

THE EPISCOPAL CHURCH IN THE
DIOCESE OF CALIFORNIA

DECEMBER 31, 2009

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, 2009, 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 2008 financial statements and, in our report dated May 19, 2009, 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, 2009, and the changes in its net assets and its 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 22 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 statement taken as a whole.

July 13, 2010

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The Episcopal Church in the Diocese of California

Statement of Financial Position

Years Ended December 31, 2009 (with comparative totals for 2008)

	2009					2008 Total
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	
Asset:						
Cash and cash equivalents	\$ 1,915,193	\$ 3,369	\$ 41,257		\$ 1,959,819	\$ 1,735,268
Receivables, net	1,562,113			\$ 248,250	1,810,363	1,949,282
Investments			14,570,012		14,570,012	11,929,068
Other investment			192,663		192,663	30,500
Notes receivable	2,110,030				2,110,030	
Notes receivable held for investment, net		36,850	105,012		141,862	162,815
Pledge receivable						20,934
Equity interests in real property	43,949	100,000	4,009,451		4,153,400	4,109,451
Property and equipment, net	1,639,488				1,639,488	1,453,036
Investments - charitable remainder unitrusts				17,819,303	17,819,303	11,664,964
Due to/from other funds	(233,967)	311,707	(77,740)			
Total assets	\$ 7,036,806	\$ 451,926	\$ 18,840,655	\$ 18,067,553	\$ 44,396,940	\$ 33,055,318
Liabilities and Net Assets						
Liabilities:						
Accounts payable and accrued expenses	\$ 812,184				\$ 812,184	\$ 911,252
Accounts payable, related parties			\$ 59,701		59,701	3,590,462
Deferred revenue	167,469				167,469	192,799
Line of credit	2,110,030				2,110,030	
Funds held in trusts for beneficiaries				\$ 14,969,516	14,969,516	9,209,073
Total liabilities	3,089,683		59,701	14,969,516	18,118,900	13,903,586
Net Assets:						
Unrestricted	3,063,049		(603,897)		2,459,152	2,721,635
Unrestricted-board designated	884,074				884,074	97,416
Total unrestricted	3,947,123		(603,897)		3,343,226	2,819,051
Temporarily restricted		\$ 451,926	11,493,898	674,259	12,620,083	10,213,154
Permanently restricted			7,890,953	2,423,778	10,314,731	6,119,527
Total net assets	3,947,123	451,926	18,780,954	3,098,037	26,278,040	19,151,732
Total liabilities and net assets	\$ 7,036,806	\$ 451,926	\$ 18,840,655	\$ 18,067,553	\$ 44,396,940	\$ 33,055,318

The Episcopal Church in the Diocese of California

Statement of Activities

Years Ended December 31, 2009 (with comparative totals for 2008)

