

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2018

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, 2018, 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, 2018, 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, 2017 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated October 22, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2017, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
October 29, 2019

The Episcopal Church in the Diocese of California

Statement of Financial Position

December 31, 2018 (with comparative totals for 2017)

	2018					2017	
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Assets:							
Cash and cash equivalents	\$ 1,873,613		\$ 995,404		\$ 1,854,543	\$ 4,723,560	\$ 4,641,596
Receivables, net	1,641,998				12,114,551	13,756,549	12,792,662
Investments	15,000		20,734,570	\$ 13,195,604		33,945,174	38,473,581
Notes receivable	2,332,065					2,332,065	3,692,600
Notes receivable held for investment, net	107,750	\$ 2,300				110,050	164,199
Equity interests in real property	43,949		1,087,500			1,131,449	1,131,449
Property and equipment, net	4,263,978					4,263,978	4,339,351
Due to/from other funds	109,152	374,570	85,680	(98)	(569,304)	-	-
Total assets	\$ 10,387,505	\$ 376,870	\$ 22,903,154	\$ 13,195,506	\$ 13,399,790	\$ 60,262,825	\$ 65,235,438
Liabilities and Net Assets							
Liabilities:							
Accounts payable and accrued expenses	\$ 1,594,028				\$ 3,901,106	\$ 5,495,134	\$ 4,346,721
Deferred revenue	16,748					16,748	5,862
Line of credit	2,332,065					2,332,065	3,692,600
Funds held in trusts for beneficiaries				\$ 10,892,640		10,892,640	12,764,223
Total liabilities	3,942,841			10,892,640	3,901,106	18,736,587	20,809,406
Net Assets:							
Without Donor Restrictions	6,444,664					6,444,664	5,383,597
With Donor Restrictions:							
Restricted for Time or Purpose		\$ 376,870	\$ 11,551,297	595,557	9,498,684	22,022,408	25,747,583
Restricted in Perpetuity			11,351,857	1,707,309		13,059,166	13,294,852
Total With Donor Restrictions		376,870	22,903,154	2,302,866	9,498,684	35,081,574	39,042,435
Total net assets	6,444,664	376,870	22,903,154	2,302,866	9,498,684	41,526,238	44,426,032
Total liabilities and net assets	\$ 10,387,505	\$ 376,870	\$ 22,903,154	\$ 13,195,506	\$ 13,399,790	\$ 60,262,825	\$ 65,235,438

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Activities

Year Ended December 31, 2018 (with comparative totals for 2017)

