

Financial Statements and Report of
Independent Certified Public Accountants

**Archdiocese of Philadelphia -
Office for Financial Services**

June 30, 2016 and 2015

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Report of Independent Certified Public Accountants

To the Archbishop of Philadelphia
Archdiocese of Philadelphia

Report on the financial statements

We have audited the accompanying financial statements of the Archdiocese of Philadelphia - Office for Financial Services (“OFS”), which comprise the statements of financial position as of June 30, 2016 and 2015, and the related statements of activities and changes in net assets and 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.

Auditor’s 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 the 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 auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to OFS’ 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 OFS’ 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 Archdiocese of Philadelphia - Office for Financial Services as of June 30, 2016 and 2015, 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.

Emphasis of matter

We draw attention to Note A to the financial statements, which describes the legal structure of OFS within the Archdiocese of Philadelphia. Our opinion is not modified with respect to this matter.

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information contained in the combining statement of financial position and combining statement of activities and changes in net assets as of and for the year ended June 30, 2016 is presented for purposes of additional analysis, rather than to present the financial position and changes in net assets of the individual organizations, and is not a required part of the financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

A handwritten signature in black ink that reads "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Philadelphia, Pennsylvania

October 17, 2016

STATEMENTS OF FINANCIAL POSITION

June 30,

| ASSETS | 2016 | 2015 |
|--|--------------------|--------------------|
| Cash and cash equivalents | \$ 37,675,065 | \$ 20,216,802 |
| Due from Archdiocesan entities, net (Note C) | | |
| Assessments and other amounts due, less allowance for doubtful accounts of \$36,268,029 and \$36,656,629 at June 30, 2016 and 2015, respectively | 4,211,974 | 5,886,348 |
| Loans receivable, less allowance for doubtful accounts of \$9,867,986 and \$11,357,600 at June 30, 2016 and 2015, respectively | 42,455,906 | 48,239,062 |
| Notes receivable from related parties | 3,865,444 | 3,925,016 |
| Interest receivable from related parties | 755,884 | 938,299 |
| Other related party receivables | 1,049,521 | 560,929 |
| Other accounts receivable (Note D) | - | 4,003,954 |
| Prepaid expenses | 2,348,555 | 2,771,356 |
| Real estate and physical plant held for sale (Note B) | 5,491,317 | 7,538,165 |
| Investment in SEI Catholic Values Funds (Note E) | 128,267,061 | 143,262,069 |
| Beneficial interest in supporting charitable trusts (Note B) | 2,029,270 | 2,201,182 |
| Real estate and physical plant, less accumulated depreciation of \$30,436,313 and \$28,706,935 at June 30, 2016 and 2015, respectively (Note B) | 14,971,827 | 16,156,806 |
| Total assets | \$ 243,121,824 | \$ 255,699,988 |
| LIABILITIES AND NET ASSETS | | |
| Liabilities | | |
| Accounts payable | \$ 4,161,322 | \$ 4,324,840 |
| Accrued expenses and other payables (Note G) | 40,265,327 | 47,799,999 |
| Deferred revenue (Note B) | 182,908 | 7,193,962 |
| Deposits - parishes, institutions and related organizations (Note L) | 130,431,479 | 131,467,066 |
| Total liabilities | 175,041,036 | 190,785,867 |
| Net assets | | |
| Unrestricted | 29,735,530 | 25,042,292 |
| Temporarily restricted | 14,803,696 | 15,051,224 |
| Permanently restricted | 23,541,562 | 24,820,605 |
| Total net assets | 68,080,788 | 64,914,121 |
| Total liabilities and net assets | \$ 243,121,824 | \$ 255,699,988 |

The accompanying notes are an integral part of these financial statements.

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year ended June 30, 2016

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
| Revenues, gains, losses and other support | | | | |
| Parish assessments | \$ 19,165,000 | \$ - | \$ - | \$ 19,165,000 |
| Contributions from related parties (Note L) | 418,692 | - | - | 418,692 |
| Collections, bequests and donations | 1,130,016 | 384,087 | - | 1,514,103 |
| Tuition income | 45,550 | - | - | 45,550 |
| Investment income | 896,723 | 89,028 | 267,248 | 1,252,999 |
| Interest income | 1,632,478 | 73,278 | - | 1,705,756 |
| Fees for services | 3,084,193 | - | - | 3,084,193 |
| Intradiocesan income | 4,970,905 | - | - | 4,970,905 |
| Other income (Note N) | 4,738,517 | - | - | 4,738,517 |
| Archdiocesan collections | - | 10,000 | - | 10,000 |
| Net gain on sale of real estate and physical plant | 10,783,408 | - | - | 10,783,408 |
| Net assets released from restrictions (Note P) | 1,109,913 | (432,545) | (677,368) | - |
| Net realized and unrealized appreciation (depreciation) on investments and beneficial interest in supporting charitable trusts | 616,216 | (371,376) | (868,923) | (624,083) |
| Premium income from insurance programs | <u>77,212,282</u> | <u>-</u> | <u>-</u> | <u>77,212,282</u> |
| Total revenues, gains, losses and other support | 125,803,893 | (247,528) | (1,279,043) | 124,277,322 |
| Expenses | | | | |
| Subsidies | 1,064,839 | - | - | 1,064,839 |
| Salaries and wages | 10,121,301 | - | - | 10,121,301 |
| Payroll taxes and fringe benefits | 6,914,964 | - | - | 6,914,964 |
| Purchased services | 9,624,327 | - | - | 9,624,327 |
| Intradiocesan expenses | 98,526 | - | - | 98,526 |
| Support expense | 3,814,895 | - | - | 3,814,895 |
| Interparochial assistance (Note L) | 1,732,141 | - | - | 1,732,141 |
| Depreciation expense | 1,729,380 | - | - | 1,729,380 |
| Interest expense (Note L) | 1,690,939 | - | - | 1,690,939 |
| Withdrawals expense | 180,994 | - | - | 180,994 |
| Insurance program expenses | <u>76,571,924</u> | <u>-</u> | <u>-</u> | <u>76,571,924</u> |
| Total expenses | <u>113,544,230</u> | <u>-</u> | <u>-</u> | <u>113,544,230</u> |
| Change in net assets before other item | 12,259,663 | (247,528) | (1,279,043) | 10,733,092 |
| Other item | | | | |
| Non-recurring contribution to Lay Employees Retirement Plan (Note K) | <u>7,566,425</u> | <u>-</u> | <u>-</u> | <u>7,566,425</u> |
| Change in net assets | 4,693,238 | (247,528) | (1,279,043) | 3,166,667 |
| Net assets | | | | |
| Beginning of year | <u>25,042,292</u> | <u>15,051,224</u> | <u>24,820,605</u> | <u>64,914,121</u> |
| End of year | <u>\$ 29,735,530</u> | <u>\$ 14,803,696</u> | <u>\$ 23,541,562</u> | <u>\$ 68,080,788</u> |

The accompanying notes are an integral part of these financial statements.