	2009					2008 Total
	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds	
Support and Revenue:						
Parish and mission assessments	\$ 3,578,977				\$ 3,578,977	\$ 3,560,326
Gifts, grants and other	590,751				590,751	244,068
Investment income, net			\$ 655,690		655,690	(352,283)
Total support and revenue	4,169,728		655,690		4,825,418	3,452,111
Expenses:						
Episcopate	436,256				436,256	391,137
Diocesan finance	518,572				518,572	478,604
Diocesan administration	662,623				662,623	387,645
Clerical	43,844				43,844	288,261
Support services-Diocese	117,012				117,012	116,587
Support services-outside Diocese	800,960				800,960	765,062
Planned giving office	147,286				147,286	149,434
Congregational development	872,109				872,109	739,590
Ordained ministry development	51,450				51,450	103,559
Congregation and lay ministries development	255,574				255,574	367,056
Social ministries	33,639				33,639	20,600
Community ministries	150,640				150,640	131,996
Communications	265,567				265,567	246,494
Payments to beneficiaries and other custodial fund disbursements	660,620				660,620	684,521
Total expenses	5,016,152				5,016,152	4,870,546
Changes in Unrestricted Net Assets before Transfers & Reclasses	(846,424)		655,690		(190,734)	(1,418,435)
Reclass of restrictions			(1,333,249)		(1,333,249)	
Transfer from Corporation Sole	135,187		(699,675)		(564,488)	
Changes in Unrestricted Net Assets after Transfers & Reclasses	(711,237)		(1,377,234)		(2,088,471)	(1,418,435)
Changes in Temporarily Restricted Net Assets:						
Gifts, grants and other		\$ 232,534	421,549	\$ 111,443	765,526	2,063,325
Change in value of unitrusts				100,685	100,685	(352,695)
Investment income, net			2,352,687		2,352,687	(4,441,279)
Interfund transfer		144,026	(144,026)		-	
Changes in Temporarily Restricted Net Assets before Transfers & Reclasses		376,560	2,630,210	212,128	3,218,898	(2,730,649)
Reclass of restrictions			1,533,277		1,533,277	
Transfer from Corporation Sole		126,840		140,560	267,400	
Changes in Temporarily Restricted Net Assets after Transfers & Reclasses		503,400	4,163,487	352,688	5,019,575	(2,730,649)
Changes in Permanently Restricted Net Assets:						
Gifts, grants, and other			34,155		34,155	37,809
Change in value of unitrusts				430,018	430,018	(379,094)
Changes in Permanently Restricted Net Assets before Transfers & Reclasses			34,155			
Reclass of restrictions			(200,028)		(200,028)	(341,285)
Transfer from Corporation Sole			3,931,059		3,931,059	
Changes in Permanently Restricted Net Assets after Transfers & Reclasses			3,765,186	430,018	4,195,204	(341,285)
Net Assets Released from Restrictions	2,612,646	(1,703,685)	(908,961)			
Change in Net Assets	1,901,409	(1,200,285)	5,642,478	782,706	7,126,308	(4,490,369)
Net Assets, beginning of year	2,045,714	1,652,211	13,138,476	2,315,331	19,151,732	23,642,101
Net Assets, end of year	\$ 3,947,123	\$ 451,926	\$ 18,780,954	\$ 3,098,037	\$ 26,278,040	\$ 19,151,732

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

Statement of Cash Flows

<i>Years Ended December 31,</i>	2009	2008
Cash Flows from Operating Activities:		
Changes in net assets	\$ 7,126,308	\$ (4,490,369)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Transfer of net assets from the Corporation Sole	(3,633,971)	
Depreciation	86,979	78,076
Net realized and unrealized (gain) loss on investments	(2,615,313)	7,101,053
Donation of stock	(123,492)	(1,190,849)
Change in charitable remainder unitrusts	(393,896)	647,935
Reclass of note receivable to investment	(194,654)	
(Increase) decrease in operating assets		
Receivables	138,919	(472,101)
Pledge receivable	20,934	10,395
Increase (decrease) in operating liabilities		
Accounts payable and accrued expenses	(99,068)	147,424
Accounts payable, related party	(3,530,761)	(1,770,285)
Deferred revenue	(25,330)	21,554
Net cash (used) provided by operating activities	(3,243,345)	82,833
Cash Flows from Investing Activities:		
Purchases of investments	(5,911,727)	(16,079,428)
Proceeds from sale of investments	6,042,079	16,572,171
Principal payments received on notes receivable held for investments	20,953	57,441
Purchases of property and equipment	(273,431)	(800,485)
Transfer of assets from the Corporation Sole	3,633,971	
Transfer of equity interest from Corporation Sole	(43,949)	
Net cash provided (used) by investing activities	3,467,896	(250,301)
Net Increase (Decrease) in Cash and Cash Equivalents	224,551	(167,468)
Cash and Cash Equivalents, beginning of year	1,735,268	1,902,736
Cash and Cash Equivalents, end of year	\$ 1,959,819	\$ 1,735,268
Noncash Investing Activities:		
Donation of stock	\$ 123,492	\$ 1,190,849
Reclass of note receivable to investment	194,654	

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 entity that administratively supports Episcopal parishes and other ancillary institutions throughout the San Francisco Bay Area in the State of California. The Diocese is governed by the Executive Council which is the legal board of directors of the Diocesan Corporation.

b. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting 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

Financial statement presentation follows the recommendations of the Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. Under ASC 958, the Diocese is required to report information regarding its financial position and activities according to three classes of net assets:

Unrestricted Net Assets. The portion of net assets that is neither temporarily restricted nor permanently restricted by donor-imposed stipulations.