	2018						2017
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Support and Revenue:							
Parish and mission assessments	\$ 3,500,650					\$ 3,500,650	\$ 3,414,025
Gifts, Fees, and other income	447,342	\$ 368,163	\$ 261,247		\$ 923,495	2,000,247	4,429,792
Change in value of charitable remainder trusts				\$ (340,433)		(340,433)	168,160
Investment income, net			(1,629,777)			(1,629,777)	3,872,905
Total support and revenue	3,947,992	368,163	(1,368,530)	(340,433)	923,495	3,530,687	11,884,882
Expenses:							
Episcopate	520,561					520,561	589,022
Diocesan communications	157,003					157,003	152,297
Congregational development	701,259					701,259	658,932
Youth, young adult, and camps	277,960					277,960	288,278
Ministry development	159,627					159,627	99,071
Multicultural and other ministries	54,252					54,252	55,687
Development & planned giving	179,879					179,879	158,487
National church & international support	590,057					590,057	609,316
Finance	403,983					403,983	401,730
Administration & support staff	1,330,999					1,330,999	1,326,637
Total expenses	4,375,580					4,375,580	4,339,457
Changes in Net Assets Before Transfers & Reclasses	(427,588)	368,163	(1,368,530)	(340,433)	923,495	(844,893)	7,545,425
Interfund Transfers							
Transfers from Endowment to Custodial Fund		102,607	(102,607)			-	-
Transfers from Endowment to Operating Fund	856,385		(856,385)			-	-
Transfers from Custodial Funds to Operating Fund	596,434	(596,434)				-	-
Transfers from Endowment to Operating	(40,788)					(40,788)	-
Payments to beneficiaries:							
Payments to endowment beneficiaries	(273,325)					(273,325)	(700,578)
Payments to custodial fund beneficiaries	(596,435)					(596,435)	(814,563)
Payments to Capital Campaign fund beneficiaries	(32,500)					(32,500)	-
Release restricted Capital Campaign funds to Operating fund	1,111,853				(1,111,853)	-	-
Payments of Capital Campaign Expenses	(1,111,853)					(1,111,853)	(903,023)
Change in Net Assets	82,183	(125,664)	(2,327,522)	(340,433)	(188,358)	(2,899,794)	5,127,261
Net Assets, beginning of year	6,362,481	502,534	25,230,676	2,643,299	9,687,042	44,426,032	39,298,771
Net Assets, end of year	\$ 6,444,664	\$ 376,870	\$ 22,903,154	\$ 2,302,866	\$ 9,498,684	\$ 41,526,238	\$ 44,426,032
Fund Balances by Classification							
Net Assets, beginning of year							
Without Donor Restrictions	\$ 6,362,481					\$ 6,362,481	\$ 5,284,349
Restricted for Time or Purpose		\$ 502,534	\$ 13,878,819	\$ 700,304	\$ 9,687,042	24,768,699	21,467,515
Restricted in Perpetuity			11,351,857	1,942,995		13,294,852	12,546,907
Net Assets, beginning of year	6,362,481	502,534	25,230,676	2,643,299	9,687,042	44,426,032	39,298,771
Changes in Net Assets:							
Without Donor Restrictions	82,183					82,183	99,248
With Donor Restrictions:							
Restricted for Time or Purpose		(125,664)	(2,327,522)	(340,433)	(188,358)	(2,981,977)	4,943,403
Restricted in Perpetuity						-	84,610
Changes in Net Assets	82,183	(125,664)	(2,327,522)	(340,433)	(188,358)	(2,899,794)	5,127,261
Net Assets, end of year							
Without Donor Restrictions	6,444,664					6,444,664	6,362,481
With Donor Restrictions:							
Restricted for Time or Purpose		376,870	11,551,297	595,557	9,498,684	22,022,408	24,768,699
Restricted in Perpetuity			11,351,857	1,707,309		13,059,166	13,294,852
Net Assets With Donor Restrictions		376,870	22,903,154	2,302,866	9,498,684	35,081,574	38,063,551
Net Assets, end of year	\$ 6,444,664	\$ 376,870	\$ 22,903,154	\$ 2,302,866	\$ 9,498,684	\$ 41,526,238	\$ 44,426,032

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Cash Flows

<i>Year Ended December 31, 2018 (with comparative totals for 2017)</i>	2018	2017
Cash Flows from Operating Activities:		
Changes in net assets	\$ (2,899,794)	\$ 5,127,261
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	77,050	81,320
Net realized and unrealized loss (gain) on investments	2,630,507	(2,842,728)
Change in value of charitable remainder trusts	340,829	(168,160)
Increase (decrease) in operating assets and liabilities:		
Receivables	(963,888)	(1,874,644)
Notes receivable	1,414,684	(860,613)
Accounts payable and accrued expenses	1,148,414	2,396,271
Deferred revenue	10,886	(8,418)
Net cash provided by operating activities	1,758,688	1,850,289
Cash Flows from Investing Activities:		
Purchases of investments	(314,512)	(495,067)
Proceeds from sale of investments		130,366
Purchases of property and equipment	(1,677)	(19,443)
Net cash used in investing activities	(316,189)	(384,144)
Cash Flows from Financing Activities:		
Net (borrowings) proceeds on line of credit	(1,360,535)	917,251
Net cash used in financing activities	(1,360,535)	917,251
Net Change in Cash and Cash Equivalents	81,964	2,383,395
Cash and Cash Equivalents, beginning of year	4,641,596	2,258,201
Cash and Cash Equivalents, end of year	\$ 4,723,560	\$ 4,641,596

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. Diocese

The Episcopal Church in the Diocese of California (the Diocese) is a nonprofit corporation that administers and 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 generally accepted in the United States of America (U.S. GAAP), and, accordingly, reflect all significant receivables, accounting principles, 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

Net Assets Without Donor Restrictions

The portion of net assets that is neither subject to time or donor-imposed restrictions and may be expended for any purpose in performing the objective of the Diocese. Net assets without donor restrictions may be designated for use by management or the Board of Directors.

Net Assets With Donor Restrictions

The portion of net assets consisting of contributions which are scheduled to be received in the future, purpose-restricted grants for which variance power was not given to the Diocese, and the portion of donor-restricted endowment funds that are not restricted in perpetuity. Net assets with donor restrictions also include the portion of net assets consisting of contributions to endowment funds where the donor indicated that a portion of the fund be retained in perpetuity and the Diocese’s interest in land required to be permanently held.