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year ended June 30, 2015

| | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|--|----------------------|---------------------------|---------------------------|----------------------|
| Revenues, gains, losses and other support | | | | |
| Parish assessments | \$ 18,875,301 | \$ - | \$ - | \$ 18,875,301 |
| Contributions from related parties (Note L) | 380,120 | - | - | 380,120 |
| Collections, bequests and donations | 818,356 | 1,278,652 | - | 2,097,008 |
| Tuition income | 79,432 | - | - | 79,432 |
| Investment income | 191,692 | 137,473 | 394,371 | 723,536 |
| Interest income | 1,879,226 | 1,946 | - | 1,881,172 |
| Fees for services | 2,470,060 | - | - | 2,470,060 |
| Intradiocesan income | 6,190,250 | - | - | 6,190,250 |
| Other income (loss) (Note N) | 5,089,581 | (2,290) | - | 5,087,291 |
| Archdiocesan collections | - | 20,000 | - | 20,000 |
| Net gain on sale of real estate and physical plant | 881,603 | - | - | 881,603 |
| Net assets released from restrictions and other reclassifications (Note P) | 658,527 | (3,465,455) | 2,806,928 | - |
| Net realized and unrealized (depreciation) appreciation on investments and beneficial interest in supporting charitable trusts | (343,826) | (76,195) | 28,439 | (391,582) |
| Premium income from insurance programs | 85,826,278 | - | - | 85,826,278 |
| | <u>122,996,600</u> | <u>(2,105,869)</u> | <u>3,229,738</u> | <u>124,120,469</u> |
| Total revenues, gains, losses and other support | | | | |
| Expenses | | | | |
| Subsidies | 431,241 | - | - | 431,241 |
| Salaries and wages | 9,806,553 | - | - | 9,806,553 |
| Payroll taxes and fringe benefits | 7,497,336 | - | - | 7,497,336 |
| Purchased services | 10,257,635 | - | - | 10,257,635 |
| Intradiocesan expenses | 361,144 | - | - | 361,144 |
| Support expense | 4,193,231 | - | - | 4,193,231 |
| Interparochial assistance (Note L) | 1,452,165 | - | - | 1,452,165 |
| Depreciation expense | 1,591,148 | - | - | 1,591,148 |
| Interest expense (Note L) | 1,599,636 | - | - | 1,599,636 |
| Withdrawals expense | 42,776 | - | - | 42,776 |
| Insurance program expenses | 72,445,539 | - | - | 72,445,539 |
| | <u>109,678,404</u> | <u>-</u> | <u>-</u> | <u>109,678,404</u> |
| Total expenses | | | | |
| Change in net assets before other item | 13,318,196 | (2,105,869) | 3,229,738 | 14,442,065 |
| Other item | | | | |
| Contribution from related party (Note B) | 28,900,000 | - | - | 28,900,000 |
| Change in net assets | 42,218,196 | (2,105,869) | 3,229,738 | 43,342,065 |
| Net assets (deficit) | | | | |
| Beginning of year | (17,175,904) | 17,157,093 | 21,590,867 | 21,572,056 |
| End of year | <u>\$ 25,042,292</u> | <u>\$ 15,051,224</u> | <u>\$ 24,820,605</u> | <u>\$ 64,914,121</u> |

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

Year ended June 30,

| | <u>2016</u> | <u>2015</u> |
|---|----------------------|----------------------|
| Cash flows from operating activities | | |
| Change in net assets | \$ 3,166,667 | \$ 43,342,065 |
| Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities: | | |
| Net gain on sale of real estate and physical plant | (10,783,408) | (881,603) |
| Depreciation expense | 1,729,380 | 1,591,148 |
| Bad debt recovery | (1,660,936) | (2,603,232) |
| Net unrealized loss on investments | 226,484 | 4,397,544 |
| Net realized loss (gain) on investments | 175,190 | (4,272,876) |
| Net depreciation in beneficial interest in supporting charitable trusts | 171,912 | 91,436 |
| Changes in assets and liabilities | | |
| Due from Archdiocesan entities | 5,630,130 | (791,710) |
| Prepaid expenses | 422,800 | (416,834) |
| Accounts payable | (163,518) | (1,953,715) |
| Accrued expenses and other payables | (5,530,553) | (9,695,270) |
| Deferred revenue | <u>(11,054)</u> | <u>7,128,594</u> |
| Net cash (used in) provided by operating activities | <u>(6,626,906)</u> | <u>35,935,547</u> |
| Cash flows from investing activities | | |
| Capital expenditures | (544,401) | (195,630) |
| Proceeds from sales of real estate and physical plant | 3,826,138 | 977,403 |
| Purchase of investments | (13,583,401) | (142,321,118) |
| Proceeds from sale of investments | 28,176,734 | 41,052,197 |
| Payments received on note receivable from Office of Catholic Education | 59,572 | 57,247 |
| Loans made to parishes | (21,654) | (115,000) |
| Repayment of loans by parishes | <u>7,207,767</u> | <u>5,902,662</u> |
| Net cash provided by (used in) investing activities | <u>25,120,755</u> | <u>(94,642,239)</u> |
| Cash flows from financing activities | | |
| Change in deposits - parishes, institutions and related organizations | <u>(1,035,586)</u> | <u>10,430,360</u> |
| Net cash (used in) provided by financing activities | <u>(1,035,586)</u> | <u>10,430,360</u> |
| Net increase (decrease) in cash and cash equivalents | 17,458,263 | (48,276,332) |
| Cash and cash equivalents | | |
| Beginning of year | <u>20,216,802</u> | <u>68,493,134</u> |
| End of year | <u>\$ 37,675,065</u> | <u>\$ 20,216,802</u> |

