

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2008

INDEPENDENT AUDITORS' REPORT

FINANCIAL STATEMENTS

AND

SUPPLEMENTAL INFORMATION

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

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

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

We have audited the accompanying statement of financial position of **THE EPISCOPAL CHURCH IN THE DIOCESE OF CALIFORNIA (the Diocese)** as of December 31, 2008, 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 2007 financial statements and, in our report dated May 28, 2008, 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, 2008, and the changes in its net assets and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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 statements taken as a whole.

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May 19, 2009

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The Episcopal Church in the Diocese of California

Statement of Financial Position

December 31,

	2008					2007 Total
	Operating	Custodial and Unexpended Income	Endowment	Deferred Gifts	Total All Funds	
Asset:						
Cash and cash equivalents	\$ 1,579,129	\$ 12,978	\$ 143,161		\$ 1,735,268	\$ 1,902,736
Receivables, net	1,502,128	252,500	194,654		1,949,282	1,477,181
Investments		-	11,929,068		11,929,068	18,272,515
Other investment		-	30,500		30,500	90,000
Notes receivable held for investment, net		45,150	117,665		162,815	220,256
Pledge receivable		-	20,934		20,934	31,329
Equity interests in real property		100,000	4,009,451		4,109,451	4,109,451
Property and equipment, net	1,453,036	-			1,453,036	730,627
Investments - charitable remainder unitrusts		-		\$ 11,664,964	11,664,964	16,308,515
Due to/from other funds	(1,528,594)	1,458,265	70,329			
Total assets	\$ 3,005,699	\$ 1,868,893	\$ 16,515,762	\$ 11,664,964	\$ 33,055,318	\$ 43,142,610
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	\$ 767,186	\$ 51,682	\$ 92,384		\$ 911,252	\$ 763,830
Accounts payable, related parties		165,000	3,284,902	\$ 140,560	3,590,462	5,360,747
Deferred revenue	192,799				192,799	171,245
Funds held in trusts for beneficiaries				9,209,073	9,209,073	13,204,687
Total liabilities	959,985	216,682	3,377,286	9,349,633	13,903,586	19,500,509
Net Assets:						
Unrestricted	1,948,298		773,337		2,721,635	3,187,280
Unrestricted - board designated	97,416				97,416	134,685
Total unrestricted	2,045,714		773,337		2,819,051	3,321,965
Temporarily restricted		1,652,211	8,239,372	321,571	10,213,154	13,859,324
Permanently restricted			4,125,767	1,993,760	6,119,527	6,460,812
Total net assets	2,045,714	1,652,211	13,138,476	2,315,331	19,151,732	23,642,101
Total liabilities and net assets	\$ 3,005,699	\$ 1,868,893	\$ 16,515,762	\$ 11,664,964	\$ 33,055,318	\$ 43,142,610

The Episcopal Church in the Diocese of California

Statement of Activities

Years Ended December 31, 2008 (with comparative totals for 2007)