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 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 held for Investment

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 for doubtful accounts.

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, 2018.

j. Deferred Revenue

Deferred revenue comprises assessment payments and payroll and benefits reimbursements from congregations in advance of the period to which they relate.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

k. Recognition of Support and Revenue

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

Gifts and grants are recognized when the donor makes an unconditional promise to give to the Diocese. Donor-restricted gifts and grants are reported as increases in net assets restricted for time or purpose or net assets restricted in perpetuity depending on the nature of the restrictions. When a restriction expires, net assets restricted for time or purpose are reclassified to net assets without restrictions.

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

l. Income Taxes

The Diocese is a tax-exempt Diocese 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, 2018, 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 U.S. 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 as well as reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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, 2017, from which the summarized information was derived.

Certain items as reported for December 31, 2017 have been reclassified to conform with the December 31, 2018 financial statement presentation.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

o. Functional Allocation of Expenses

The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities. Accordingly, costs have been allocated among the programs and supporting services that are benefited based on direct costs and salaries and related costs have been allocated by management using time spent in each functional area.

p. Recent Accounting Pronouncement

Pronouncement Adopted

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-14, *Not-for-Profit Entities (Topic 958) Presentation of Financial Statements of Not-for-Profit*, which changes presentation and disclosure requirements for non-profit entities to provide more relevant information about their resources (and the changes in those resources) to donors, granters, creditors, and other users. These include qualitative and quantitative requirements in the following areas: net asset classes, investment return, expenses, and liquidity. In addition, underwater endowments of \$978,884 were reclassified from net assets without restrictions to net assets with restrictions, retrospectively. Accordingly, the accounting change has been retrospectively applied to all periods presented, with the exception of the omission of prior year functional expenses and liquidity and availability of resourced information as permitted by the ASU.

q. Subsequent Events

The Diocese has reviewed the changes in net assets for the period of time from December 31, 2018 through October 29, 2019, 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 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 Episcopal Church in the Diocese of California

Notes to Financial Statements

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 net assets restricted for time or purpose 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 net assets with donor restrictions in perpetuity funds falls below the historical value, the deficiency is reflected as net assets with donor restrictions. At the end of 2018, this deficiency was \$1,031,277 (original corpus was \$17,067,138). The net assets with donor restrictions in perpetuity represent the historic value of additions to the endowment, and the net assets with donor restrictions represent appreciation (depreciation) 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 net assets restricted in perpetuity and net assets restricted for time or purpose on the statement of financial position.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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.

Note 3 - Receivables:

Receivables consist of the following at December 31, 2018 and 2017:

	2018	2017
Assessments	\$ 146,326	\$ 145,353
Reimbursable expenses of related entities, net of allowance	1,284,541	1,382,657
Capital Campaign	12,114,552	11,142,992
Other receivables	211,130	121,660
	<hr/>	<hr/>
	\$ 13,756,549	\$ 12,792,662

At December 31, 2018, pledges receivable for the Capital Campaign are due as follows:

Current	\$ 5,263,597
Two to Five Years	5,581,670
Six to Ten Years	2,000,000
	<hr/>
	12,845,267
Less: discounts to net present value	(523,245)
Less: bad debt	(207,470)
	<hr/>
Total	\$ 12,114,552

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 2016, 2017, and 2018, a group of congregations successfully completed capital campaigns working with diocesan staff and campaign consultants. The Expanding Horizons Campaign is expected to continue through the end of 2019. Contributions to be received after one year are discounted at a rate of 4.5%.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 4 - Investments:

The fair value of investments at December 31, 2018 and 2017 is as follows:

	2018	2017
Mutual funds	\$ 277,228	\$ 270,000
DFMS Trust Fund	20,457,344	22,780,566
T. Rowe Price	15,000	15,395
Charitable trusts	13,195,604	15,407,620
	<u>\$ 33,945,176</u>	<u>\$ 38,473,581</u>

Investment income for the years ended December 31, 2018 and 2017 consists of the following:

	2018	2017
Interest and dividends, net of management fees	\$ 997,242	\$ 942,764
Realized gains	3,488	580
Unrealized (losses) gains	(2,630,507)	2,929,561
	<u>\$ (1,629,777)</u>	<u>\$ 3,872,905</u>

Investment income is included in:

Net assets without donor restrictions		\$ (15)
Net assets restricted for time or purpose	\$ (1,629,777)	3,872,920
	<u>\$ (1,629,777)</u>	<u>\$ 3,872,905</u>

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.