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

NOTE A - ORGANIZATION

The Archdiocese of Philadelphia (the “Archdiocese”) was proclaimed a Catholic diocese in 1808 and raised to an Archdiocese in 1875. The Archdiocese oversees the activities of the Roman Catholic Church (the “Church”) for the five counties of Philadelphia, Bucks, Chester, Delaware and Montgomery in the southeastern part of the Commonwealth of Pennsylvania and is operated in accordance with the provisions of the 1983 Code of Canon Law, as amended, of the Church. The Archdiocese of Philadelphia - Office for Financial Services (“OFS”) provides programs and services to the parishes, schools and other related ecclesiastical entities in the territory of the Archdiocese. OFS is considered to be a component of the Archdiocese of Philadelphia and not a separate legal entity.

The accompanying financial statements include the following funds which operate under the auspices of OFS:

General Fund - Includes the accounts of separate ministry departments of the Archdiocese. The fund also includes all of the OFS unrestricted and donor-restricted resources available for support of the Archdiocesan operations including:

- Resources invested in plant facilities (land, property and equipment).
- Interparochial Cooperation Commission (“IPCC”) to provide support for the benefit of financially struggling parishes.
- Assisted living support for retired priests residing in the Villa St. Joseph and Regina Coeli residences.

Custodian Fund - Includes funds received, via special collections, and held by the Archdiocese for the beneficiaries of those special collections. All collected funds received are remitted to the beneficiary or used solely to support the individual mandate of the specific special collection. OFS does not have variance power as it relates to these funds and as such records a related payable at the time of receipt.

Archdiocese of Philadelphia Risk Insurance Trust (“Risk Insurance Trust”) - Represents the risk management program of the Archdiocese, including property, general liability, workers’ compensation and auto insurance policies covering substantially all participating Archdiocesan entities, as well as the management and administration of the program and all related claims.

Archdiocese of Philadelphia Welfare Benefits Trust (“Welfare Benefits Trust”) - Represents the medical benefits program of the Archdiocese, including health, dental prescription and vision insurance coverages for substantially all participating Archdiocesan entities, as well as the management and administration of the program.

Archdiocese of Philadelphia Deposit and Loan Program Trust Fund (“Deposit and Loan Program Trust”) - Represents a cooperative deposit and lending program established primarily for the benefit of the parishes and other Archdiocesan entities. This trust replaced the existing Trust and Loan Fund as of September 1, 2014, at which time the assets and liabilities of the Trust and Loan Fund were assigned to and assumed by the Deposit and Loan Program Trust.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE A - ORGANIZATION - Continued

The accompanying financial statements do not include the assets, liabilities or activities of the more than 200 parishes located in the territory of the Archdiocese, except for parish deposits maintained in the Deposit and Loan Program Trust and other receivables set forth in the accompanying financial statements. The parishes are separate canonical operating entities distinct from the offices and funds included herein. The parishes maintain separate accounts and their respective assets in their own names, and carry out their own programs. Other ecclesiastical entities and organizations, which are related to, but operated separately and distinctly from OFS, are also not included in the accompanying financial statements.

The excluded financial reporting entities include, but are not limited to, the following:

- Archdiocese of Philadelphia Office of Catholic Education - Diocesan High Schools (“OCE”)
- Archdiocese of Philadelphia Office of Catholic Education - Administration Account (“OCE”)
- Archdiocese of Philadelphia Office of Catholic Education - Schools of Special Education (“SPED”)
- The Philadelphia Theological Seminary of St. Charles Borromeo (a Pennsylvania civil corporation; a.k.a. St. Charles Borromeo Seminary)
- Catholic Health Care Services of the Archdiocese of Philadelphia (a Pennsylvania civil corporation; “CHCS”)
- Catholic Social Services (a Pennsylvania civil corporation) and affiliated nonprofit organizations
- Catholic Charities of the Archdiocese of Philadelphia (a Pennsylvania civil corporation; a.k.a. Catholic Charities Appeal of the Archdiocese of Philadelphia)
- Heritage of Faith - Vision of Hope (a Pennsylvania civil corporation; “HOF~VOH”)
- The Archdiocese of Philadelphia Catholic Cemeteries Office (“Cemeteries Office”)
- The Archdiocese of Philadelphia - Philadelphia Catholic Cemeteries LLC
- Archdiocese of Philadelphia Cemetery Permanent Lot Care Fund Irrevocable Trust
- World Meeting of Families - Philadelphia

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

2. Financial Statement Presentation

Information regarding the financial position and activities of OFS is reported according to three classes of net assets based on the existence or absence of donor-imposed restrictions as follows: unrestricted, temporarily restricted and permanently restricted net assets.

Unrestricted net assets are free of donor-imposed restrictions.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Temporarily restricted net assets include gifts, pledges, trusts, remainder interests, income and appreciation, for which donor imposed restrictions have not been met. Such restrictions include purpose restrictions where donors have specified the purpose for which the net assets are to be spent, and/or time restrictions imposed by donors or implied by the nature of the gift.

Permanently restricted net assets include gifts, pledges, trusts, and remainder interests, which require by donor restriction that the corpus be invested in perpetuity and only the income be made available for operations in accordance with donor restrictions.

3. Cash and Cash Equivalents

OFS considers all unrestricted highly liquid investments with an original maturity of three months or less, and which are not held as components of its respective investment portfolio, to be cash equivalents. At June 30, 2016, OFS has cash balances on deposit with financial institutions that exceeded the balance insured by the Federal Deposit Insurance Corporation ("FDIC") of \$250,000. OFS has not experienced any losses in such accounts and does not believe it is subject to significant credit risk.

