

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2017

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, 2017, 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, 2017, 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, 2016 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated September 27, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
October 22, 2018

The Episcopal Church in the Diocese of California

Statement of Financial Position

December 31, 2017 (with comparative totals for 2016)

	2017						2016
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Assets:							
Cash and cash equivalents	\$ 1,608,355		\$ 1,018,242		\$ 2,014,999	\$ 4,641,596	\$ 2,258,201
Receivables, net	1,649,670				11,142,992	12,792,662	10,918,018
Investments	15,395		23,050,566	\$ 15,407,620		38,473,581	32,574,549
Notes receivable	3,692,600					3,692,600	2,775,349
Notes receivable held for investment, net	161,899	\$ 2,300				164,199	220,836
Equity interests in real property	43,949		1,087,500			1,131,449	1,131,449
Property and equipment, net	4,339,351					4,339,351	4,401,228
Due to/from other funds	292,155	500,234	74,368	(98)	(866,659)		
Total assets	\$ 11,803,374	\$ 502,534	\$ 25,230,676	\$ 15,407,522	\$ 12,291,332	\$ 65,235,438	\$ 54,279,630
Liabilities and Net Assets							
Liabilities:							
Accounts payable and accrued expenses	\$ 1,742,431				\$ 2,604,290	\$ 4,346,721	\$ 1,950,450
Deferred revenue	5,862					5,862	14,280
Line of credit	3,692,600					3,692,600	2,775,349
Funds held in trusts for beneficiaries				\$ 12,764,223		12,764,223	10,240,780
Total liabilities	5,440,893			12,764,223	2,604,290	20,809,406	14,980,859
Net Assets:							
Unrestricted	6,362,481		\$ (978,884)			5,383,597	5,284,349
Temporarily restricted		\$ 502,534	14,857,703	700,304	9,687,042	25,747,583	21,467,515
Permanently restricted			11,351,857	1,942,995		13,294,852	12,546,907
Total net assets	6,362,481	502,534	25,230,676	2,643,299	9,687,042	44,426,032	39,298,771
Total liabilities and net assets	\$ 11,803,374	\$ 502,534	\$ 25,230,676	\$ 15,407,522	\$ 12,291,332	\$ 65,235,438	\$ 54,279,630

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Activities

Year Ended December 31, 2017 (with comparative totals for 2016)

	2017						2016
	Operating	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total All Funds	Total
Support and Revenue:							
Parish and mission assessments	\$ 3,414,025					\$ 3,414,025	\$ 3,342,991
Gifts, Fees, and other income	419,616	\$ 641,582	\$ 995,584		\$ 2,373,010	4,429,792	10,513,411
Change in value of charitable remainder trusts				\$ 168,160		168,160	52,965
Investment income, net			3,872,905			3,872,905	929,878
Total support and revenue	3,833,641	641,582	4,868,489	168,160	2,373,010	11,884,882	14,839,245
Expenses:							
Episcopate	589,022					589,022	560,881
Diocesan communications	152,297					152,297	178,712
Congregational development	658,932					658,932	653,046
Youth, young adult, and camps	288,278					288,278	248,834
Ministry development	99,071					99,071	156,920
Multicultural and other ministries	55,687					55,687	50,076
Development & planned giving	158,487					158,487	187,566
National church & international support	609,316					609,316	688,926
Finance	401,730					401,730	339,401
Administration & support staff	1,326,637					1,326,637	1,349,598
Total expenses	4,339,457					4,339,457	4,413,960
Changes in Net Assets Before Transfers & Reclasses							
	(505,816)	641,582	4,868,489	168,160	2,373,010	7,545,425	10,425,285
Interfund Transfers							
Transfers from Endowment to Custodial Fund		122,303	(122,303)			-	-
Transfers from Endowment to Operating Fund	1,305,657		(1,305,657)			-	-
Transfers from Custodial Funds to Operating Fund	814,563	(814,563)				-	-
Payments to beneficiaries:							
Payments to endowment beneficiaries	(700,578)					(700,578)	(365,638)
Payments to custodial fund beneficiaries	(814,563)					(814,563)	(1,004,330)
Release of campaign restrictions	903,023				(903,023)	-	-
Payments of Cap Campaign Expenses	(903,023)					(903,023)	(883,790)
Change in Net Assets	99,263	(50,678)	3,440,529	168,160	1,469,987	5,127,261	8,171,527
Net Assets, beginning of year	6,263,218	553,212	21,790,147	2,475,139	8,217,055	39,298,771	31,127,244
Net Assets, end of year	\$ 6,362,481	\$ 502,534	\$ 25,230,676	\$ 2,643,299	\$ 9,687,042	\$ 44,426,032	\$ 39,298,771
Fund Balances by Classification							
Net Assets, beginning 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, beginning of year	6,263,218	553,212	21,790,147	2,475,139	8,217,055	39,298,771	31,127,244
Changes in Net Assets:							
Unrestricted Net Assets	99,263		(15)			99,248	(4,125)
Temporarily Restricted Net Assets		(50,678)	3,440,544	83,550	1,469,987	4,943,403	8,092,628
Permanently Restricted Net Assets			-	84,610		84,610	83,024
Changes in Net Assets	99,263	(50,678)	3,440,529	168,160	1,469,987	5,127,261	8,171,527
Net Assets, end of year							
Unrestricted Net Assets	6,362,481	-	(978,884)	-	-	5,383,597	5,284,349
Temporarily Restricted Net Assets	-	502,534	14,857,703	700,304	9,687,042	25,747,583	21,467,515
Permanently Restricted Net Assets	-	-	11,351,857	1,942,995	-	13,294,852	12,546,907
Net Assets, end of year	\$ 6,362,481	\$ 502,534	\$ 25,230,676	\$ 2,643,299	\$ 9,687,042	\$ 44,426,032	\$ 39,298,771

