

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2016

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

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

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, 2016, and the related statements 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.

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, 2016, and the changes in net assets 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, 2015 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated June 21, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
September 27, 2017

The Episcopal Church in the Diocese of California

Statement of Financial Position

December 31, 2016 (with comparative totals for 2015)

	2016						2015
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Assets:							
Cash and cash equivalents	\$ 1,504,619		\$ 166,345		\$ 587,237	\$ 2,258,201	\$ 2,483,856
Receivables, net	1,643,525				9,274,493	10,918,018	1,764,891
Investments			19,858,533	\$ 12,716,016		32,574,549	32,616,222
Notes receivable	2,775,349					2,775,349	3,445,685
Notes receivable held for investment, net	218,536	\$ 2,300				220,836	262,746
Equity interests in real property	43,949		1,087,500			1,131,449	1,131,449
Property and equipment, net	4,401,228					4,401,228	4,439,437
Due to/from other funds	(76,947)	550,912	677,769	(97)	(1,151,637)		
Total assets	\$ 10,510,259	\$ 553,212	\$ 21,790,147	\$ 12,715,919	\$ 8,710,093	\$ 54,279,630	\$ 46,144,286
Liabilities and Net Assets							
Liabilities:							
Accounts payable and accrued expenses	\$ 1,457,412				\$ 493,038	\$ 1,950,450	\$ 1,147,648
Deferred revenue	14,280					14,280	16,940
Line of credit	2,775,349					2,775,349	3,445,685
Funds held in trusts for beneficiaries				\$ 10,240,780		10,240,780	10,406,769
Total liabilities	4,247,041			10,240,780	493,038	14,980,859	15,017,042
Net Assets:							
Unrestricted	6,263,218		\$ (978,869)			5,284,349	5,288,474
Temporarily restricted		\$ 553,212	12,080,494	616,754	8,217,055	21,467,515	13,374,887
Permanently restricted			10,688,522	1,858,385		12,546,907	12,463,883
Total net assets	6,263,218	553,212	21,790,147	2,475,139	8,217,055	39,298,771	31,127,244
Total liabilities and net assets	\$ 10,510,259	\$ 553,212	\$ 21,790,147	\$ 12,715,919	\$ 8,710,093	\$ 54,279,630	\$ 46,144,286