4. Due from/to Archdiocesan Entities

Assessments and other amounts due:

The balance includes outstanding amounts due from Archdiocesan entities (parishes and other related ecclesiastical entities) related to:

- **Parish Assessments:** An assessment is levied on parishes and certain other Archdiocesan entities to: fund the work of the Archbishop and the operations and support functions of the pastoral center; subsidize the IPCC parishes; and maintain the apostolic ministries and programs shared by the whole local Church.
- **Risk Insurance:** Risk insurance billings for property, general liability, workers' compensation, and auto and disability insurance coverage provided to parishes and other Archdiocesan entities by the Risk Insurance Trust.
- **Medical Benefits:** Billings for health, dental, prescription and vision provided to parishes and other Archdiocesan entities by the Welfare Benefits Trust.

Loans Receivable:

Loans are made to parishes and other Archdiocesan entities through the Deposit and Loan Program Trust. Loans are due in varying amounts over terms not more than 25 years. The loans to parishes bear interest using the simple interest rate method on principal amounts outstanding. Except in arrangements which have been specifically negotiated, at both June 30, 2016 and 2015, the variable interest rate on outstanding loans is 4.5%.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Notes Receivable from Related Parties:

The notes receivable balance is comprised of notes due from OCE and St. John Neumann Place, L.P., (“SJNPLP”). The note due from OCE relates to funds loaned by OFS in connection with the payoff of the Series 2001 and 2008 Revenue Bonds in June 2012. The OCE note was restructured in June 2014. The note due from SJNPLP represents a second mortgage due to OFS for property acquired by SJNPLP, used to create affordable housing which qualifies for federal low-income housing tax credits. The 30-year mortgage bears interest at 6.25% compounded annually through December 2036.

Interest Receivable from Related Parties:

The interest receivable balance consists of interest accrued on notes receivable, as well as loans receivable due from parishes and other Archdiocesan entities as part of the Deposit and Loan Program Trust.

Other Related Party Receivables:

Other related party receivables consist of amounts due to OFS from parishes and other related ecclesiastical entities for inter-diocesan charges due for rent, utilities and various other items that have been paid by OFS on behalf of a separate Archdiocesan entity.

5. Allowance for Doubtful Accounts

OFS provides for an allowance for doubtful accounts when information available indicates that it is probable that a receivable has been impaired. The allowance for doubtful accounts is provided based upon management’s judgments including such factors as prior collection history, economic condition of the counterparty and type of receivable. The amount of expected impairment is based on management’s best estimate.

6. Prepaid Expenses

The Risk Insurance Trust pays the risk insurance premiums for coverage obtained on behalf of parishes and other Archdiocesan entities at the beginning of the respective policy periods. This cost is amortized over the respective policy period.

7. Investments

On April 30, 2015, various funds previously held in the Non-Pension Asset Portfolio (“NPAP”) were liquidated and re-invested with a newly hired investment company, SEI, a provider of institutional asset management services. SEI created two publicly traded Catholic Values mutual funds: the Catholic Values Equity Fund and the Catholic Values Fixed Income Fund (“Catholic Values Funds”), which provide Catholic institutions with high quality investment products that align with their core values, without sacrificing diversification or return potential. Specifically, the Catholic Values Funds align with the investment directives set forth by the United States Conference of Catholic Bishops (“USCCB”). The Archdiocese appointed SEI Private Trust Company to act as custodian (the “Custodian”) of the investments, which consist of certain cash and securities and are more fully described in Notes E and F. Investment allocation decisions are the responsibility of the applicable Archdiocesan entity’s board or finance council.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investments are reported at fair value. Realized gains and losses are reported to the participating entities monthly. Gains and losses realized by the participating entities as a result of sales are recorded in their specific accounts. Unrealized gains and losses are included in the statement of activities and changes in net assets as net appreciation or depreciation in the fair value of investments.

8. Charitable Gift Annuities

The Archdiocese is responsible for processing the annuity payments for charitable gift annuities. These assets are included in the investments in the Catholic Values Funds described above at June 30, 2016 and 2015. Periodic annuity payments are made to the donor or their beneficiaries until death. Upon receipt of the assets, a liability is recorded at the present value of the estimated future payments to be distributed over the donor's and/or other beneficiaries' expected life, based on the GAM-2000 Mortality Tables and discount rates set when the annuity agreement is established, which range between 3.08% and 6.17%. The liability at June 30, 2016 and 2015 was \$390,263 and \$432,562, respectively, and is classified in accrued expenses and other payables on the statements of financial position.

9. Beneficial Interest in Supporting Charitable Trusts

The Archdiocese is the sole beneficiary of the income of individual trusts established by Anthony P. Falcone, held in perpetuity by a third party, and William P. Mulvihill, also held in perpetuity by a third party. The supporting charitable trusts require the income to be paid to the Archdiocese. The beneficial interest in the supporting charitable trusts is recorded at the fair value of the assets. At June 30, 2016 and 2015, the allocable fair value of the net assets of the trusts was as follows:

| | <u>2016</u> | <u>2015</u> |
|----------------------|---------------------|---------------------|
| Anthony P. Falcone | \$ 1,195,017 | \$ 1,291,382 |
| William P. Mulvihill | <u>834,253</u> | <u>909,800</u> |
| | <u>\$ 2,029,270</u> | <u>\$ 2,201,182</u> |

The underlying investments of the beneficial interest in the supporting charitable trusts consist of government obligations, corporate obligations, mutual funds and equity securities. OFS receives statements from each of the trustees, which detail the fair value of each investment in the supporting charitable trusts.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

10. Real Estate and Physical Plant

Land, buildings, building improvements and equipment are capitalized at cost, or their fair market value if donated. Depreciation for fixed assets is computed on a straight-line basis over the estimated useful lives, which are as follows:

| | |
|-----------------------|---------------|
| Buildings | 30 years |
| Building improvements | 15 - 20 years |
| Equipment | 3 - 15 years |

The legal title of certain real estate and improvements is held in the name of the Archdiocese in trust for the exclusive benefit and charitable use of parishes or related ecclesiastical entities within the territory of the Archdiocese. The Archdiocese has legal title, but does not have any proprietary, equitable or beneficial interest in any such real property and improvements. Each parish or related ecclesiastical entity is a separate juridical person and is the owner and holder of the proprietary, beneficial and equitable interest in its personal and real property and related improvements which, in all events, is subject to the provisions of canon law. Accordingly, such real property and improvements and any other assets and associated liabilities of the parishes within the territory of the Archdiocese are not included in the accompanying financial statements. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the expected future cash flows from the use of the asset and its eventual disposition are less than the carrying amount of the asset, an impairment loss is recognized and measured using the asset's fair value. No impairment losses were recognized for the years ended June 30, 2016 and 2015.