Temporarily Restricted Net Assets. The portion of net assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Diocese.

Permanently Restricted Net Assets. The portion of net assets whose use by the organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Diocese.

d. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, cash and cash equivalents include time deposits and all highly liquid debt instruments with original maturities of three months or less.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

e. Receivables

Receivables 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.

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

i. Property and Equipment

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

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 have been prepared on the accrual basis of accounting.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 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.

The Financial Accounting Standards Board issued new guidance on accounting for uncertainty in income taxes. The Diocese adopted this new guidance for the year ended December 31, 2009. Management evaluated the Diocese's tax positions and concluded that the Diocese had maintained its tax exempt status and had taken no uncertain tax positions that required adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements.

m. Use of Estimates

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

n. Subsequent Events

The Diocese has reviewed the results of operations for the period of time from December 31, 2009 through July 13, 2010, 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 subsequent events have occurred, the nature of which would require disclosure.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

o. New Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued *The FASB Accounting Standards* (Codification). The Codification is the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities effective for financial statements issued for periods ending after September 15, 2009. The Codification does not change accounting principles generally accepted in the United States of America and had no affect on the Diocese's financial position or results of operations.

Note 2 - Description of Funds:

a. Operating Fund

This fund is used to account for all expenditures related to unrestricted support and revenue. 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 and Trust Fund

This fund is used to account for assets contributed by donors which are subject to various restrictions, both temporary and permanent. 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, 2009 and 2008:

	2009	2008
Assessments	\$ 220,297	\$ 198,023
Reimbursable expenses from related entities, net of allowance	1,083,770	1,078,543
Endowment receivables		194,654
Custodial receivables		252,500
Other receivables	506,296	225,562
	\$ 1,810,363	\$ 1,949,282

Note 4 - Investments:

The fair value of investments at December 31, 2009 and 2008 is as follows:

	2009	2008
Corporate stocks	\$ 5,214,632	\$ 4,543,334
Mutual funds	9,355,380	7,385,734
	\$ 14,570,012	\$ 11,929,068

Investment income for the year ended December 31, 2009 and 2008 consists of the following:

	2009	2008
Interest and dividends, net of management fees of \$50,873 and \$54,683, respectively	\$ 401,888	\$ 366,451
Realized gains and losses	(2,193,612)	511,285
Unrealized gains and losses	4,800,101	(5,912,244)
	\$ 3,008,377	\$ (5,034,508)

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

Notes to Financial Statements

Investment income is included in:			
Unrestricted net assets	\$	655,690	\$ (559,912)
Temporarily restricted net assets		2,352,687	(4,474,596)
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	\$	3,008,377	\$ (5,034,508)

Note 5 - Fair Value of Measurements:

Effective January 1, 2008, the Diocese adopted ASC 820 *Fair Value Measurements*, which provides a framework for measuring fair value under generally accepted accounting principles. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 has been applied prospectively as of the beginning of the year.

ASC 820 prioritizes the inputs to the valuation techniques used to measure fair value into a three-level valuation hierarchy. The valuation hierarchy is based upon the relative reliability and availability of the inputs to market participants for the valuation of an asset or liability as of the measurement date. Pursuant to ASC 820, when the fair value of an asset or liability contains inputs from different levels of the hierarchy, the level within which the fair value measurement in its entirety is categorized is based upon the lowest level input that is significant to the fair value measurement in its entirety. The three levels of this valuation hierarchy consist of the following:

- 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.
- 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 Diocese's investments in common stocks are diversified in different industries.