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Activities

	2016						2015
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Support and Revenue:							
Parish and mission assessments	\$ 3,342,991					\$ 3,342,991	\$ 3,247,525
Gifts, grants and other	438,612	\$ 784,233	\$ 31,947		\$ 9,258,619	10,513,411	2,219,572
Change in value of charitable remainder trusts				\$ 52,965		52,965	9,762
Investment income, net			929,878			929,878	(273,109)
Total support and revenue	3,781,603	784,233	961,825	52,965	9,258,619	14,839,245	5,203,750
Expenses:							
Episcopate	560,881					560,881	533,149
Diocesan communications	178,712					178,712	146,526
Congregational development	653,046					653,046	655,150
Youth, young adult, and camps	248,834					248,834	279,681
Ministry development	156,920					156,920	184,115
Multicultural and other ministries	50,076					50,076	54,748
Development & planned giving	187,566					187,566	294,308
National church & international support	688,926					688,926	703,926
Finance	339,401					339,401	364,988
Administration & support staff	1,349,598					1,349,598	1,029,950
Capital Campaign						-	192,774
Total expenses	4,413,960					4,413,960	4,439,315
Changes in Net Assets Before Transfers & Reclasses							
	(632,357)	784,233	961,825	52,965	9,258,619	10,425,285	764,435
Interfund Transfers							
Transfers from Endowment to Custodial Fund		124,517	(124,517)			-	-
Transfers from Endowment to Operating Fund	916,624		(916,624)			-	-
Transfers from Custodial Funds to Operating Fund	1,004,330	(1,004,330)				-	-
Payments to beneficiaries:							
Payments to endowment beneficiaries	(365,638)					(365,638)	(324,690)
Payments to custodial fund beneficiaries	(1,004,330)					(1,004,330)	(1,102,847)
Release restricted Cap Campaign funds to Operating fund	883,790				(883,790)	-	-
Transfer of Terminated Unitrust			1,293,434	(1,293,434)		-	-
Payments of Cap Campaign Expenses	(883,790)					(883,790)	-
Change in Net Assets	(81,371)	(95,580)	1,214,118	(1,240,469)	8,374,829	8,171,527	(663,102)
Net Assets, beginning of year	6,344,589	648,792	20,576,029	3,715,608	(157,774)	31,127,244	31,790,346
Net Assets, end of year	\$ 6,263,218	\$ 553,212	\$ 21,790,147	\$ 2,475,139	\$ 8,217,055	\$ 39,298,771	\$ 31,127,244
Fund Balances by Classification							
Net Assets, beginning of year							
Unrestricted Net Assets	\$ 6,344,589		\$ (898,341)		(157,774)	\$ 5,288,474	\$ 5,937,681
Temporarily Restricted Net Assets		\$ 648,792	12,109,376	\$ 616,719	\$ -	13,374,887	13,411,430
Permanently Restricted Net Assets			9,364,994	3,098,889	-	12,463,883	12,441,235
Net Assets, beginning of year	6,344,589	648,792	20,576,029	3,715,608	(157,774)	31,127,244	31,790,346
Changes in Net Assets:							
Unrestricted Net Assets	(81,371)		(80,528)		157,774	(4,125)	(649,207)
Temporarily Restricted Net Assets		(95,580)	(28,882)	35	8,217,055	8,092,628	(36,543)
Permanently Restricted Net Assets			1,323,528	(1,240,504)		83,024	22,648
Changes in Net Assets	(81,371)	(95,580)	1,214,118	(1,240,469)	8,374,829	8,171,527	(663,102)
Net Assets, end of year							
Unrestricted Net Assets	6,263,218	-	(978,869)	-	-	5,284,349	5,288,474
Temporarily Restricted Net Assets	-	553,212	12,080,494	616,754	8,217,055	21,467,515	13,374,887
Permanently Restricted Net Assets	-	-	10,688,522	1,858,385	-	12,546,907	12,463,883
Net Assets, end of year	\$ 6,263,218	\$ 553,212	\$ 21,790,147	\$ 2,475,139	\$ 8,217,055	\$ 39,298,771	\$ 31,127,244

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Cash Flows

<i>Year Ended December 31, 2016 (with comparative totals for 2015)</i>	2016	2015
Cash Flows from Operating Activities:		
Changes in net assets	\$ 8,171,527	\$ (663,102)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	80,778	76,828
Net realized and unrealized gain on investments	(811,696)	534,404
Stock contribution		(29,547)
Loss (gain) on disposal of fixed assets	721	719
Change in value of charitable remainder trusts	1,240,469	(9,762)
Increase (decrease) in operating assets and liabilities:		
Receivables	(9,153,127)	100,324
Notes receivable	41,910	49,463
Accounts payable and accrued expenses	802,801	116,470
Deferred revenue	(2,660)	(3,620)
Net cash provided by operating activities	370,723	172,177
Cash Flows from Investing Activities:		
Purchases of investments	(23,113,969)	(2,792,312)
Proceeds from sale of investments	22,308,758	1,753,974
Proceeds from capital gains distributions	252,123	787,812
Purchases of property and equipment	(43,290)	(17,705)
Net cash used in investing activities	(596,378)	(268,231)
Cash Flows from Financing Activities:		
Borrowings from line of credit - net		(48,694)
Net cash used in financing activities	-	(48,694)
Net Decrease in Cash and Cash Equivalents	(225,655)	(144,748)
Cash and Cash Equivalents, beginning of year	2,483,856	2,628,604
Cash and Cash Equivalents, end of year	\$ 2,258,201	\$ 2,483,856

See accompanying notes to the financial statements.