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 Episcopal Church in the Diocese of California

Notes to Financial Statements

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, 2018, DFMS was invested approximately 33% in domestic equities, 30% in international equities, 17.5% in fixed income, 16% in alternative investments, and 3.5% in real estate

The table below presents investment assets at fair value as of December 31, 2018 on a recurring basis.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Investments:			
Mutual Funds:			
US Equity Fund	\$ 277,228	\$ 277,228	
DFMS Trust Fund	20,457,344		\$ 20,457,344
Klingham/unitrust Money Market	15,000	15,000	
	20,749,572	292,228	20,457,344
Charitable Trusts:			
Cash & Equivalents	362,275		362,275
Domestic REIT	1,328,269		1,328,269
International REIT	692,934		692,934
Non-U.S. Bond Fund	534,999		534,999
Non-U.S. Equity Fund	2,874,962		2,874,962
U.S. Bond Funds	114,058		114,058
U.S. Equity Bond	4,339,469		4,339,469
U.S. Government Assets/Bonds	2,547,368		2,547,368
U.S. Treasury Notes/Bonds	401,270		401,270
	13,195,604		13,195,604
Total assets measured at fair value	\$ 33,945,176	\$ 292,228	\$ 33,652,948

There are no investments measured at Level 3.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 a trust, its remaining principal is distributed to the charitable Diocese 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, 2018 and 2017:

	2018	2017
Funds (See Note 4)	\$ 13,195,604	\$ 15,407,620
Due to other funds	(98)	(98)
Less funds held in trust for beneficiaries	(10,892,640)	(12,764,223)
	<hr/>	<hr/>
	\$ 2,302,866	\$ 2,643,299

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, 2018 and 2017 is \$(340,829) and \$168,160, 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, 2018 and 2017:

	2018	2017
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
	<hr/>	<hr/>
	\$ 1,131,449	\$ 1,131,449

Note 7 - Property and Equipment:

At December 31, 2018 and 2017, property and equipment comprised the following:

	2018	2017
Diocesan House	\$ 1,071,447	\$ 1,071,447
S. F. Campus Center partial interest	30,000	30,000
Computers/servers	106,571	104,893
Other furniture and equipment	158,762	158,762
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/>
	3,605,993	3,604,315
Less accumulated depreciation	(1,158,228)	(1,081,177)
	<hr/>	<hr/>
	2,447,765	2,523,138
Land	1,816,213	1,816,213
	<hr/>	<hr/>
	\$ 4,263,978	\$ 4,339,351

Depreciation expense for the years ended December 31, 2018 and 2017 was \$77,050 and \$81,320, 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 (5.5% at December 31, 2018). The line of credit is subject to renewal every two years, and the next renewal date is October 1, 2020.

The credit agreement requires the Diocese to meet certain financial covenants. As of December 31, 2018, the Diocese was in compliance with all such provisions of the agreement.

Total principal payments on the line of credit are \$2,332,065 at December 31, 2018. 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, 2018		
Congregations:		
Christ Church, Los Altos	\$ 135,000	\$ 135,000
Church of Our Savior, Mill Valley	73,900	73,900
Church of the Epiphany, San Carlos	40,311	40,311
St. Michael and All Angels, Concord	59,100	59,100
St. Clare's	69,999	69,999
St. Paul's, Oakland	565,000	565,000
St. Bartholomew's - Livermore	15,590	15,590
Total congregations	958,900	958,900
Other:		
Berkeley Emergency Food and Housing	48,195	48,195
Episcopal Community Services	590,000	590,000
St. Dorothy's Rest	734,970	734,970
Total other	1,373,165	1,373,165
Total	\$ 2,332,065	\$ 2,332,065

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 9 - Endowments:

The Diocese's endowment comprises 123 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 U.S. 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 net assets with donor restrictions in perpetuity as (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 net assets with donor restrictions in perpetuity is classified as net assets with donor restrictions until those amounts are appropriated for expenditure by the Diocese in a manner consistent with the standard of prudence prescribed by State Prudent Management of Institutional Funds Act (SPMIFA).

In accordance with SPMIFA, the Diocese 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 Diocese 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 Diocese, (7) the investment policies of the Diocese.

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 U.S. GAAP, deficiencies of this nature that are reported in net assets with donor restrictions were \$1,031,277 and \$978,884 as of December 31, 2018 and 2017, respectively.

