

**FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS REPORT FOR THE
YEARS ENDED DECEMBER 31, 2017 AND 2016**

Episcopal Diocese of Texas
(An operating unit of the Protestant
Episcopal Church in the Diocese of Texas)

Financial Statements
and Independent Auditors' Report
for the years ended December 31, 2017 and 2016

Episcopal Diocese of Texas
(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

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Independent Auditors' Report

To the Council of
the Protestant Episcopal Church in the Diocese of Texas:

We have audited the accompanying financial statements of Episcopal Diocese of Texas (an operating unit of the Protestant Episcopal Church in the Diocese of Texas), which comprise the statements of financial position as of December 31, 2017 and 2016 and the related statements of activities and of cash flows for the years 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

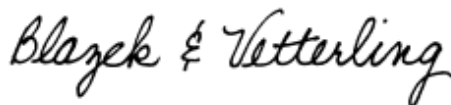
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about 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 auditors' 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 Diocese of Texas as of December 31, 2017 and 2016 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



June 20, 2018

Episcopal Diocese of Texas
(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

Statements of Financial Position as of December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash	\$ 478,776	\$ 205,323
Assessments and other receivables, net:		
Diocesan operating entities	677,583	440,875
Parishes and missions	426,922	302,657
Other	2,457	3,054
Prepaid expenses	113,141	110,059
Property, net (<i>Note 2</i>)	<u>425,120</u>	<u>340,716</u>
TOTAL ASSETS	<u>\$ 2,123,999</u>	<u>\$ 1,402,684</u>

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable and accrued expenses	\$ 300,037	\$ 335,794
Due to Diocesan operating entities	239,295	59,876
Due to related entities	215,251	
Funds held for parishes and missions	35,639	55,913
Deferred revenue	<u>132,406</u>	<u>90,158</u>
Total liabilities	<u>922,628</u>	<u>541,741</u>
Commitments (<i>Note 6</i>)		
Net assets:		
Unrestricted	798,465	789,672
Temporarily restricted (<i>Note 3</i>)	<u>402,906</u>	<u>71,271</u>
Total net assets	<u>1,201,371</u>	<u>860,943</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 2,123,999</u>	<u>\$ 1,402,684</u>

See accompanying notes to financial statements.

Episcopal Diocese of Texas
(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

Statement of Activities for the year ended December 31, 2017

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Diocesan assessments of parishes and missions	\$ 7,917,275		\$ 7,917,275
Support from Diocesan operating entities:			
Protestant Episcopal Church Council of the Dioceses of Texas	383,669		383,669
The Episcopal Health Foundation	720,721	\$ 74,182	794,903
The Bishop Quin Foundation	451,159	207,091	658,250
Episcopal Foundation of Texas	239,562	37,091	276,653
The Great Commission Foundation	256,006	55,636	311,642
Contributions		392,335	392,335
Program fees	<u>641,039</u>	<u>4,288</u>	<u>645,327</u>
Total revenue	10,609,431	770,623	11,380,054
Net assets released from restrictions:			
Program expenditures	<u>438,988</u>	<u>(438,988)</u>	
Total	<u>11,048,419</u>	<u>331,635</u>	<u>11,380,054</u>
EXPENSES:			
Diocesan clergy and lay salaries and related benefits	5,013,553		5,013,553
Diocesan programs	1,564,533		1,564,533
Outreach and service	1,788,902		1,788,902
Diocesan center operations	1,386,775		1,386,775
Administrative support for congregations	397,668		397,668
Travel, business, and continuing education	520,029		520,029
Hurricane Harvey response and recovery	<u>368,166</u>		<u>368,166</u>
Total expenses (Note 5)	<u>11,039,626</u>		<u>11,039,626</u>
CHANGES IN NET ASSETS	8,793	331,635	340,428
Net assets, beginning of year	<u>789,672</u>	<u>71,271</u>	<u>860,943</u>
Net assets, end of year	<u>\$ 798,465</u>	<u>\$ 402,906</u>	<u>\$ 1,201,371</u>

See accompanying notes to financial statements.