	2008					2007 Total
	Operating	Custodial and Unexpended Income	Endowment	Deferred Gifts	Total All Funds	
Support and Revenue:						
Parish and mission assessments	\$ 3,560,326				\$ 3,560,326	\$ 3,598,002
Gifts, grants and other	244,068				244,068	275,427
Investment income, net	207,629		\$ (559,912)		(352,283)	266,440
Total support and revenue	4,012,023		(559,912)		3,452,111	4,139,869
Expenses:						
Episcopate	391,137				391,137	371,593
Diocesan finance	478,604				478,604	484,370
Diocesan administration	387,645				387,645	426,294
Clerical	288,261				288,261	232,341
Support services - Diocese	116,587				116,587	88,169
Support services - outside Diocese	765,062				765,062	751,100
Planned giving office	149,434				149,434	150,111
Congregational development	739,590				739,590	732,636
Ordained ministry development	103,559				103,559	94,064
Ministry development	367,056				367,056	332,460
Social ministries	20,600				20,600	20,945
Community Ministries	131,996				131,996	137,638
Communications	246,494				246,494	237,933
Payments to beneficiaries and other custodial fund disbursements	684,521				684,521	869,262
Total expenses	4,870,546				4,870,546	4,928,916
Changes in Unrestricted Net Assets	(858,523)		(559,912)		(1,418,435)	(789,047)
Changes in Temporarily Restricted Net Assets:						
Gifts, grants and other		754,942	1,156,628	151,755	2,063,325	855,986
Change in value of unitrusts				(352,695)	(352,695)	
Investment income, net		33,317	(4,474,596)		(4,441,279)	555,893
Interfund transfer		203,979	(203,979)			
Change in temporarily restricted net assets		992,238	(3,521,947)	(200,940)	(2,730,649)	1,411,879
Change in Permanently Restricted Net Assets:						
Gifts, grants, and other			37,809		37,809	157,568
Change in value of unitrust				(379,094)	(379,094)	
Change in permanently restricted net assets			37,809	(379,094)	(341,285)	157,568
Net Assets Released from Restrictions	915,521	(337,590)	(577,931)			
Change in Net Assets	56,998	654,648	(4,621,981)	(580,034)	(4,490,369)	780,400
Net Assets, beginning of year	1,988,716	997,563	17,760,457	2,895,365	23,642,101	22,861,701
Net Assets, end of year	\$ 2,045,714	\$ 1,652,211	\$ 13,138,476	\$ 2,315,331	\$ 19,151,732	\$ 23,642,101

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

Statement of Cash Flows

<i>Years Ended December 31,</i>	2008	2007
Cash Flows from Operating Activities:		
Changes in net assets	\$ (4,490,369)	\$ 780,400
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	78,076	70,320
Net realized and unrealized loss on investments	7,101,053	327,180
Donation of stock	(1,190,849)	
Change in charitable remainder unitrusts	647,935	(107,548)
Changes in operating assets and liabilities:		
Receivables	(472,101)	233,726
Pledge receivable	10,395	275,311
Accounts payable and accrued expenses	147,424	59,075
Accounts payable, related party	(1,770,285)	(363,438)
Deferred revenue	21,554	36,138
Net cash provided by operating activities	82,833	1,311,164
Cash Flows from Investing Activities:		
Purchases of investments	(16,079,428)	(4,258,199)
Proceeds from sale of investments	16,572,171	4,141,690
Principal payments received on notes receivable held for investments	57,441	35,911
Purchases of property and equipment	(800,485)	(46,855)
Sale of investment in equity interest in real property		51,500
Net cash used by investing activities	(250,301)	(75,953)
Net (Decrease) Increase in Cash and Cash Equivalents	(167,468)	1,235,211
Cash and Cash Equivalents, beginning of year	1,902,736	667,525
Cash and Cash Equivalents, end of year	\$ 1,735,268	\$ 1,902,736

Noncash Investing Activities:

Contribution of stock	\$ 1,190,849
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The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies

a. Diocese

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

b. Basis of Accounting

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

c. Basis of Presentation

The Diocese reports information regarding its financial position and activities according to 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 Diocese 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 Diocese 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. Investments

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

g. Notes Receivable Held for Investment

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

h. Equity Interest in Real Property

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

i. Property and Equipment

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

j. Deferred Revenue

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

k. Recognition of Support and Revenue

Current year parish and mission assessments are recognized as revenue in the period in which they are earned.

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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

l. Income Taxes

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

m. Use of Estimates

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

n. Prior Year Summarized Comparative Information

The financial statements include certain prior year summarized information in total but not by net asset class. Accordingly, such information should be read in conjunction with the Diocese's financial statements for the year ended December 31, 2007, from which the summarized information was derived.

o. New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement No. 159 (FAS No. 159), *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115*, (effective as of the beginning of an entity's first fiscal year that begins after November 5, 2007). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The Diocese has evaluated FAS 159 and determined that it does not choose to apply it at this time.

Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48), was issued in July 2006 and establishes standards for the recognition of income taxes for tax positions taken in income tax returns. In December 2008, a FASB Staff Position deferred the effective date for certain nonpublic enterprises, including nonpublic not-for-profit organizations, permitting adoption for years beginning after December 15, 2008. The Diocese is not subject to income taxes due to its exempt status. All transactions are deemed related to the mission of the Diocese therefore no provision for income taxes is included in these financial statements.

