

DIOCESE OF KALAMAZOO

FINANCIAL STATEMENTS

For the Year Ended June 30, 2016

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SEBER TANS, PLC

CONSULTANTS & CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

The Most Reverend Paul J. Bradley, Bishop of Kalamazoo
Diocese of Kalamazoo

Report on the Financial Statements

We have audited the accompanying financial statements of the Diocese of Kalamazoo (a nonprofit organization) (the Diocese), which comprise the statement of financial position as of June 30, 2016, 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 error or fraud.

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 of 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 Diocese'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 Diocese of Kalamazoo as of June 30, 2016, and changes in its net assets and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Seber Tans, PLC". The signature is written in a cursive, flowing style.

Seber Tans, PLC
Kalamazoo, Michigan
February 17, 2017

Diocese of Kalamazoo
Statement of Financial Position
June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Combined Totals
ASSETS				
Current Assets				
Cash and cash equivalents	\$ 589,298	\$ 1,597,224	\$ -	\$ 2,186,522
Notes receivable	4,201	-	-	4,201
Accounts receivable	100,634	1,843,134	-	1,943,768
Total Current Assets	694,133	3,440,358	-	4,134,491
Notes receivable, less current portion	43,346	-	-	43,346
Investments				
Held at Nat'l Catholic Invest. Pool	5,461,051	-	-	5,461,051
Beneficial Interest in Foundation	1,314,100	7,836,427	195,461	9,345,988
Total Investments	6,775,151	7,836,427	195,461	14,807,039
Property and Equipment				
Land improvements	621,936	-	-	621,936
Buildings and improvements	2,321,178	-	-	2,321,178
Furnishings and equipment	662,013	-	-	662,013
	3,605,127	-	-	3,605,127
Accumulated depreciation	1,362,939	-	-	1,362,939
Net Property and Equipment	2,242,188	-	-	2,242,188
Total Assets	\$ 9,754,818	\$ 11,276,785	\$ 195,461	\$ 21,227,064
LIABILITIES AND NET ASSETS				
Liabilities				
Accounts payable	\$ 98,635	\$ -	\$ -	\$ 98,635
Accrued compensation	90,656	-	-	90,656
Custodial funds payable	448,012	-	-	448,012
Total Liabilities	637,303	-	-	637,303
Net Assets				
Unrestricted				
Undesignated	6,352,498	-	-	6,352,498
Designated for property and equipment	2,242,188	-	-	2,242,188
Other designated	522,829	-	-	522,829
Temporarily restricted	-	11,276,785	-	11,276,785
Permanently restricted	-	-	195,461	195,461
Total Net Assets	9,117,515	11,276,785	195,461	20,589,761
Total Liabilities and Net Assets	\$ 9,754,818	\$ 11,276,785	\$ 195,461	\$ 21,227,064

See Accompanying Notes to Financial Statements

Diocese of Kalamazoo
Statement of Activities
For the Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Combined Totals
Revenues and Other Support				
Bishop's Annual Appeal	\$ 42,109	\$ 3,370,361	\$ -	\$ 3,412,470
Donations and grants	1,418,721	5,567,396	4,777	6,990,894
Fees	371,607	6,620	-	378,227
Miscellaneous and reclassifications	422,437	-	-	422,437
Investment income	81,624	21,193	-	102,817
Net assets released from restrictions:				
Satisfaction of purpose restrictions and reclassifications	(245,833)	269,762	(23,929)	-
Expiration of time restrictions	3,370,362	(3,370,362)	-	-
Total Revenues and Other Support	5,461,027	5,864,970	(19,152)	11,306,845
Expenses				
Program services				
Pastoral formation	790,275	-	-	790,275
Christian formation	386,924	-	-	386,924
Family ministry	469,617	-	-	469,617
Education	469,054	-	-	469,054
Christian service	421,819	-	-	421,819
Outreach	43,022	-	-	43,022
Diocesan services and administration	1,474,307	-	-	1,474,307
Fundraising	799,300	-	-	799,300
Total Expenses	4,854,318	-	-	4,854,318
Change in Net Assets Before Other Income (Loss)	606,709	5,864,970	(19,152)	6,452,527
Other Income (loss)				
Net appreciation (depreciation) of investments	4,062	(60,203)	-	(56,141)
Change in Net Assets	610,771	5,804,767	(19,152)	6,396,386
Net assets at beginning of year	8,506,744	5,472,018	214,613	14,193,375
Net Assets at End of Year	\$ 9,117,515	\$ 11,276,785	\$ 195,461	\$ 20,589,761