See accompanying notes to the financial statements.

The Episcopal Church in the Diocese of California

Statement of Cash Flows

<i>Year Ended December 31, 2017 (with comparative totals for 2016)</i>	2017	2016
Cash Flows from Operating Activities:		
Changes in net assets	\$ 5,127,261	\$ 8,171,527
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	81,320	80,778
Net realized and unrealized gain on investments	(2,842,728)	(811,696)
Loss (gain) on disposal of fixed assets		721
Change in value of charitable remainder trusts	(168,160)	1,240,469
Increase (decrease) in operating assets and liabilities:		
Receivables	(1,874,644)	(9,153,127)
Notes receivable	56,637	41,910
Accounts payable and accrued expenses	2,396,271	802,801
Deferred revenue	(8,418)	(2,660)
Net cash provided by operating activities	2,767,539	370,723
Cash Flows from Investing Activities:		
Purchases of investments	(495,067)	(23,113,969)
Proceeds from sale of investments	130,366	22,308,758
Proceeds from capital gains distributions	-	252,123
Purchases of property and equipment	(19,443)	(43,290)
Net cash used in investing activities	(384,144)	(596,378)
Cash Flows from Financing Activities:		
Borrowings from line of credit - net	-	-
Net cash used in financing activities	-	-
Net Change in Cash and Cash Equivalents	2,383,395	(225,655)
Cash and Cash Equivalents, beginning of year	2,258,201	2,483,856
Cash and Cash Equivalents, end of year	\$ 4,641,596	\$ 2,258,201

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 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 U.S. generally accepted accounting principles (U.S. GAAP), 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.

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

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, 2017.

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 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, 2017, 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 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, 2016, from which the summarized information was derived.

Certain items as reported for December 31, 2016 have been reclassified to conform with the December 31, 2017 financial statement presentation. Such classification had no effect on the Diocese's financial position or activities.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

o. Recent Accounting Pronouncements

In August 2016, the FASB issued Accounting Standard Update (ASU) 2016-14 – Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-For-Profit Entities. The ASU made 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, 2017 through October 22, 2018, 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 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 2017, this deficiency increased to \$978,884. The permanently restricted net assets represent the historic value of additions to the endowment, and the temporarily restricted net assets represent appreciation of the endowment fund balances.