Episcopal Diocese of Texas
(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

Statement of Activities for the year ended December 31, 2016

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Diocesan assessments of parishes and missions	\$ 7,837,016		\$ 7,837,016
Support from Diocesan operating entities:			
Protestant Episcopal Church Council of the Dioceses of Texas	436,265		436,265
The Episcopal Health Foundation	550,580		550,580
The Bishop Quin Foundation	377,124		377,124
Episcopal Foundation of Texas	234,470		234,470
The Great Commission Foundation	247,070		247,070
Contributions		\$ 112,303	112,303
Program fees	<u>479,507</u>		<u>479,507</u>
Total revenue	10,162,032	112,303	10,274,335
Net assets released from restrictions:			
Program expenditures	<u>78,941</u>	<u>(78,941)</u>	
Total	<u>10,240,973</u>	<u>33,362</u>	<u>10,274,335</u>
EXPENSES:			
Diocesan clergy and lay salaries and related benefits	4,467,618		4,467,618
Diocesan programs	1,562,671		1,562,671
Outreach and service	1,596,627		1,596,627
Diocesan center operations	1,232,731		1,232,731
Administrative support for congregations	562,744		562,744
Travel, business, and continuing education	<u>501,366</u>		<u>501,366</u>
Total expenses (Note 5)	<u>9,923,757</u>		<u>9,923,757</u>
CHANGES IN NET ASSETS	317,216	33,362	350,578
Net assets, beginning of year	<u>472,456</u>	<u>37,909</u>	<u>510,365</u>
Net assets, end of year	<u>\$ 789,672</u>	<u>\$ 71,271</u>	<u>\$ 860,943</u>

See accompanying notes to financial statements.

Episcopal Diocese of Texas
(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

Statements of Cash Flows for the years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 340,428	\$ 350,578
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation	157,912	135,165
Provision for uncollectible accounts	11,191	79,174
Changes in operating assets and liabilities:		
Assessments and other receivables	(371,567)	(14,997)
Prepaid expenses	(3,082)	(9,931)
Accounts payable and accrued expenses	(35,757)	166,527
Due to Diocesan operating entities	179,419	36,591
Due to related entities	215,251	
Funds held for parishes and missions	(20,274)	(8,459)
Deferred revenue	42,248	38,317
Grants payable		(100,881)
Net cash provided by operating activities	<u>515,769</u>	<u>672,084</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property	<u>(242,316)</u>	<u>(177,390)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances on note payable		200,000
Payments on note payable		<u>(550,000)</u>
Net cash used by financing activities		<u>(350,000)</u>
NET CHANGE IN CASH	273,453	144,694
Cash, beginning of year	<u>205,323</u>	<u>60,629</u>
Cash, end of year	<u>\$ 478,776</u>	<u>\$ 205,323</u>

See accompanying notes to financial statements.

Episcopal Diocese of Texas

(An operating unit of the Protestant Episcopal Church in the Diocese of Texas)

Notes to Financial Statements for the years ended December 31, 2017 and 2016

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Episcopal Diocese of Texas (EDOT) is an operating unit of the Protestant Episcopal Church in the Diocese of Texas (the Diocese). EDOT was organized in 1836 in the State of Texas, and is a constituent of the Protestant Episcopal Church of the United States of America. The Diocese is an ecclesiastical territory that extends from the Louisiana border to portions of central, eastern, and southeastern Texas. The authority of the Diocese is vested in the Bishop, the Council of the Episcopal Diocese of Texas and a standing committee. EDOT carries out the ministry of the Diocese and is supported primarily through assessments from parishes within the Diocese. EDOT functions in coordination with the operations of the Protestant Episcopal Church Council in the Diocese of Texas, which guarantees its outstanding liabilities and provides Diocesan operating facilities and other support.

Related entities – The Executive Board (the Board) of the Diocese is composed of the Bishop and fifteen members elected by the Council of the Episcopal Diocese of Texas. The Board is responsible for the governance of EDOT and pursuant to various Canons, the Board has certain oversight responsibilities relating to the affairs of the following related Diocesan operating entities:

- *EDOT Financial Services Corporation (FSC)* was created to provide human resources, accounting, financial, and investment management services support to the related Diocesan operating entities, as well as administering health benefits for clergy and certain lay employees throughout the Diocese.
- *Protestant Episcopal Church Council of the Diocese of Texas (Church Corporation)* receives, holds, manages, and administers funds and properties acquired by gift or purchase for the use and benefit of the Diocese and any Diocesan institution. Additionally, it may also receive, hold, and manage funds held for the use and benefit of any parish or mission in the Diocese.
- *The Great Commission Foundation (GCF)* was created in 2013 to support missionary and church planting strategies of the Diocese.
- *Episcopal Foundation of Texas (EFT)* was created to hold and administer certain assets for the purpose of providing grants and loans for religious, educational, and charitable purposes to designated Diocesan entities.
- *The Bishop Quin Foundation (BQ)* was created in 1943 to commemorate the 25th anniversary of the consecration of the Right Reverend Clinton S. Quin as Bishop. The broad objectives of BQ include such religious, charitable, and educational activities as determined by the Bishop and the Board of Trustees to be in furtherance of the spiritual and physical welfare of the Diocese.
- *The Episcopal Health Foundation (EHF)* was created in 2013 with proceeds from the transfer of the membership of the St. Luke's Episcopal Health System to an unrelated not-for-profit entity. The focus of EHF is to promote the health and well-being of the 10 million people in the 57 counties of the Episcopal Diocese of Texas.