Diocese of Kalamazoo
Statement of Cash Flows
For the Year Ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$ 6,396,386
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	62,523
Net depreciation of investments	56,141
Change in:	
Accounts and notes receivable	378,429
Accounts payable	(235,647)
Accrued compensation	(20,648)
Custodial payable	(227,522)
Net Cash Provided by Operating Activities	<u>6,409,662</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of investments	(90,123)
Proceeds from sale of investments, net	301,104
Transfer of investments to Foundation, net	(9,345,988)
Additions to property and equipment	(248,582)
Net Cash Used by Investing Activities	<u>(9,383,589)</u>

CASH FLOWS FROM FINANCING ACTIVITIES

Transfer of deposit and loan program assets and liabilities to Trust, net	<u>(3,457,444)</u>
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Net Change in Cash and Cash Equivalents **(6,431,371)**

Cash and cash equivalents at beginning of year 8,617,893

Cash and Cash Equivalents at End of Year **\$ 2,186,522**

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE A – Summary of Significant Accounting Policies

Organization Purpose

The Diocese of Kalamazoo (the Diocese) provides governance and administers programs and services for the Roman Catholic parishes, schools and other affiliated organizations within nine counties of Southwestern Michigan. The accompanying financial statements include only those funds over which the Diocese maintains operational control. They do not include the financial condition and results of operations of the parishes, schools, and other affiliated organizations. Under laws of the State of Michigan, all assets and liabilities of the parishes are in the name of the Bishop; however, each parish, school, or other organization is an operation distinct from the Diocese, maintains separate accounts, carries on its own services and programs, and reports annually to its respective constituency. The payments of promissory notes signed by the Bishop for the various parishes are the primary responsibility of the parishes and are not included in these financial statements.

Basis of Presentation

The financial statements of the Diocese have been prepared on the accrual basis of accounting. Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Diocese and changes therein are classified and reported as follows:

Unrestricted net assets are not subject to donor-imposed restrictions. Designated funds are unrestricted funds which have been set aside for property and equipment and future needs of the Diocese.

Temporarily restricted net assets are subject to donor-imposed restrictions that may or will be met, either by the actions of the Diocese and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently restricted net assets are subject to donor-imposed restrictions and maintained permanently by the Diocese. Generally, the donors of these assets permit the Diocese to use all or part of the income earned on any related investments for general or specific purposes.

Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of management's estimates. These estimates affect the amounts reported in the financial statements and the disclosures provided. Actual results may differ from management's estimates.

Functional Allocation of Expenses

Expenses are summarized by functional classification in the statement of activities. Such expenses are charged directly to the related functional area.

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE A – Summary of Significant Accounting Policies (Continued)

Risk

The Diocese utilizes various investment instruments, which are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in their values could occur in the near term and such changes could materially affect the amounts reported in the financial statements.

Additionally, some investments held by the Diocese are invested in the securities of foreign companies, which involve special risks and considerations not typically associated with investing in securities of U.S. companies. These risks include devaluation of currencies, and less reliable, possible adverse, political and economic developments. Moreover, securities of many foreign companies and their markets may be less liquid and their prices more volatile than those of securities of comparable U.S. companies.