d. Deferred Gifts Fund

This fund is used to account for funds held in trust and administered by the Diocese, the income of which is payable to individual beneficiaries. Income earned but not paid to beneficiaries is treated as a liability, which is included with "Funds Held in Trust for Beneficiaries." Upon the expiration of the income beneficiaries' interests, the principal will be distributed in accordance with the conditions prescribed by the deferred gift agreements. Any principal that will ultimately be distributed to third party beneficiaries has been recorded as a liability, "Funds Held in Trusts for Beneficiaries." The remainder is distributable to the Diocese and is stated at the estimated present value, which is calculated based on the actuarial life expectancy of the donor or designees. The discount rates used, ranging between 5% and 6.5%, approximate the 30 year U.S. Treasury Bond rate in the year of origination. The fund balances are a combination of permanently restricted net assets and temporarily restricted net assets on the statement of financial position.

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, 2017 and 2016:

	2017	2016
Assessments	\$ 145,353	\$ 145,897
Reimbursable expenses of related entities, net of allowance	1,382,657	1,323,651
Capital Campaign	11,142,992	9,274,493
Other receivables	121,660	173,977
	<hr/>	<hr/>
	\$ 12,792,662	\$ 10,918,018

At December 31, 2017, pledges receivable for the Capital Campaign are due as follows:

Current	\$ 4,704,093
Long-term	8,834,627
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	13,538,720
Less: discounts to net present value	(2,241,676)
Less: allowance for bad debt	(154,052)
	<hr/>
Total	\$ 11,142,992

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 and 2017, several congregations successfully completed capital campaigns working with diocesan staff and campaign consultants. More congregations are participating in 2018, and 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, 2017 and 2016 is as follows:

	2017	2016
Mutual funds	\$ 270,000	\$ 239,961
DFMS Trust Fund	22,780,566	19,618,572
T. Rowe Price	15,395	
Charitable trusts	15,407,620	12,716,016
	<hr/>	<hr/>
	\$ 38,473,581	\$ 32,574,549

Investment income for the years ended December 31, 2017 and 2016 consists of the following:

	2017	2016
Interest and dividends, net of management fees	\$ 942,764	\$ 197,945
Realized gains	580	218,118
Unrealized (losses) gains	2,929,561	513,815
	<hr/>	<hr/>
	\$ 3,872,905	\$ 929,878

Investment income is included in:

Unrestricted net assets	\$ (15)	\$ (80,528)
Temporarily restricted net assets	3,872,920	1,010,406
	<hr/>	<hr/>
	\$ 3,872,905	\$ 929,878

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, 2017, 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, 2017 on a recurring basis.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Investments:			
Mutual Funds:			
Non-US Equity Fund	\$ 270,000	\$ 270,000	
DFMS Trust Fund	22,780,566		\$ 22,780,566
T. Rowe Price	15,395	15,395	
Charitable Trusts:			
Cash & Equivalents	449,178		449,179
Domestic REIT	1,202,082		1,202,082
International REIT	768,811		768,811
Non-U.S. Bond Fund	573,113		573,113
Non-U.S. Equity Fund	3,435,300		3,435,300
U.S. Bond Funds	2,640,629		2,640,629
U.S. Equity Bond	5,845,139		5,845,139
U.S. Government Assets/Bonds	173,841		173,841
U.S. Treasury Notes/Bonds	319,527		319,527
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Total assets measured at fair value	\$ 38,473,581	\$ 285,395	\$ 38,188,186

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 investments in charitable remainder unitrusts consist of the following at December 31, 2017 and 2016:

	2017	2016
Funds (See Note 4)	\$ 15,407,620	\$ 12,716,016
Due to other funds	(98)	(97)
Less funds held in trust for beneficiaries	(12,764,223)	(10,240,780)
	<hr/>	<hr/>
	\$ 2,643,299	\$ 2,475,139

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, 2017 and 2016 is \$168,160 and \$(1,240,469), 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, 2017 and 2016:

	2017	2016
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, 2017 and 2016, property and equipment comprised the following:

	2017	2016
Diocesan House	\$ 1,071,447	\$ 1,071,447
S. F. Campus Center partial interest	30,000	30,000
Computers/servers	104,893	87,195
Other furniture and equipment	158,762	157,017
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/>
	3,604,315	3,584,872
Less accumulated depreciation	(1,081,177)	(999,857)
	<hr/>	<hr/>
	2,523,138	2,585,015
Land	1,816,213	1,816,213
	<hr/>	<hr/>
	\$ 4,339,351	\$ 4,401,228

Depreciation expense for the years ended December 31, 2017 and 2016 was \$81,320 and \$80,778, 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 (4.5% at 12/31/17). 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, 2017, 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 \$3,692,600 at December 31, 2017. 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, 2017		
Congregations:		
St. Clare's, Pleasanton	\$ 131,114	\$ 131,114
Christ Church, Los Altos	1,249	1,249
Church of the Epiphany, San Carlos	90,311	90,311
St. Michael and All Angels, Concord	59,100	59,100
St. Paul's, Walnut Creek	285,881	285,881
St. Paul's, Oakland	565,000	565,000
Church of Our Savior, Mill Valley	301,250	301,250
St. Timothy's, Danville	10,000	10,000
Christ Church, Sausalito		
Total congregations	1,443,905	1,353,594
Other:		
Berkeley Emergency Food and Housing	72,195	72,195
Episcopal Community Services	1,440,000	1,440,000
St. Dorothy's Rest	736,501	736,501
Total other	2,248,695	2,339,006
Total	\$ 3,692,600	\$ 3,692,600

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 9 - Endowments:

The Diocese's endowment comprises 120 individual funds established to support general operations of the Diocese or specific congregations and programs in the Diocese. The endowment includes donor-restricted endowment funds and funds designated by the Executive Council to function as endowments. As required by U.S. GAAP as previously defined, 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 \$978,884 and \$978,869 as of December 31, 2017 and 2016, respectively.

Return Objectives and Risk Parameters

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

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 three-year rolling average. The investment managers are required to invest funds so as to ensure that required distributions of income or principal are met.

Net changes in endowment funds for the year ended December 31, 2017 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2016	\$ (978,869)	\$ 12,080,494	\$ 10,688,522	\$ 21,790,147
Investment Return:				
Income		329,552		329,552
Net appreciation/ (depreciation)	(15)	3,440,544		3,440,529
Total investment return	(15)	3,770,096		3,770,096
Contributions		434,493	663,334	1,097,828
Appropriations		(1,427,960)		(1,427,960)
Interfund transfer				
Other Income		580		580
Endowment Net Assets December 31, 2017	\$ (978,884)	\$ 14,857,703	\$ 11,351,856	\$ 25,230,676

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 10 - Net Assets:

Temporarily restricted net assets were restricted for specific purposes at December 31, 2017, as follows:

	Custodial	Endowment	Deferred Gifts	Capital Campaign	Total
Support Diocese	\$ 204,688	\$ 4,417,988	\$ 554,666		\$ 5,177,342
Education		58,185	20,140		78,325
Congregational Support		4,052,291	116,076		4,168,367
Congregational Development	174,204	1,589,784			1,763,988
Social Ministry	14,586	2,574,539			2,589,125
Scholarship	109,056	2,164,916	9,422		2,283,394
Capital Campaign				\$ 9,687,042	9,687,042
	\$ 502,534	\$ 14,857,703	\$ 700,304	\$ 9,687,042	\$ 25,747,583

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2017 and 2016.

Permanently restricted net assets were invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2017, as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 8,164,195	\$ 977,861	\$ 9,142,056
Education	230,676	371	231,047
Congregational Support	1,846,467	513,813	2,360,280
Congregational Development	338,745	213,813	552,558
Social Ministry	558,495	237,137	795,632
Scholarships	213,279		213,279
	\$ 11,351,857	\$ 1,942,995	\$ 13,294,852

Note 11 - 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 2017 and 2016 contribution by the Diocese to the defined contribution pension plan approximated \$79,872 and \$61,126, respectively.

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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 2017 and 2016, the Diocese contributed approximately \$141,636 and \$164,933, 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 represented 76% of all non-investment revenue the Diocese received in 2017.