Real estate and physical plant and accumulated depreciation at June 30, 2016 and 2015 consist of:

| | <u>2016</u> | <u>2015</u> |
|-------------------------------------|----------------------|----------------------|
| Land | \$ 1,058,767 | \$ 977,538 |
| Buildings | 34,804,848 | 34,940,680 |
| Building improvements | 7,119,055 | 6,796,765 |
| Equipment | 2,237,723 | 2,148,758 |
| Construction on progress | <u>187,747</u> | <u>-</u> |
| | 45,408,140 | 44,863,741 |
| Accumulated depreciation | <u>(30,436,313)</u> | <u>(28,706,935)</u> |
| Real estate and physical plant, net | <u>\$ 14,971,827</u> | <u>\$ 16,156,806</u> |

Depreciation expense of \$1,729,380 and \$1,591,148 was incurred for the years ended June 30, 2016 and 2015, respectively.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

11. Real Estate and Physical Plant Held for Sale

OFS has certain buildings and properties no longer in use which are being marketed for sale as of June 30, 2016 and 2015. The carrying value of assets held for sale previously classified under real estate and physical plant, net, consists of the following at June 30, 2016 and 2015:

| | <u>2016</u> | <u>2015</u> |
|--|---------------------|---------------------|
| Land | \$ 1,724,484 | \$ 1,724,484 |
| Building | <u>3,766,833</u> | <u>5,813,681</u> |
| Real estate and physical plant held for sale | <u>\$ 5,491,317</u> | <u>\$ 7,538,165</u> |

12. Conditional Asset Retirement Obligation

OFS has recognized the cost associated with the eventual remediation and abatement of asbestos and other regulated substances located within the construction of OFS' real estate and physical plant. The estimated cost of the abatement was determined by a third-party firm that conducted a survey for asbestos identification and prepared contractor estimates for the cost of potential remediation consistent with management's future remediation plans. As of June 30, 2016 and 2015, the conditional asset retirement liability is \$310,042 and \$2,302,237, respectively. Included in the balance at June 30, 2016 and 2015 is \$11,925 and \$11,466, respectively, for the accretion of interest and \$-0- of new liabilities related to conditional asset retirement obligations recognized during each of the years ended June 30, 2016 and 2015. During the year ended June 30, 2016, the Mary Immaculate Center was sold, resulting in the recovery of unamortized accretion of \$2,004,119, which is included in the gain on sale of real estate.

OFS considers a conditional asset retirement an obligation that includes a legal obligation associated with the retirement of a tangible long-lived asset in which the timing and/or method of settling the obligation is conditional on a future event that may or may not be within the control of OFS. Recognition of a liability is required for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated, even if conditional on a future event. The Archdiocese records the fair value of a liability for a legal obligation associated with an asset retirement in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized.

13. Self-Insurance Reserves

Risk Insurance Trust

The statements of financial position include liabilities with respect to self-insured workers' compensation, general liability, property liability and auto liability claims as of June 30, 2016 and 2015. These obligations represent an estimate of the expected ultimate cost for these claims, less amounts paid to date. The Risk Insurance Trust estimates the required reserves for such claims on a non-discounted basis utilizing an actuarial method that is based upon various assumptions which include, but are not limited to, historical loss experience and projected loss

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

development factors. The required liability is also subject to adjustment in the future based upon the changes in claims experience, including changes in the number of incidents and changes in the ultimate cost per incidents. Actual amounts ultimately paid could differ from these estimates. Self-insurance reserves are included in the accrued expenses and other payables caption on the statements of financial position.

Welfare Benefits Trust

The statements of financial position include self-insurance liabilities with respect to the medical insurance program as of June 30, 2016 and 2015. These obligations represent an estimate of the expected ultimate cost for claims incurred but not paid ("IBNP"). The Welfare Benefits Trust estimates the required reserves for such claims on a non-discounted basis utilizing a Development Method which assumes that the progression of claim payment follows runoff patterns that are assumed to remain stable over time. The results, produced by the Development Method, were adjusted for months where the data were deemed noncredible. These adjustments were made using the Projection Method which is based on the change in costs per exposure unit over time. The medical estimate is based on historical incurred and paid claims data for the 48-month period ended June 30, 2016 and 2015. Self-insurance reserves are included in the accrued expenses and other payables caption on the statements of financial position.

14. Deferred Revenue

OFS had received deposits on certain properties under agreement of sale as of June 30, 2015. Deferred revenue associated with these properties totaled \$- and \$7,001,305 at June 30, 2016 and 2015, respectively. All sales transactions related to these deposits either were closed during the year ended June 30, 2016 or the deposits were earned in accordance with the provisions of the agreement of sale and the gains on the properties were recorded in the financial statements. Other deferred revenue totaled \$182,908 and \$192,657 at June 30, 2016 and 2015, respectively.

15. Revenue, Gains, Losses and Other Support

Parish Assessments

Parishes within the territory of the Archdiocese are assessed a fee to help support the mission of the Church in Philadelphia and the four surrounding counties as permitted by canon law. The annual parish assessment for the year ended June 30, 2016 is based upon 10.5% of the parish operating income for the fiscal year ended June 30, 2014. The annual parish assessment for the fiscal year ended June 30, 2015 is based upon 10.5% of the parish operating income for the year ended June 30, 2013. Operating income includes Sunday collections, other parish collections, church socials and donations, interest, dividends, rental income and net cemetery income.