The table below presents the balances of assets measured at fair value at December 31, 2009 on a recurring basis:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments:				
Common Stock	\$ 5,214,632	\$ 5,214,632		
Mutual Funds	9,355,380	9,355,380		
Total investments	14,570,012	14,570,012		
Charitable Trusts – mutual funds	17,819,303		\$ 17,819,303	
Total assets measured at fair value	\$ 32,389,315	\$ 14,570,012	\$ 17,819,303	\$ -

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

Mutual funds consist of fixed income, domestic equities and international equity funds with concentrations of 38%, 41% and 21%, respectively.

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

Notes to Financial Statements

Note 6 - 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% (as of gift receipt date) and is classified as funds held in trust for beneficiary.

The investments in charitable remainder unitrusts consist of the following at December 31, 2009 and 2008:

	2009	2008
Funds	\$ 17,819,003	\$ 11,664,964
Less funds held in trust for beneficiaries	(14,969,516)	(9,209,073)
<u>Less accounts payable to related party</u>		<u>(140,560)</u>
	<u>\$ 2,849,487</u>	<u>\$ 2,315,331</u>

The contribution revenue and changes in value of charitable remainder trusts recognized under such agreements for the year ended December 31, 2009 and 2008 are the following:

	2009	2008
Contributions	\$ 111,443	\$ 151,755
Change in value	530,703	(731,789)
Corporation Sole transfer – see Note 16	140,560	
	<u>\$ 782,706</u>	<u>\$ (580,034)</u>

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

Notes to Financial Statements

Note 7 - Notes Receivable Held for Investment:

Notes receivable held for investment consists of the following at December 31, 2009 and 2008:

	2009	2008
Note receivable from Episcopal Church of the Redeemer and Redeemer Pre-School; bearing interest at 4%; principal and interest due through August 2014; secured by Episcopal Bishop of California property.	\$ 105,012	\$ 114,559
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
Note Receivable from St. James Episcopal Church, Oakland; bearing interest at 0% and due in 2016.	36,850	45,150
	\$ 141,862	\$ 162,815

Note 8 - Equity Interests in Real Property:

Equity interests in real property, which are recorded at cost, consist of the following at December 31, 2009 and 2008:

	2009	2008
45% equity interest in real property owned by the Executive Officer of the Diocese	\$ 249,661	\$ 249,661
24% equity interest in real property owned by Bayani Rico	43,949	
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
	\$ 4,153,400	\$ 4,109,451

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

Notes to Financial Statements

Note 9 - Property and Equipment:

At December 31, 2009 and 2008, property and equipment consisted of the following:

	2009	2008
Diocesan House	\$ 1,027,752	\$ 1,022,862
S. F. Campus Center partial interest	30,000	30,000
Computers/server	96,547	96,547
Other furniture and equipment	76,943	65,739
Automobile	27,108	27,108
Hearst Street, Berkeley	906,197	659,487
Lyon Street Improvement	72,707	62,077
	<hr/>	<hr/>
	2,237,254	1,963,820
Less accumulated depreciation	(597,766)	(510,784)
	<hr/>	<hr/>
	\$ 1,639,488	\$ 1,453,036

Depreciation expense for the year ended December 31, 2009 and 2008 was \$86,979 and \$78,076, respectively.

Note 10 - Line of Credit:

Due to the transfer of the assets and liabilities of Episcopal Bishop California (the Corporation) to the Diocese as described in Note 16, 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; bearing interest at the prime rate (3.25%); interest payable monthly; principal due on October 2, 2010; unsecured.

