compensation depending upon the employee contribution. The 2014 and 2013 contribution by the Diocese to the defined contribution pension plans approximated \$57,745 and \$55,372, respectively.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

The Diocese also provides pension benefits for its clergy employees through a national plan. The plan is a defined benefit pension plan funded by assessments charged to the Diocese based on a specified percentage of compensation. In 2014 and 2013, the Diocese contributed approximately \$160,500 and \$130,000 (18% of compensation), respectively, to the clergy defined benefit pension plan.

Note 12 - 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. Periodically, throughout the year, the Diocese has maintained balances in operation and money market accounts in excess of federally insured limits.

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

The Diocese bills and collects assessment revenue from the various congregations. Assessment revenues comprised 61% of all non-investment revenue the Diocese received in 2014.