Return Objectives and Risk Parameters

The Diocese has adopted investment and spending policies for endowment assets that will ultimately provide a predictable stream of funding to provide support for the various programs and ministries of the Diocese of California. Endowment assets include those assets of donor-restricted funds that the Diocese 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 expects to provide annual distributions of 4.25% of the market value of the portfolio as calculated on a twelve-quarter 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, 2018 were as follows:

	With Restrictions	With Restrictions in Perpetuity	Total
Endowment Net Assets, December 31, 2017	\$ 13,878,819	\$ 11,351,857	\$ 25,230,676
Investment Return:			
Income			
Net appreciation/ (depreciation)	(1,629,777)		(1,629,777)
Total investment return	(1,629,777)		(1,629,777)
Contributions	261,247		261,247
Appropriations	(958,992)		(958,992)
Endowment Net Assets December 31, 2018	\$ 11,551,297	\$ 11,351,857	\$ 22,903,154

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 10 - Net Assets:

Net assets with donor restrictions for specific purposes at December 31, 2018, as follows:

	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total
Support Diocese	\$ 189,182	\$ 2,780,170	\$ 470,490		\$ 3,439,842
Education			17,867		17,867
Congregational Support		3,383,149	101,245		3,484,394
Congregational Development	54,881	1,378,320			1,433,201
Social Ministry	14,850	2,130,131			2,144,981
Scholarship	117,957	1,879,527	5,955		2,003,439
Capital Campaign				\$ 9,498,684	9,498,684
	\$ 376,870	\$ 11,551,297	\$ 595,557	\$ 9,498,684	\$ 22,022,408

Net assets released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2018 were \$1,968,238.

Net assets with donor restrictions in perpetuity were invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2018, as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 8,164,195	\$ 853,655	\$ 9,017,850
Education	230,676		230,676
Congregational Support	1,846,467	460,973	2,307,440
Congregational Development	338,745	187,804	526,549
Social Ministry	558,495	204,877	763,372
Scholarships	213,279		213,279
	\$ 11,351,857	\$ 1,707,309	\$ 13,059,166

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 11 - Liquidity and Availability:

The Diocese relies upon contributions and pledges to conduct its operations.

The following reflects the Diocese's financial assets as of the date of the Statement of Financial Position, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the date of the Statement of Financial Position. Amounts not available include amounts set aside for the Diocese's lending program.

	2018
Financial assets, at year-end	
Cash and cash equivalents	\$ 4,723,560
Receivables, net	13,756,550
Investments	33,945,176
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Total financial assets	52,425,286
Less those unavailable for general expenditures within one year, due to:	
Funds held in trust	10,892,640
Restricted by donor with time or purpose restrictions	22,022,408
Restricted by donor in perpetuity	13,059,166
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Financial assets available to meet cash needs for general expenditures within one year	\$ 6,451,072

In addition to contributions and program revenue are received throughout the year to fund general expenditures.

Note 12 - Retirement Plans:

The Diocese provides a defined contribution pension plan for lay employees. The Diocese contributes between 5% and 9% of lay employee compensation depending upon the employee contribution. The 2018 and 2017 contribution by the Diocese to the defined contribution pension plan approximated \$88,725 and \$79,872, 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 2018 and 2017, the Diocese contributed approximately \$127,977 and \$141,636, respectively, to the clergy defined benefit pension plan.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 13 - Concentrations of Credit Risk:

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

The Diocese invests its cash deposits with two financial institutions. Periodically, throughout the year, the Diocese has maintained balances in operating and money market accounts higher than federally insured limits.

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

The Diocese bills and collects assessment revenue from the various congregations. Assessment revenues represented 88.7% of all non-investment and contribution revenue the Diocese received in 2018.

Note 14 - Functional Expense:

The table below shows the allocation of expenses for 2018:

	Program	General and Administrative	Development	Total
Salaries	\$ 641,087	\$ 500,443	\$ 147,265	\$ 1,288,795
Benefits	274,579	245,965	45,054	565,598
Diocese Assessment	534,828			534,828
Direct Support of Congregations	293,225			293,255
Legal Fees		235,110		253,110
Direct Support of Diocese	184,004			184,004
Audit & Insurance		141,003		141,003
Other	767,650	365,367		1,133,017
Total	\$ 2,695,373	\$ 1,487,888	\$ 192,319	\$ 4,375,580