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 its 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 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 using 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 represent amounts due to the Diocese from congregations for assessments and for payroll and benefits advances, capital campaign pledges, 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 using 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 represent amounts funded by the Diocese for the purchase of property by related parties. The Diocese has an equity interest in such property for the portion 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 (three 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, 2016.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

j. Deferred Revenue

Deferred revenue comprises assessment payments and payroll and benefits reimbursements 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, 2016, 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, 2015, from which the summarized information was derived.

Certain items as reported for December 31, 2015 have been reclassified to conform with the December 31, 2016 financial statement presentation. Such classification had no effect on the Diocese's financial position or activities.

o. Recent Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-14 – Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-For-Profit Entities. The amendments in this Accounting Standards Update make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. The amendments in the Update are effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Application to interim financial statements is permitted but not required in the initial year of application. Early application of the amendments in the Update is permitted and applied retrospectively. The Organization is currently evaluating the impact of this pronouncement on its financial statements.

p. Subsequent Events

The Diocese has reviewed the changes in net assets for the period of time from December 31, 2016 through September 27, 2017, 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.

The Episcopal Church in the Diocese of California

Notes to 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 Diocese provides programming and staff support to eighty congregations, numerous ministries, and various diocesan institutions such as its university centers, St. Dorothy's Rest, and Bishop's Ranch. The Diocese employs a planned giving officer as a resource to its congregations and institutions, and manages both an endowment and a planned giving portfolio, of which congregations and others are the primary beneficiaries. The Diocese provides a centralized payroll and benefits administration service to its congregations, schools, and institutions. The Diocese also pays an apportionment for the support of The Episcopal Church.

The Executive Council 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 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.

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 2016, this deficiency increased to \$978,869. 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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.

e. Capital Campaign Fund

This fund is used to account for the receipts and expenses of the diocesan capital campaign, formally known as the Expanding Horizons Campaign, which began its silent phase in the fall of 2015. In addition to raising money to support diocesan needs and initiatives, the Expanding Horizons Campaign also features a collaborative phase with congregations of the Diocese. In the collaborative phase, which began in the second quarter of 2016, congregations may elect to utilize the support and resources of diocesan development staff and campaign consultants, whose fees are paid by the Diocese, to conduct their own capital campaigns on a revenue sharing basis with the Diocese.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 3 - Receivables:

Receivables consist of the following at December 31, 2016 and 2015:

	2016	2015
Assessments	\$ 145,897	\$ 125,247
Reimbursable expenses of related entities, net of allowance	1,323,651	1,487,194
Capital Campaign	9,274,493	
Other receivables	173,977	152,450
	<hr/>	<hr/>
	\$ 10,918,018	\$ 1,764,891

At December 31, 2016, pledges receivable for the Capital Campaign are due as follows:

Current	\$ 1,405,656
Long-term	9,986,968
	<hr/>
	11,392,624
Less: discounts to net present value	(1,918,384)
Less: bad debt	(199,747)
	<hr/>
Total	\$ 9,274,493

In 2016, the Diocese announced two major commitments to the campaign, a \$10 million pledge payable over ten years beginning in 2017, and a \$500,000 pledge payable over five years. In a pilot phase of the collaborative campaign, two congregations successfully completed capital campaigns working with diocesan staff and its campaign consultants. The Diocese anticipates more congregations will participate in 2017, and that the Expanding Horizons Campaign will continue at least through the end of 2018. Contributions to be received after one year are discounted at a rate of 3.75%.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 4 - Investments:

The fair value of investments at December 31, 2016 and 2015 is as follows:

	2016	2015
Mutual funds	\$ 239,961	\$ 2,201,489
Stock		29,548
DFMS Trust Fund	19,618,572	
TIFF Multi-Asset Fund		16,262,711
Charitable trusts	12,716,016	14,122,474
	<hr/>	<hr/>
	\$ 32,574,549	\$ 32,616,222