**The Episcopal Church in the
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Notes to Financial Statements

Total principal payments due to Union Bank on the line of credit are \$2,110,030 at December 31, 2009. This debt is incurred by the Diocese on behalf of various parishes and missions as follows:

<i>December 31, 2009</i>	Line of Credit and Other Notes Payable	Corresponding Receivable
Missions:		
Belmont, Good Shepherd	\$ 71,862	\$ 71,862
Livermore, St. Bartholomew	4,997	4,997
Total missions	76,859	76,859
Parishes:		
Lafayette, St. Anselm's	108,616	108,616
Oakland, St. Augustine's	99,973	99,973
Orinda, St. Stephens	421,000	421,000
Pleasanton, St. Clare's	606,967	606,967
San Francisco, St. Aidan's	56,500	56,500
San Leandro, All Saints'	40,188	40,188
Berkeley, All Souls	2,608	2,608
Concord, St. Michael and All Angels	59,500	59,500
Total parishes	1,395,352	1,395,352
Total parish and missions	1,472,211	1,472,211
Other Properties:		
Berkeley Emergency Food and Housing	158,444	158,444
Bishop's Ranch	126,875	126,875
Episcopal Community Services	255,000	255,000
Ohloff House	97,500	97,500
Total other properties	637,819	637,819
Total	\$ 2,110,030	\$ 2,110,030

The Episcopal Church in the Diocese of California

Notes to Financial Statements

Note 11 - Endowment Funds:

In 2008, the Diocese implemented ASC 958-205 *Reporting 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 Diocese's endowments consist of 102 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 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 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.

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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 \$603,897 and 559,912 as of December 31, 2009 and 2008, 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.

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.

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Notes to Financial Statements

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, 2008	\$ 773,337	\$ 8,239,372	\$ 4,125,767	\$ 13,138,476
Investment Return:				
Income		401,888		401,888
Net appreciation	655,690	1,950,799		2,606,489
Total investment return	655,690	2,352,687		3,008,377
Contributions		421,549	34,155	455,704
Corp Sole Transfer	(699,675)		3,931,059	3,231,384
Reclass of restrictions	(1,333,249)	1,533,277	(200,028)	-
Appropriation of endowment assets		(1,052,987)		(1,052,987)
Endowment Net Assets, December 31, 2009	\$ (603,897)	\$ 11,493,898	\$ 7,890,953	\$ 18,780,954
Endowment Net Assets, December 31, 2007	\$ 1,333,249	\$ 12,339,250	\$ 4,087,958	\$ 17,760,457
Investment Return:				
Income		366,451		366,451
Net depreciation	(559,912)	(4,841,046)		(5,400,958)
Total investment return	(559,912)	(4,474,595)		(5,034,507)
Contributions		1,156,627	37,809	1,194,436
Appropriation of endowment assets		(781,910)		(781,910)
Endowment Net Assets, December 31, 2008	\$ 773,337	\$ 8,239,372	\$ 4,125,767	\$ 13,138,476

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Notes to Financial Statements

Note 12 - Net Assets:

Temporarily restricted net assets are restricted for specific purposes as of December 31, 2009.

	Custodial	Endowment	Deferred Gifts	Total
Support Diocese	\$ 178,908	\$ 4,368,071	\$ 421,631	\$ 4,968,610
Education		47,983	80,417	128,400
Congregational Support		1,830,978	130,761	1,961,739
Congregational Development	137,344	1,306,219		1,443,563
Social Ministry	25,117	2,161,760	41,450	2,228,327
Scholarships	110,557	1,778,887		1,889,444
	\$ 451,926	\$ 11,493,898	\$ 674,259	\$ 12,620,083

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction for the year ended December 31, 2009 and 2008.

Permanently restricted net assets are invested in perpetuity with the income available to support the programs of the Diocese as of December 31, 2009 are as follows:

	Endowment	Deferred Gifts	Total
Support Diocese	\$ 5,682,524	\$ 1,289,749	\$ 6,972,273
Education	183,863	252,584	436,447
Congregational Support	1,127,272	656,529	1,783,801
Congregational Development	318,951	17,943	336,894
Social Ministry	497,527	206,973	704,500
Scholarships	80,816		80,816
	\$ 7,890,953	\$ 2,423,778	\$ 10,314,731

Note 13 - Related Parties:

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

In 2009, the Episcopal Bishop and the Executive Council of the Diocese agreed to the transfer of all of Corporation Sole's assets and liabilities (except for real estate) from the Corporation to the Diocese (See Note 16).