Pledges/Contributions

Unconditional promises to give (i.e., pledges) are recorded as receivables and revenues at fair value at the date the promise is received within the appropriate net asset category. Donor-restricted gifts that are received and either spent or deemed spent within the same year are reported as unrestricted revenues. Gifts of long-lived assets received without donor restrictions are reported at fair value as unrestricted revenue. Gifts specified for the acquisition or construction of long-lived assets are reported as unrestricted net assets when the assets are placed in service.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Classification of Gifts

OFS reports gifts of cash and other assets as restricted revenue if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities and changes in net assets as net assets released from restrictions.

Premium Income from Archdiocesan Insurance Program

The Risk Insurance Trust acts on behalf of participating Archdiocesan entities and parishes to procure adequate insurance coverage. The costs of the premiums and related expenses are billed to the participating entities. Unpaid insurance billings are included in amounts due from Archdiocesan entities.

16. Income Tax Status

The Archdiocese is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code through its inclusion in the USCCB group ruling and listing in the Official Catholic Directory.

The Archdiocese follows the accounting guidance for uncertainties in income tax positions which requires that a tax position be recognized or not recognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. The Archdiocese does not believe its financial statements include any material uncertain tax positions. Any interest and penalties, if applicable, would be recorded in support expenses. The Archdiocese is no longer subject to U.S. federal and state tax examinations for years prior to the year ended June 30, 2013.

17. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

18. Liquidity

Management believes that the existing liquidity position is adequate to meet current needs. To address long-term liquidity needs, management has taken steps to reduce OFS operating costs. Further actions, including asset sales, have been and will continue to be undertaken to further strengthen liquidity and the statement of financial position.

19. Reclassifications

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements. The reclassifications had no impact on total assets, total liabilities, total net assets or change in net assets.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

20. Contribution from Related Party

On November 3, 2014, Center Management Group LLC (“CMG”) of Flushing, New York acquired the operating assets and real property of the following CHCS facilities: St. Monica Manor, St. John Neumann Nursing Home, Immaculate Mary Home, St. Francis Country House, St. Martha Nursing Home, Villa St. Martha and St. Mary Manor. The purchase price paid by CMG was \$145 million. Subsequent to the closing of the transaction, the proceeds were allocated as follows:

| | |
|---|---------------------------|
| <u>Purchase price</u> | \$ 145,000,000 |
| Closing costs | (5,505,429) |
| Payoff CHCS external debt | (8,271,691) |
| Amounts retained by CHCS to satisfy working capital obligations and other items | <u>(25,622,880)</u> |
| Proceeds transferred from CHCS | \$ <u>105,600,000</u> |
| <u>Proceeds transferred to Archdiocesan entities via OFS</u> | |
| Distributions to CHCS and Catholic Social Services for ongoing ministry support | \$ 8,500,000 |
| Distributions to certain parishes for ongoing ministry support | 5,700,000 |
| Distribution to priests’ retirement plans | <u>62,500,000</u> |
| | <u>76,700,000</u> |
| <u>Proceeds transferred to OFS</u> | |
| Distribution to Risk Insurance Trust | 19,600,000 |
| Distribution to OFS | <u>9,300,000</u> |
| | <u>28,900,000</u> |
| Proceeds transferred from CHCS | \$ <u>105,600,000</u> |

21. New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers*, to improve financial reporting by creating common revenue recognition guidance. The core principle of this guidance is that an entity should recognize revenue in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods and services at the date the performance obligation has occurred. ASU 2014-09 is effective for periods beginning after December 15, 2017. An entity will apply this update using either a full retrospective application, which applies the standard to each prior period presented, or under the modified retrospective application, in which an entity recognizes the cumulative effect of initially applying the new standard as an adjustment to the opening statement of financial position at the date of initial application. OFS has not determined the impact of ASU 2014-09 at this time.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

In August 2016, the FASB issued a new standard related to the presentation of financial statements of not-for-profit entities. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the currently required three classes, as well as the annual change in each of the two classes; (2) the removal of the requirement to present or disclose the indirect method (reconciliation) when using the direct method for the statement of cash flows; and (3) the requirement to provide various enhanced disclosures relating to various not-for-profit specific topics. The new standard is effective for annual financial statements beginning after December 15, 2017. OFS has not determined the impact of the new standard at this time.

NOTE C - DUE FROM ARCHDIOCESAN ENTITIES, NET

A summary of the various receivable balances held by OFS due from Archdiocesan entities at June 30, 2016 and 2015 is presented as follows:

(a) Assessments and other amounts due:

| | <u>2016</u> | <u>2015</u> |
|---|---------------------|---------------------|
| Assessments due from parishes | \$ 18,411,148 | \$ 20,484,400 |
| Risk and medical insurance premiums due from Archdiocesan entities and parishes | 22,017,655 | 21,859,771 |
| Miscellaneous receivables | <u>51,200</u> | <u>198,806</u> |
| | 40,480,003 | 42,542,977 |
| Allowance for doubtful accounts | <u>(36,268,029)</u> | <u>(36,656,629)</u> |
| Assessments and other amounts due, less allowance for doubtful accounts | <u>\$ 4,211,974</u> | <u>\$ 5,886,348</u> |

(b) Loans receivable:

The Archdiocese maintains a centralized lending program through its Deposit and Loan Program Trust. The loans receivable consist of loans made by the Deposit and Loan Program Trust to parishes and other Archdiocesan entities (see Note B). The amount due from parishes and other Archdiocesan entities at June 30, 2016 and 2015 is as follows:

| | <u>2016</u> | <u>2015</u> |
|--|----------------------|----------------------|
| Loans receivable, principally due from parishes and OCE | \$ 52,323,892 | \$ 59,596,662 |
| Less: allowance for doubtful accounts | <u>(9,867,986)</u> | <u>(11,357,600)</u> |
| Loans receivable, net of allowance for doubtful accounts | <u>\$ 42,455,906</u> | <u>\$ 48,239,062</u> |

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE C - DUE FROM ARCHDIOCESAN ENTITIES, NET

Credit quality of loans receivable:

OFS receives loan requests from parishes and other Archdiocesan entities. These loans, when approved, are made through the Deposit and Loan Program Trust. All loan requests are subject to a due diligence review of the requesting parish's ability to support future loan payments. This review is performed by the Office for Parish Service and Support. Upon completion of this due diligence, the loan request is presented to the College of Counselors, for approval.