Investment income for the years ended December 31, 2016 and 2015 consists of the following:

	2016	2015
Interest and dividends, net of management fees	\$ 197,945	\$ 262,320
Realized gains	218,118	855,708
Unrealized (losses) gains	513,815	(1,391,137)
	<hr/>	<hr/>
	\$ 929,878	\$ (273,109)

Investment income is included in:

Unrestricted net assets	\$ (80,528)	\$ (471,298)
Temporarily restricted net assets	1,010,406	198,189
	<hr/>	<hr/>
	\$ 929,878	\$ (273,109)

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

In late 2016 the Executive Council of the Diocese, upon recommendation of its Investment committee, approved moving the diocesan endowment funds from The Investment Fund for Foundations (“TIFF”) to the Endowment Portfolio of the Domestic and Foreign Missionary Society of the Protestant Episcopal Church in the United States of America (“DFMS”), which is the business operations arm of The Episcopal Church. Transfer of the endowment funds to DFMS was completed on December 28, 2016.

The DFMS Endowment portfolio comprises more than one thousand trust funds and is managed by approximately fifteen external investment managers. These funds are maintained in a common investment portfolio and participate on a pro-rata basis in all returns, and are overseen by the Office of the Treasurer of The Episcopal Church under the direction of its Investment Committee. Co-investors such as the Diocese and other Episcopal entities are not charged entry, exit, or management fees by DFMS. At December 31, 2016, DFMS was invested approximately 33% in domestic equities, 7% in global equities, 15% in international equities, 6% in emerging markets equities, 9% in hedge funds, 4% in real estate, 5% in convertibles, and 16% in fixed income.

The table below presents investment assets at fair value as of December 31, 2016 on a recurring basis.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Investments:			
Mutual Funds:			
Non-US Equity Fund	\$ 239,961	\$ 239,961	
DFMS Trust Fund	19,618,572		\$ 19,618,572
Charitable Trusts:			
Cash & Equivalents	317,241		317,241
Domestic REIT	995,077		995,077
International REIT	578,555		578,555
Non-U.S. Bond Fund	490,709		490,709
Non-U.S. Equity Fund	2,582,059		2,582,059
U.S. Bond Funds	2,446,200		2,446,200
U.S. Equity Bond	5,092,102		5,092,102
U.S. Government Assets/Bonds	88,190		88,190
U.S. Treasury Notes/Bonds	125,883		125,883
<u>Total assets measured at fair value</u>	<u>\$ 32,574,549</u>	<u>\$ 239,961</u>	<u>\$ 32,334,588</u>

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, 2016 and 2015:

	2016	2015
Funds (See Note 4)	\$ 12,716,016	\$ 14,122,474
Due to other funds	(97)	(97)
Less funds held in trust for beneficiaries	(10,240,780)	(10,406,769)
	<hr/>	<hr/>
	\$ 2,475,139	\$ 3,715,608

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, 2016 and 2015 is \$(1,240,469) and \$9,762, 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, 2016 and 2015:

	2016	2015
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
50% equity interest in real property owned by the former Bishop	927,500	927,500
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	\$ 1,131,449	\$ 1,131,449

Note 7 - Property and Equipment:

At December 31, 2016 and 2015, property and equipment comprised the following:

	2016	2015
Diocesan House	\$ 1,071,447	\$ 1,071,447
S. F. Campus Center partial interest	30,000	30,000
Computers/servers	87,195	70,432
Other furniture and equipment	157,017	134,520
Automobile	42,481	42,481
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/>
	3,584,872	3,545,612
Less accumulated depreciation	(999,857)	(922,388)
	<hr/>	<hr/>
	2,585,015	2,623,224
Land	1,816,213	1,816,213
	<hr/>	<hr/>
	\$ 4,401,228	\$ 4,439,437

Depreciation expense for the years ended December 31, 2016 and 2015 was \$80,778 and \$76,828, 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 (3.75% at 12/31/16). The line of credit is subject to renewal every two years, and the next renewal date is October 1, 2018.