Cash Equivalents

For purposes of the statement of cash flows, the Diocese considers deposit accounts, money market funds, and certificates of deposit with original maturity of three months or less to be cash equivalents.

The Diocese maintains most of its cash balances at one financial institution. The bank balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Diocese had approximately \$1,900,000 in excess of the insured limits at June 30, 2016.

Financial Instruments

The Diocese's financial instruments consist of cash balances, accounts receivable, investments, and accounts payable. The Diocese's estimates of fair value approximate their carrying amounts as of June 30, 2016.

Investments, Beneficial Interest in Foundation, and Investment Income

The Diocese has funds invested with the National Catholic Investment Pool (the Investment Pool) (formerly the Diocesan Investment Pool) and a third-party investment advisor indirectly through the Foundation. Investments made directly to the Investment Pool are reported as Investment in the accompanying financial statements. Investments made with the Foundation are reported as Beneficial Interest in Foundation in the accompanying financial statements. Investments in the Investment Pool and with the Foundation consist of cash, certificates of deposits, mutual funds, corporate bonds and government bonds.

The Michigan Catholic Conference (MCC, Inc.) is the administrator of the Investment Pool. The assets of the Investment Pool are held by the Northern Trust Company (Custodian) and are managed by independent investment managers. The Foundation assets are held by Charles Schwab, who invest the assets at the Foundation's direction. Investments are stated at fair value based on their closing value as reported on a national securities exchange.

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE A – Summary of Significant Accounting Policies (Continued)

Accounts Receivable

Accounts receivable, resulting primarily from the Bishop's Annual Appeal, represent unconditional promises to give and are due and payable within one year. No allowance for uncollectible promises has been recorded as management expects that such receivables are fully collectible at June 30, 2016. Periodically management reviews accounts receivable and may write-off uncollectible amounts.

Property and Equipment

Purchased assets are stated at cost. Donations of property and equipment are recorded at their market value on date of donation. Property and equipment are depreciated over the estimated useful lives using the straight-line method. Depreciation expense was approximately \$63,000 for the year ended June 30, 2016.

Contributions

Contributions to the Diocese are recorded as revenue when a donor makes a promise to give that is, in substance, unconditional. Contributions that are restricted by the donor are reported as temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets.

Income Taxes

In a determination letter dated March 25, 1946, and updated annually since that time, the Internal Revenue Service ruled that all organizations listed in The Official Catholic Directory are exempt from federal income taxes under Section 501(c)3 of the Internal Revenue Code. The Diocese is listed in the 2016 edition of The Official Catholic Directory and, therefore, is exempt from federal income taxes. The Diocese has evaluated relevant criteria and determined that no significant contingencies exist with regard to its tax positions.

NOTE B – Formation of Trust and Foundation

In 2016, the Diocese formed two separate and distinct entities: the Diocese of Kalamazoo Parish Deposit & Loan Fund Trust (the Trust) and the Catholic Foundation of Southwestern Michigan (the Foundation). The Trust operates a deposit and loan fund that accepts excess reserves from parishes of the Diocese and either invests the funds or loans the funds to other parishes of the Diocese for construction and renovation projects. The Foundation was formed in 2016 for the benefit of the Diocese and its parishes, schools, and other organizations. The Foundation holds funds of the participating organizations, including the Diocese, and invests these funds for the benefit of the participating organizations. In March 2016, the Diocese deposited funds with the Foundation. The funds deposited are unrestricted, restricted for specific purposes or time restricted, or endowed. These funds are subject to withdrawal restrictions and are reported in the accompanying financial statements as Beneficial Interest in Foundation.

The Trust and Foundation operations are distinct from the Diocese, maintain separate books and records, carry out their own services and programs, and report at least annually to their own boards. Therefore, the financial results of the Trust and the Foundation are not included in the accompanying financial statements.