The Episcopal Church in the Diocese of California

Notes to Financial Statements

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

Funds investment in the Diocese pooled endowment	\$ 3,231,386
Charitable remainder trusts for the benefit of the Bishop	140,560
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	\$ 3,371,946

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, 2009 and 2008, the balance due to the Church of Incarnation was \$59,701 and \$53,516, respectively.

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 2009 and 2008 contribution by the Diocese to the defined contribution pension plans approximated \$54,300 and \$57,810, respectively.

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 2009 and 2008, the Diocese contributed approximately \$154,517 and \$110,110, (18% of compensation), respectively, to the clergy defined benefit pension plan.

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, \$1,785,000 and \$1,415,000 were not federally insured at December 31, 2009 and 2008, 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 7, consist of notes secured by property and unsecured notes.

**The Episcopal Church in the
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Notes to Financial Statements

The Diocese bills and collects assessment revenue from the various parishes. Assessment revenues comprised 73% of all non investment revenue the Diocese received in 2009.

Note 16 - Transfer of Assets from the Episcopal Bishop of California:

The Episcopal Bishop of California, a Corporation Sole (the Corporation) is the legal owner of most of the real estate used by the Diocese and by certain parishes and other related organizations within the Diocese. The Corporation has also been the legal owner of various financial assets (and related liabilities), including its own endowment fund assets. In 2009 the Episcopal Bishop and the Executive Council of the Diocese agreed to the transfer of all of the Corporation's assets and liabilities (except for real estate) from the Corporation to the Diocese. The purpose of this transfer was to simplify the financial affairs and operations of the Diocese and the Corporation. The assets and liabilities transferred to the Diocese in December 2009 were as follows:

Cash	\$ 239,599
Investments:	
Unitrusts	140,560
Endowment	3,231,386
	<hr/>
	3,371,946
Notes Receivable	2,056,759
Equity Interest	43,949
	<hr/>
Total Assets	\$ 5,712,253
	<hr/>
Liabilities	\$ 2,078,282
	<hr/>
Net Assets (Deficit):	
Unrestricted	(564,488)
Temporarily Restricted	267,400
Permanently Restricted	3,931,059
	<hr/>
Total Net Assets	3,633,971
	<hr/>
Total Liabilities and Net Assets	\$ 5,712,253
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**The Episcopal Church in the
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Changes in Fund Asset Balance

Year Ended December 31, 2009

	Operating	Custodial and Unexpended Income	Endowment and Trust	Deferred Gifts	Total All Funds
Beginning Balance - December 31, 2008	\$ 2,045,714	\$ 1,652,211	\$ 13,138,476	\$ 2,315,331	\$ 19,151,732
Income:					
Assessment income	3,578,977				3,578,977
Gifts and grants	589,790	232,534	455,704	782,706	2,060,734
Investment income, net			401,888		401,888
Realized and unrealized gains			2,606,489		2,606,489
Expenses:					
Operating departments (exclude payments to beneficiaries and other custodial)	(4,355,532)				(4,355,532)
Interfund Transfer:					
Endowments Fund to Operating Fund	908,961		(908,961)		
Less: payments to beneficiaries	(281,850)				(281,850)
Custodial Funds to Operating Fund	1,703,685	(1,703,685)			
Less: payments to beneficiaries	(378,770)				(378,770)
Endowment Fund to Custodial Fund		144,026	(144,026)		
Related Party Transfer In:					
The Episcopal Bishop, a Corporation Sole	136,148	126,840	3,231,384		3,494,372
Ending Balance - December 31, 2009	\$ 3,947,123	\$ 451,926	\$ 18,780,954	\$ 3,098,037	\$ 26,278,040