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

b. Custodial and Unexpended Income Fund

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

c. Endowment

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

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 Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Note 3 - Receivables:

Receivables consist of the following at December 31, 2008 and 2007:

	2008	2007
Assessments	\$ 198,023	\$ 173,303
Reimbursable expenses from related entities, net of allowance	1,078,543	1,142,126
Endowment receivables	194,654	53,499
Custodial receivables	252,500	
Other receivables	225,562	108,253
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	\$ 1,949,282	\$ 1,477,181
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Note 4 - Pledge Receivable:

The pledge receivable is from one donor with no defined payment date. The discounted balances at December 31, 2008 and 2007 are \$20,934 and \$31,329, respectively.

Note 5 - Investments:

The fair value of investments at December 31, 2008 and 2007 is as follows:

	2008	2007
Corporate equity	\$ 4,543,334	\$ 14,459,556
Mutual funds	7,385,734	
Money market funds		3,812,959
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	\$ 11,929,068	\$ 18,272,515
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**The Episcopal Church in the
Diocese of California**

Notes to Financial Statements

Investment income for the year ended December 31, 2008 and 2007 consists of the following:

	2008	2007
Interest and dividends, net of management fees of \$54,683 and \$38,634, respectively	\$ 366,451	\$ 1,074,160
Realized gains and losses	511,285	1,134,282
Unrealized gains and losses	(5,912,244)	(1,386,109)
	\$ (5,034,508)	\$ 822,333
Investment income is included in:		
Unrestricted net assets	\$ (559,912)	\$ 266,440
Temporarily restricted net assets	(4,474,596)	555,893
	\$ (5,034,508)	\$ 822,333

Note 6 - Fair Value of Measurements:

Effective January 1, 2008, the Diocese adopted Statement No. 157, *Fair Value Measurements*, (FAS 157) which provides a framework for measuring fair value under generally accepted accounting principles. FAS 157 applies to all financial instruments that are being measured and reported on a fair value basis. FAS 157 has been applied prospectively as of the beginning of the year.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also established a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

**The Episcopal Church in the
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Notes to Financial Statements

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying Statement of Financial Position, as well as the general classification of such instruments pursuant to the valuation hierarchy.

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 table below presents the balances of assets measured at fair value at December 31, 2008 on a recurring basis.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments:				
Common stock	\$ 4,543,334	\$ 4,543,334		
Mutual funds	7,385,734	7,385,734		
Total investments	11,929,068	11,929,068		
Charitable Trusts	11,664,964		\$ 11,664,964	
Total assets measured at fair value	\$ 23,594,032	\$ 11,929,068	\$ 11,664,964	

Financial Instruments 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 investment, notes and pledge receivable, equity interest in real property and payables.

**The Episcopal Church in the
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Notes to Financial Statements

Note 7 - Charitable Remainder Unitrusts:

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

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

The investments in charitable remainder unitrusts consist of the following at December 31, 2008 and 2007:

	2008	2007
Funds	\$ 11,664,964	\$ 16,308,515
Less funds held in trust for beneficiaries	(9,209,073)	(13,204,687)
Less accounts payable to related party	(140,560)	(185,270)
	\$ 2,315,331	\$ 2,918,558

The contribution revenue and changes in value of charitable remainder trusts recognized under such agreements for the year ended December 31, 2008 and 2007 are the following:

	2008	2007
Contributions	\$ 151,755	\$ 289,995
Change in value	(731,789)	(21,652)
	\$ (580,034)	\$ 268,433

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

Notes to Financial Statements

Note 8 - Notes Receivable Held for Investment:

Notes receivable held for investment consists of the following at December 31, 2008 and 2007:

	2008	2007
Note receivable from Episcopal Church of the Redeemer and Redeemer Pre-School; bearing interest at 6%; principal and interest due through January 2014; secured by Episcopal Bishop of California property.	\$ 114,559	\$ 158,294
Note receivable from St. Augustine Episcopal Church; bearing interest at 6%; principal and interest due through December 2008; secured by a Deed of Trust.	3,106	10,308
Note Receivable from St. James Episocpal Church, Oakland; bearing interest at 0% and due in 2016.	45,150	51,750
Note Receivable from individual; bearing interest at 8%; principal and interest due when certain secured property is sold.		51,408
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Less valuation allowance relating to interest accruals		(51,504)
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	\$ 162,815	\$ 220,256
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Note 9 - Equity Interests in Real Property:

Equity interests in real property, which are recorded at cost, consist of the following at December 31, 2008 and 2007:

	2008	2007
45% equity interest in real property owned by the former Executive Officer of the Diocese	\$ 249,661	\$ 249,661
31% equity interest in real property owned by the Culmers	160,000	160,000
22% equity interest in real property owned by the Mission Clergy	100,000	100,000
50% equity interest in real property owned by the former Bishop	927,500	927,500
100% equity interest in real property for current Bishop	2,672,290	2,672,290
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	\$ 4,109,451	\$ 4,109,451
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**The Episcopal Church in the
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Notes to Financial Statements

Note 10 - Property and Equipment:

At December 31, 2008 and 2007, property and equipment consisted of the following:

	2008	2007
Diocesan House	\$ 1,022,862	\$ 998,194
S. F. Campus Center partial interest	30,000	30,000
Computers/server	96,547	61,824
Other furniture and equipment	65,739	46,209
Automobile	27,108	27,108
Hearst Street, Berkeley	659,487	
Lyon Street Improvement	62,077	
	1,963,820	1,163,335
Less accumulated depreciation	(510,784)	(432,708)
	\$ 1,453,036	\$ 730,627

Depreciation expense for the year ended December 31, 2008 and 2007 was \$78,076 and \$70,320, respectively.

Note 11 – Endowment Funds:

In 2008, the Diocese implemented FSP FAS 117-1 “Endowments of Not-for-Profit Organizations – Net Assets Classification of Funds Subject to Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

The Diocese's endowments consist of 99 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.

Interpretation of Relevant Law

The Executive Council has interpreted the SPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, 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.

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 \$559,912 as of December 31, 2008. There were no such deficiencies as of December 31, 2007.

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.

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

Notes to Financial Statements

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.

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, 2007	\$ 1,333,249	\$ 12,339,250	\$ 4,087,958	\$ 17,760,457
<hr/>				
Investment Return:				
Income		366,451		366,451
Net depreciation	(559,912)	(4,841,046)		(5,400,958)
<hr/>				
Total investment return	(559,912)	(4,474,595)		(5,034,507)
<hr/>				
Contributions		1,156,627	37,809	1,194,436
Appropriation of endowment assets		(781,910)		(781,910)
<hr/>				
Endowment Net Assets, December 31, 2008	\$ 773,337	\$ 8,239,372	\$ 4,125,767	\$ 13,138,476

**The Episcopal Church in the
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Notes to Financial Statements

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2006	\$ 1,314,569	\$ 12,243,934	\$ 3,858,931	\$ 17,417,434
Investment Return:				
Income	55,953	553,727	124,117	733,797
Net depreciation	(37,273)	(214,554)		(251,827)
Total investment return	18,680	339,173		481,970
Contributions		205,406	104,910	310,316
Appropriation of endowment assets		(449,263)		(449,263)
Endowment Net Assets, December 31, 2007	\$ 1,333,249	\$ 12,339,250	\$ 4,087,958	\$ 17,760,457

Note 12 – Net Assets:

Temporarily restricted net assets are restricted for specific purposes as of December 31, 2008.

	Custodial	Endowment	Deferred Gifts	Total
Support Diocese	\$ 639,836	\$ 2,425,706	\$ 156,706	\$ 3,222,248
Education		34,049	66,227	100,276
Congregational Support		1,600,838	69,939	1,670,777
Congregational Development	865,226	1,138,198		2,003,424
Social Ministry	45,336	1,458,988	28,699	1,533,023
Scholarships	101,813	1,581,593		1,683,406
	\$1,652,211	\$ 8,239,372	\$ 321,571	\$ 10,213,154

**The Episcopal Church in the
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Notes to Financial Statements

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the years ended December 31, 2008 and 2007.