Allowances for doubtful accounts are established for all loans to parishes and other Archdiocesan entities based upon prior collection experience and current factors specific to each entity that, in management's opinion, may influence the entities' ability to repay the loan. All loan balances deemed to be impaired are adjusted to the net realizable value at the time this determination is established.

| | <u>2016</u> | <u>2015</u> |
|--|----------------------|----------------------|
| Gross loans receivable | \$ 52,323,892 | \$ 59,596,662 |
| Less: allowance for doubtful accounts: | | |
| Beginning of year | (11,357,600) | (13,236,696) |
| Decreases to allowance | <u>1,489,614</u> | <u>1,879,096</u> |
| End of year | <u>(9,867,986)</u> | <u>(11,357,600)</u> |
| Loans receivable, net | <u>\$ 42,455,906</u> | <u>\$ 48,239,062</u> |

(c) Notes receivable from related parties:

| | <u>2016</u> | <u>2015</u> |
|--|---------------------|---------------------|
| Note receivable due from OCE | \$ 2,770,444 | \$ 2,830,016 |
| SJNPLP, bears interest at 6.25%, due in 2036 | <u>2,860,000</u> | <u>2,860,000</u> |
| | 5,630,444 | 5,690,016 |
| Allowance for doubtful accounts | <u>(1,765,000)</u> | <u>(1,765,000)</u> |
| Notes receivable from related parties, net of allowance for doubtful accounts | <u>\$ 3,865,444</u> | <u>\$ 3,925,016</u> |

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE C - DUE FROM ARCHDIOCESAN ENTITIES, NET - Continued

Note receivable due from OCE

In June 2012, OCE entered into a term note agreement totaling \$3,000,000 with OFS. The term note carries a fixed interest rate of 4% per annum and is amortized over 30 years commencing on June 1, 2012. In June 2014, the term note agreement was amended to extend the maturity date until June 1, 2042.

The future principal payments relating to the note receivable outstanding at June 30, 2016 are as follows:

| | |
|------------|---------------------|
| 2017 | \$ 61,991 |
| 2018 | 64,508 |
| 2019 | 67,125 |
| 2020 | 69,853 |
| 2021 | 72,689 |
| Thereafter | <u>2,434,278</u> |
| Total | <u>\$ 2,770,444</u> |

On May 31, 2012, the Archdiocese of Philadelphia created a promissory note to the Deposit and Loan Program Trust of the Archdiocese. On May 20, 2013, the promissory note was amended to increase the note to \$82,000,000. The balance of this promissory note at June 30, 2016 and 2015 was \$43,532,482 and \$44,950,000, respectively. The promissory note is collateralized by specific pledged real estate assets as documented in the May 31, 2012 promissory note, as amended. As pledged assets are sold or monetized, net proceeds from the transactions will be used to fulfill the obligation acknowledged via the promissory note. If a transaction for any of the pledged properties results in net proceeds in excess of \$20 million, the Archdiocese has discretion to use the excess for another purpose so long as the value for remaining pledged properties is at least equal to the remaining obligation.

During the year ended June 30, 2016, the Archdiocese used \$1,417,518 from proceeds received on the sale of pledged properties to further pay down this promissory note. The promissory note is recorded as an asset and liability on the financial statements of the Deposit and Loan Program Trust and General Fund, respectively, and is eliminated within the OFS statements of financial position at June 30, 2016 and 2015.

(d) Interest receivable from related parties:

| | <u>2016</u> | <u>2015</u> |
|---|--------------------|--------------------|
| Note receivable from SJNPLP | \$ 2,253,210 | \$ 1,959,653 |
| Deposit and Loan Program Trust | <u>1,805,386</u> | <u>1,890,989</u> |
| | 4,058,596 | 3,850,642 |
| Allowance for doubtful accounts | <u>(3,302,712)</u> | <u>(2,912,343)</u> |
| Interest receivable from related parties, net of allowance for doubtful accounts | <u>\$ 755,884</u> | <u>\$ 938,299</u> |

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE C - DUE FROM ARCHDIOCESAN ENTITIES, NET - Continued

(e) Other related party receivables:

OFS maintains receivable balances due from other related Archdiocesan entities. The balance of other related party receivables at June 30, 2016 and 2015 is comprised of:

| | <u>2016</u> | <u>2015</u> |
|--|---------------------|-------------------|
| Archdiocesan payroll receivable | \$ 470,011 | \$ - |
| Intradiocesan charges for utilities and other items, net | 234,516 | 159,776 |
| Other | <u>344,994</u> | <u>401,153</u> |
| Total other related party receivables | <u>\$ 1,049,521</u> | <u>\$ 560,929</u> |

NOTE D - OTHER ACCOUNTS RECEIVABLE

OFS maintains receivable balances due from parties unrelated to the Archdiocesan entities. The balance of other accounts receivable at June 30, 2015 is comprised of:

| | <u>2015</u> |
|--|---------------------|
| Insurance reimbursement receivable for paid claims/costs | \$ <u>4,003,954</u> |
| Total other accounts receivable | <u>\$ 4,003,954</u> |

NOTE E - INVESTMENTS

The total investments of OFS at June 30, 2016 and 2015 are detailed as follows:

| | <u>2016</u> | <u>2015</u> |
|---|-----------------------|-----------------------|
| Investment in SEI Catholic Values Funds | \$ 126,515,816 | \$ 141,345,946 |
| Investment in the Trust of Josephine Nalle Unitrust | 1,549,050 | 1,695,207 |
| Mutual funds | <u>202,195</u> | <u>220,916</u> |
| Total investments | <u>\$ 128,267,061</u> | <u>\$ 143,262,069</u> |

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE E - INVESTMENTS - Continued

Investment in SEI Catholic Values Funds

Investments held at SEI are reported at fair value and consist of the following:

Catholic Values Equity Fund (or "equity fund") - Invests in common stocks and is managed by SEI. The equity fund is valued at the closing price of the traded fund.