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE B – Formation of Trust and Foundation (Continued)

Upon commencement of the Trust and the Foundation operations, the Diocese transferred certain assets and liabilities to each organization. Assets and liabilities transferred by the Diocese to the Trust and Foundation upon commencement were:

	<u>Trust</u>	<u>Foundation</u>
Cash and cash equivalents	\$ 3,457,444	\$ -
Notes and deposits receivable	6,031,203	-
Investments	11,045,925	2,244,145
Notes and deposits payable	(20,534,572)	-
	<u>\$ -</u>	<u>\$ 2,244,145</u>

During 2016, subsequent to formation of the Foundation, the Diocese transferred approximately \$7,102,000 to the Foundation

NOTE C – Investments and Beneficial Interest in Foundation

The Diocese's investments (including investments purchased, sold, and held during the year) appreciated (depreciated) in fair value for the year ended June 30, as follows:

	<u>2016</u>
Net realized gain on investments	\$ 169,348
Net unrealized loss on investments	(225,489)
	<u>\$ (56,141)</u>

As described in Note B, the Diocese formed the Foundation during 2016. The Diocese is a beneficiary organization of the Foundation and recognizes its rights to assets held by the Foundation on its behalf. The Diocese has recognized its rights to these assets by recording its beneficial interest in the Foundation assets in the accompanying financial statements. The Diocese has chosen to transfer to the Foundation assets that are restricted for specific purposes, whether temporarily or permanently, and undesignated funds. The income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the increase or decrease in temporarily restricted net assets in the accompanying financial statements.

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE D – Financial Instruments and Fair Value Measurements

As described in Note A, the Diocese's estimates of the fair value of financial assets and liabilities approximate carrying value. Financial accounting standards establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described as follows:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Diocese has the ability to access.
- Level 2 Inputs to the valuation methodology include:
- quoted prices for similar assets or liabilities in active markets;
 - quoted prices for identical or similar assets or liabilities in inactive markets;
 - inputs other than quoted prices that are observable for the asset or liability;
 - inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following table summarizes the valuation of the Diocese's financial instruments by the aforementioned pricing categories at June 30, 2016:

	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 2,437,061	\$ 2,437,061	\$ -	\$ -
Certificats of deposits	1,325,687	1,325,687		
Mututal Funds:				
Diamond Hill Large Cap Value	1,460,100	1,460,100	-	-
Wells Capital Growth	2,244,609	2,244,609	-	-
Rhumblin - International	201,810	201,810	-	-
Loomis Sayles Small/Mid Cap	537,505	537,505	-	-
Blackrock Intermediate Bond	526,246	-	526,246	-
Boyd Watterson Short Term Bond	490,759	-	490,759	-
Corporate bonds	3,643,971		3,643,971	-
Municipal bonds	1,090,881		1,090,881	-
Short-term bond fund	172,079		172,079	-
Exchange traded Funds	553,519		553,519	-
Other	122,812		122,812	-
Subtotal	<u>\$ 14,807,039</u>	<u>\$ 8,206,772</u>	<u>\$ 6,600,267</u>	<u>\$ -</u>

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE E – Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at June 30, 2016:

Undesignated, time restricted funds	\$ 5,500,000
Diocesan Services Appeal programs and services	3,370,361
Battle Creek Health Care Fund	1,414,948
Education of priests and seminarians	763,987
Needs of the poor and disadvantaged	120,198
Other	107,291
	<u>\$ 11,276,785</u>

During 2016, the Diocese received a contribution of \$6,814,000. The contribution, which was otherwise unrestricted, contained a clause requiring \$5,500,000 to be restricted from use until June 30, 2019, should any claims be made on the donor's estate.

Permanently restricted net assets totaled \$195,461 at June 30, 2016, and are restricted for investment in perpetuity, the income from which is expendable to support the education of men for the priesthood. During 2016, the Diocese reviewed its past accounting for permanently restricted assets and determined that \$23,929 recorded as permanently restricted should be reclassified to temporarily restricted net assets.