Permanently restricted net assets are invested in perpetuity, with the income available to support the programs of the Diocese as of December 31, 2008 are as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 1,951,343	\$ 1,057,587	\$ 3,008,930
Education	183,863	213,488	397,351
Congregational Support	1,093,267	543,906	1,637,173
Congregational Development	318,951	9,661	328,612
Social Ministry	497,527	169,118	666,645
Scholarships	80,816		80,816
	\$ 4,125,767	\$ 1,993,760	\$ 6,119,527

Note 13 - Related Parties:

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

Included in accounts payable, related party are the following funds due to the Bishop (a Corporation Sole) at December 31, 2008 and 2007:

	2008	2007
Funds investment in the Diocese pooled endowment	\$ 3,231,386	\$ 4,902,553
Charitable remainder trusts for the benefit of the Bishop	140,560	185,270
	\$ 3,371,946	\$ 5,087,823

Also included in accounts payable, related party is funds held for others. Several years ago, the Church of Incarnation, a church within the Diocese, gave funds to the Diocese to invest and hold for them. At December 31, 2008, the balance due to the Church of Incarnation was \$53,516 and \$82,294, respectively.

**The Episcopal Church in the
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Notes to Financial Statements

The Diocese has made several promises to give to related parties:

	Amounts owed 2008	Amounts owed 2007
Church Divinity School of the Pacific due over five years		\$ 20,000
Grace Cathedral \$25,000 due over five years	\$ 5,000	10,000
Bay School \$200,000 due over 10 years	160,000	160,000
	\$ 165,000	\$ 190,000

These amounts are payable as follows:

	2008	2007
Less than one year	\$ 25,000	\$ 45,000
One to five years	80,000	85,000
More than five years	60,000	60,000
	\$ 165,000	\$ 190,000

Note 14 - 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 2008 and 2007 contribution by the Diocese to the defined contribution pension plans approximated \$57,810 and \$68,500.

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 2008, the Diocese contributed approximately \$110,110 and \$130,316, (18% of compensation), respectively, to the clergy defined benefit pension plan.

**The Episcopal Church in the
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Notes to Financial Statements

Note 15 - 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, \$1,415,000 and \$5,485,000 was not federally insured at December 31, 2008 and 2007, 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 8, consist of notes secured by property and unsecured notes.

The Diocese bills and collects assessment revenue from the various parishes. Assessment revenues comprised 60% of all non investment revenue the Diocese received in 2008.

The Episcopal Church in the Diocese of California

Changes in Fund Asset Balances (see Independent Auditors' Report on Supplemental Information)

December 31, 2008

	Operating Fund	Custodial and Unexpended	Endowment Fund	Deferred Gifts	Total
Beginning Balance - December 31, 2007	\$ 1,988,716	\$ 997,563	\$ 17,760,457	\$ 2,895,365	\$ 23,642,101
Income:					
Assessment income	3,560,326				3,560,326
Gifts and grants	244,068	754,942	1,194,436	(580,034)	1,613,412
Investment Income	207,629	33,317	366,451		607,397
Realized and unrealized gains (losses)			(5,400,958)		(5,400,958)
Expenses:					
Episcopate	(391,137)				(391,137)
Diocesan finance	(478,604)				(478,604)
Diocesan administration	(387,645)				(387,645)
Clerical	(288,261)				(288,261)
Support services-Diocese	(116,587)				(116,587)
Support services-outside Diocese	(765,062)				(765,062)
Planned giving office	(149,434)				(149,434)
Congregational development	(739,590)				(739,590)
Ordained ministry development	(103,559)				(103,559)
Congregation and lay ministries development	(367,056)				(367,056)
Social ministries	(20,600)				(20,600)
Community Ministries	(131,996)				(131,996)
Communications	(246,494)				(246,494)
Interfund Transfers:					
Endowment Fund to Operating Fund	577,931		(577,931)		-
Less: payments to beneficiaries	(346,931)				(346,931)
Custodial Funds to Operating Fund	337,590	(337,590)			-
Less: payments to beneficiaries	(337,590)				(337,590)
Endowment Fund to Custodial Funds		203,979	(203,979)		-
Ending Balance - December 31, 2008	\$ 2,045,714	\$ 1,652,211	\$ 13,138,476	\$ 2,315,331	\$ 19,151,732