EDOT routinely engages in transactions with related entities that are directly or indirectly governed by the Council of the Diocese. These entities include parishes, schools, missions, and other Diocesan entities.

Basis of presentation – These financial statements include only the assets, liabilities, net assets, and activities of EDOT. The accompanying financial statements do not include the assets, liabilities, net assets, and activities of the related Diocesan operating entities, parishes, missions, or other Diocesan entities. Each of these related entities is an operating entity distinct from EDOT, maintains separate financial records, and administers its own services and programs.

Cash concentration – Bank deposits exceed the federally insured limit per depositor per institution.

Federal income tax status – The Protestant Episcopal Church in the Diocese of Texas is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code as a religious organization and is classified as a public charity under §170(b)(1)(A)(i) under the group exemption of the Protestant Episcopal Church in the United States of America.

Allowances for uncollectible accounts are provided when it is believed they may not be collected in full. The amount of bad debt expense recognized each period and the resulting adequacy of the allowance at the end of each period are determined using a specific analysis of each receivable balance. The allowance for uncollectible accounts was approximately \$105,000 at December 31, 2017 and 2016.

Property with a cost of \$500 or more and an estimated useful life of more than one year is capitalized and reported at cost, if purchased, and at fair value at the date of gift if donated. EDOT provides for depreciation using the straight-line method based upon estimated useful lives of 3 to 15 years.

Net asset classification – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Diocesan assessments of parishes and missions – In order to provide funds for its operation, the Diocese levies assessments on its parishes and missions based on size of operating revenues and certain other factors. Revenue from these assessments is recognized in the period in which the assessments are levied.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are recognized in the same manner when the conditions are substantially met.

Program fees are recognized as revenue when the services are provided. Fees paid in advance are reported as deferred revenue.

Donated materials, use of facilities and services are recognized at fair value as unrestricted contributions when an unconditional commitment is received from the donor. The related expense is recognized as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. A substantial number of volunteers have contributed significant amounts of time in connection with programs, administration and fundraising for which no amount has been recorded in the financial statements because the services did not meet the criteria for recognition under generally accepted accounting principles.

Functional allocation of expenses – During the years ended December 31, 2017 and 2016, management estimates that approximately 78% of expenses were attributable to program services and 22% were attributable to management and general activities.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent financial accounting pronouncements – In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. Under this ASU, a lessee should recognize in the statement of financial position a lease liability and a lease asset representing its right to use the underlying asset for the term of the lease for both finance and operating leases. An entity may make an accounting policy election not to recognize lease assets and lease liabilities for leases with a term of 12 months or less. Recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not changed significantly. Qualitative and quantitative disclosures are required by lessees and lessors to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The ASU is effective for fiscal periods beginning after December 15, 2019. Management has not yet determined the impact adoption of this ASU will have on the financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU are aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions*. New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. EDOT is required to adopt this ASU for fiscal year 2018. Adoption of this ASU will impact the presentation and disclosures of the financial statements.

NOTE 2 – PROPERTY

Property consists of the following:

	<u>2017</u>	<u>2016</u>
Furniture, fixtures and equipment	\$ 733,474	\$ 776,887
Vehicles	<u>244,632</u>	<u>222,200</u>
Total property, at cost	978,106	999,087
Accumulated depreciation	<u>(552,986)</u>	<u>(658,371)</u>
Property, net	<u>\$ 425,120</u>	<u>\$ 340,716</u>

NOTE 3 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2017</u>	<u>2016</u>
Natural disaster relief	\$ 185,774	\$ 8,633
General convention	170,000	
Scholarships and missions	<u>47,132</u>	<u>62,638</u>
Total temporarily restricted net assets	<u>\$ 402,906</u>	<u>\$ 71,271</u>

NOTE 4 – RETIREMENT PLANS

Clergy Plan

EDOT is a participating employer in pension plans sponsored and administered by The Church Pension Fund (the Fund). The Fund, a corporation chartered in 1914 by the Legislature of the State of New York, was established by the General Convention of the Episcopal Church. The Fund and its affiliates are official agencies of the Episcopal Church and operate under the Canons of the Episcopal Church.

The Clergy Pension Plan (the Clergy Plan) is a defined benefit plan providing retirement, death and disability benefits to eligible clergy of the Episcopal Church. The Clergy Plan (the Plan) is exempt from the federal income taxes and, as church plans are exempt from the Employee Retirement Income Security Act of 1974, the Plan is not subject to Pension Benefit Guaranty Corporation requirements.