NOTE F – Retirement Plans

The Diocese participates in the Michigan Catholic Conference Lay Employees Retirement Plan (Lay Plan), a multi-employer defined benefit pension plan established for the benefit of lay employees of the Catholic dioceses, parishes, schools, and other diocesan organizations. The Lay Plan number and Employer Identification Number is 38-1971920.

The Diocese's contributions to the Lay Plan were approximately \$78,000 and \$90,000 for the years ended June 30, 2016 and 2015, respectively. The amount of contributions to the Lay Plan was 8.1 percent of wages of all covered employees. The Diocese's contributions to the Lay Plan did not represent more than 5 percent of the total contributions received by the Lay Plan.

Specific Plan information for the Diocese is not available from the Lay Plan's administrator. If the Diocese terminates its participation in the Lay Plan, the Diocese would be obligated to make a contribution to the Lay Plan in an amount equal to its proportionate share of any unfunded liability. The termination liability would be calculated by the actuaries as outlined in the Lay Plan document.

The Diocese also sponsors the Priests' Retirement Plan (Priests' Plan) through the Michigan Catholic Conference, a defined benefit pension plan established for the benefit of priests ordained or incardinated in the Diocese. The Priests' Plan number and employer identification number is 20-8419571.

The Diocese sponsors the Priests' Plan on behalf of the parishes in southwestern Michigan. The amount of contributions required during the year is allocated to the various parishes and then the parishes make their contributions directly to MCC. The Diocese's contribution allocation is insignificant and has been paid by the parishes.

Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016

NOTE F – Retirement Plans (Continued)

Specific plan information for the Diocese is not available from the Priests' Plan administrator. In the event of termination of the Priests' Plan, assets would be allocated in the following order of preference: 1) to provide for continuance of pension payments to retirees; 2) to provide for payment of pension benefits to all other priest participants based on their accrued benefits as of the termination date; and 3) to the Diocese if any assets remained. No retiree, participant, or other person has any rights or claims under the Priests' Plan in excess of the assets available to pay benefits.

The following information is based on the valuation reports of the Lay Plan and Priests' Plan as of July 1, 2015:

	Michigan Catholic Conference Lay Employees' Retirement Plan	Michigan Catholic Conference Priests' Plan
Total fair value of plan assets	\$ 1,300,435,037	\$ 5,686,214
Actuarial present value of accumulated plan benefits	1,445,713,866	5,773,703
Total contributions received by the plan during previous fiscal year	23,936,354	424,785
Funded Ratio	90.00%	98.50%

NOTE G – Self Insurance

The Diocese is self-insured for general liability, property, vehicle and other liabilities for up to one million dollars. Insurance for losses above the self-insured liability has been purchased through MCC.

The Diocese is authorized by the Michigan Department of Insurance and Financial Services to self-insure no-fault risk for its vehicles for the twelve-month certification period ending June 30, 2017. An authorized self-insurer is required to establish a fully funded loss reserve to pay claims which are anticipated in, and/or submitted for payment during, the certification period, as well as to pay claims which have been incurred and submitted before then but have not yet been paid. The loss reserve for the Diocese has been determined by a qualified actuary and is fully funded as of the commencement of the current certification period. Included in cash is approximately \$17,000 at June 30, 2016, restricted to cover the estimated loss reserve; the Diocese has recorded a corresponding liability.

NOTE H – Cash Flow Information

The Diocese did not pay any cash for interest during the year ended June 30, 2016. As shown in Note B, the Diocese formed the Trust as of January 1, 2016, and transferred assets and liabilities totaling \$20,534,572, of which \$17,077,128 of this transfer was non-cash assets.

**Diocese of Kalamazoo
Notes to Financial Statements
For the Year Ended June 30, 2016**

NOTE 1 – Subsequent Events

Management has evaluated subsequent events through February 17, 2017, the date on which the financial statements were available to be issued.