The credit agreement requires the Diocese to meet certain financial covenants. As of December 31, 2016, the Diocese was in compliance with all such provisions of the agreement.

Total principal payments due to Union Bank on the line of credit are \$2,775,349 at December 31, 2016. This debt is incurred by the Diocese on behalf of various congregations and ministries as follows:

	Line of Credit and Other Notes Payable	Corresponding Receivable
December 31, 2016		
Congregations:		
St. Clare's, Pleasanton	\$ 282,797	\$ 282,797
Christ Church, Los Altos	100,066	100,066
St. Mark's, Berkeley	66,558	66,558
St. Michael and All Angels, Concord	59,100	59,100
St. Paul's, Walnut Creek	297,881	297,881
St. Paul's, Oakland	565,000	565,000
Church of Our Savior, Mill Valley	401,250	401,250
St. Timothy's, Danville	30,000	30,000
Christ Church, Sausalito	250	250
Total congregations	1,802,902	1,802,902
Other:		
Berkeley Emergency Food and Housing	84,194	84,194
Episcopal Community Services	-	-
St. Dorothy's Rest	888,253	888,253
Total other	972,447	972,447
Total	\$ 2,775,349	\$ 2,775,349

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 9 - Endowments:

The Diocese's endowment comprises 113 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 \$978,869 and \$898,341 as of December 31, 2016 and 2015, 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Net changes in endowment funds for the year ended December 31, 2016 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2015	\$ (898,341)	\$ 12,109,376	\$ 9,364,994	\$ 20,576,029
Investment Return:				
Income		416,063		416,063
Net appreciation/ (depreciation)	(80,528)	594,343		513,815
Total investment return	(80,528)	1,010,406		929,878
Contributions		1,853	30,094	31,947
Appropriations		(1,041,142)		(1,041,142)
Interfund transfer			1,293,434	1,293,434
Other Income				
Endowment Net Assets December 31, 2016	\$ (978,869)	\$ 12,080,494	\$ 10,688,522	\$ 21,790,147

Note 10 - Net Assets:

Temporarily restricted net assets were restricted for specific purposes at December 31, 2016, as follows:

	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total
Support Diocese	\$ 163,769	\$ 3,592,175	\$ 488,491	\$	\$ 4,244,435
Education		47,309	17,737		65,046
Congregational Support		3,294,835	102,227		3,397,062
Congregational Development	220,886	1,292,621			1,513,507
Social Ministry	12,630	2,093,305	8,299		2,114,234
Scholarship	155,927	1,760,249			1,916,176
Capital Campaign				8,217,055	8,217,055
	\$ 553,212	\$12,080,494	\$ 616,754	\$ 8,217,055	\$21,467,515

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2016 and 2015.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Permanently restricted net assets were invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2016, as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 7,687,128	\$ 935,279	\$ 8,622,407
Education	217,197	355	217,552
Congregational Support	1,738,570	491,439	2,230,009
Congregational Development	318,951	204,502	523,453
Social Ministry	525,860	226,810	752,670
Scholarships	200,816		200,816
	<u>\$ 10,688,522</u>	<u>\$ 1,858,385</u>	<u>\$ 12,546,907</u>

Note 11 - Retirement Plans:

The Diocese provides a defined contribution pension plan covering lay employees. The Diocese contributes between 5% and 9% of lay employee compensation depending upon the employee contribution. The 2016 and 2015 contribution by the Diocese to the defined contribution pension plan approximated \$61,126 and \$61,326, respectively.

The Diocese also provides pension benefits for its clergy employees through the Church Pension Plan. The plan is a defined benefit pension plan funded by assessments charged at 18% of pensionable compensation, as defined by the plan. In 2016 and 2015, the Diocese contributed approximately \$164,933 and \$178,425, 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 four 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 24% of all non-investment revenue the Diocese received in 2016.