The assets of the Plan are pooled along with other assets of the Fund solely for investment purposes for the benefit of all participants. The Fund may amend, terminate or modify the terms of the Plan, including the employer assessment rate, at any time, without notice and for any reason. Should the Plan terminate, the Fund has the authority to distribute assets in accordance with the terms of the respective Plan's documents.

All bishops, priests and deacons who are canonically resident in a domestic diocese of the Episcopal Church and who are not participating in the International Clergy Pension Plan must participate in the Clergy Plan if the cleric receives \$200 or more per month in compensation for three or more consecutive months from the same employer.

Participating employers pay assessments to the Plan on behalf of the eligible participants. Assessments for the Clergy Plan are equal to 18% of the applicable participants' compensation, which includes salaries, other cash compensation and the value of housing. Assessments fund benefits are provided by the Plan. Assessments are not held in individual accounts, but are invested in a general fund of pooled contributions for all employees participating in the Plan.

EDOT recognizes its assessments in the period that the related services are provided by the clergy. During 2017 and 2016, EDOT recognized assessments to the Plan totaling approximately \$290,000 and \$247,000, respectively.

The funding positions of the Plan as of March 31, 2017 and 2016 as reported in the Fund's latest audited financial statements are summarized below. The amount designated for assessment deficiencies represents an allocation of assets for the actuarial present value of the estimated amount to be paid out in benefits in excess of the estimated amount to be received in assessments in connection with the Plan.

	<u>2017</u>	<u>2016</u>
Net assets available for pension benefits – after amount designated for assessment deficiencies	\$ 9,287,173,000	\$ 8,300,861,000
Less: Actuarial present value of accumulated plan benefit obligations	<u>(6,502,134,000)</u>	<u>(6,715,978,000)</u>
Surplus	<u>\$ 2,785,039,000</u>	<u>\$ 1,584,883,000</u>
Funding percentage	143%	124%

Non-clergy employees

EDOT sponsors a defined contribution benefit plan for non-clergy employees, which is qualified under §403(b) of the Internal Revenue Code. EDOT makes contributions based on employees' annual compensation. EDOT contributed approximately \$270,000 and \$150,000 to this plan in 2017 and 2016, respectively.

NOTE 5 – RELATED ENTITY TRANSACTIONS

EDOT provides support to parishes, schools, missions, and other Diocesan entities. During 2017 and 2016, EDOT expended approximately \$453,000 and \$687,000 to parishes, schools, and missions, respectively. Additionally, EDOT uses Camp Allen Camp and Conference Center (Camp Allen) facilities for meetings and conferences and recognized expenses for use of those facilities totaling approximately \$365,000 and \$356,000 during 2017 and 2016, respectively. EDOT recognized expenses provided by FSC for administrative support totaling approximately \$331,000 and \$334,000 during 2017 and 2016, respectively, and for clergy health costs totaling approximately \$50,000 and \$305,000 for 2017 and 2016, respectively. EDOT paid EFT \$60,000 and \$75,000 for rent expense in 2017 and 2016, respectively. These amounts are included in expenses in these financial statements.

NOTE 6 – COMMITMENTS

Leases – EDOT leases office space and office equipment under operating leases. The office space for the Austin Diocesan offices is leased from EFT through May 31, 2029, at a rate of approximately \$60,000 per year. The office space for the Tyler Diocesan offices is leased from Church Corporation through April 30, 2026, at a rate of approximately \$22,200 per year. Future minimum lease payments are as follows:

2018	\$ 143,000
2019	131,000
2020	107,000
2021	97,000
2022	96,000
Thereafter	<u>509,000</u>
Total minimum lease payments	<u>\$ 1,083,000</u>

Rental expense for 2017 and 2016 was \$150,000 and \$131,000, respectively.

Line of Credit – EDOT has a \$1,000,000 line of credit with a bank with an interest rate of prime less 0.75% and a 3.75% floor (3.75% at December 31, 2017), expiring in October 2019. The line of credit is guaranteed by Church Corporation. There were no amounts outstanding under this agreement at December 31, 2017 or 2016.

Hurricane Disaster Conditional Grants – During December 2017, EHF, GCF, EFT and BQ conditionally committed up to \$5.5 million to EDOT for Hurricane Harvey response and recovery initiatives. As of December 31, 2017, \$204,000 has been funded and recognized as contribution revenue. It is expected that as EDOT identifies and approves claims of support for churches and schools, the conditions of the grant will be met.

NOTE 7 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through June 20, 2018, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.