Catholic Values Fixed Income Fund (or "fixed income fund") - Invests in mutual funds, corporate obligations, United States Treasury obligations and municipal obligations and is managed by SEI. The fixed income fund is valued at the closing price of the traded fund.

Cash Plus (or "fund") - Investments are liquid in nature and invested in short duration U.S. government bonds.

At June 30, 2016, OFS' investments are summarized and classified as follows:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Investment in SEI Catholic Values Funds | \$ 97,104,597 | \$ 7,914,434 | \$ 21,496,785 | \$ 126,515,816 |
| Investment in the Trust of Josephine Nalle Unitrust | - | 1,549,050 | - | 1,549,050 |
| Mutual funds | <u>-</u> | <u>202,195</u> | <u>-</u> | <u>202,195</u> |
| | <u>\$ 97,104,597</u> | <u>\$ 9,665,679</u> | <u>\$ 21,496,785</u> | <u>\$ 128,267,061</u> |

Through April 30, 2015, the investment in the Trustee Account consisted of investments in the NPAP and other investment accounts. For administrative and other needs, the Archdiocese formed the NPAP to pool together certain investments in order to more efficiently manage the investments of various entities and related organizations within the Archdiocese of Philadelphia. The investments in the NPAP were held by a custodian and managed based on sub-accounts as follows:

Equity Sub-Account (or "fund") - Invested in common stocks and was managed by multiple investment managers.

Fixed Income Sub-Account (or "fund") - Invested in mutual funds, corporate obligations, United States Treasury obligations and municipal obligations and was managed by multiple investment managers.

Liquidity Sub-Account (or "fund") - Investments were liquid in nature and were used to buy and sell units of the equity and fixed income funds or for expected short-term needs.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE E - INVESTMENTS - Continued

The Trustee Account was unitized on a periodic basis to allow for the investment, at unit value, by entities in the NPAP. OFS' investment in the Trustee Account was stated at unit value. The Investment Committee of the Archdiocese of Philadelphia ("Investment Committee") had primary responsibility for determining the asset investment allocations to be used. Management was responsible for ensuring that asset investment allocations among the funds were maintained as determined by the Investment Committee.

At June 30, 2015, OFS' investments are summarized and classified as follows:

| | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|---|-----------------------|-----------------------------------|-----------------------------------|-----------------------|
| Investment in SEI Catholic Values Funds | \$ 110,152,906 | \$ 8,589,124 | \$ 22,603,916 | \$ 141,345,946 |
| Investment in the Trust of Josephine Nalle Unitrust | - | 1,695,207 | - | 1,695,207 |
| Mutual funds | <u>-</u> | <u>220,916</u> | <u>-</u> | <u>220,916</u> |
| | <u>\$ 110,152,906</u> | <u>\$ 10,505,247</u> | <u>\$ 22,603,916</u> | <u>\$ 143,262,069</u> |

NOTE F - FAIR VALUE MEASUREMENTS

Accounting Standards Codification ("ASC") 820, *Fair Value Measurements and Disclosures*, establishes a single authoritative definition of fair value, sets a framework for measuring fair value, and requires additional disclosures about fair value measurements. The 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 under ASC 820 are described as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities as of the measurement date.
- Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities.
- Level 3 Inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE F - FAIR VALUE MEASUREMENTS - Continued

Fair value calculations may not be indicative of net realizable value or reflective of future fair values. Furthermore, although OFS believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair value measurements of investments in entities that calculate net asset value (“NAV”) per share or its equivalent as of June 30, 2016 and 2015 are as follows:

| Description | Fair value | | Unfunded commitments | Redemption frequency | Redemption notice period |
|--|--------------|--------------|----------------------|----------------------|--------------------------|
| | 2016 | 2015 | | | |
| Investment in the Trust of Josephine Nalle Unitrust ^(a) | \$ 1,549,050 | \$ 1,695,207 | \$ - | daily | 1 day |

^(a) The Trust of Josephine Nalle Unitrust is comprised of cash, equity and fixed income securities held with Wells Fargo Bank, N.A. (“Wells Fargo”). The NAV is derived based on the ending market value of the trust assets as reported by Wells Fargo on June 30, 2016 and 2015. The investment strategy is a balanced appreciation model that focuses on capital growth with income.

The following table presents the fair values of the investments held by OFS by level within the fair value hierarchy, as of June 30, 2016:

| | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant inputs supported by little or no market activity (Level 3) | Total fair value |
|---|---|---|--|------------------|
| Assets | | | | |
| Investments | | | | |
| Investment in SEI Catholic Values Funds | \$ 126,515,816 | \$ - | \$ - | \$ 126,515,816 |
| Investment in the Trust of Josephine Nalle Unitrust | - | - | 1,549,050 | 1,549,050 |
| Mutual funds | 202,195 | - | - | 202,195 |
| Beneficial interest in supporting charitable trusts | - | - | 2,029,270 | 2,029,270 |
| Total assets at June 30, 2016 | \$ 126,718,011 | \$ - | \$ 3,578,320 | \$ 130,296,331 |

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE F - FAIR VALUE MEASUREMENTS - Continued

The following table presents the fair values of the investments held by OFS by level within the fair value hierarchy, as of June 30, 2015:

| | Quoted prices in active markets <u>(Level 1)</u> | Significant other observable inputs <u>(Level 2)</u> | Significant inputs supported by little or no market activity <u>(Level 3)</u> | Total fair value |
|--|---|--|--|-----------------------|
| Assets | | | | |
| Investments | | | | |
| Investment in SEI Catholic Values Funds | \$ 141,345,946 | \$ - | \$ - | \$ 141,345,946 |
| Investment in the Trust of Josephine Nalle Unitrust | - | - | 1,695,207 | 1,695,207 |
| Mutual funds | 220,916 | - | - | 220,916 |
| Beneficial interest in supporting charitable trusts | <u>-</u> | <u>-</u> | <u>2,201,182</u> | <u>2,201,182</u> |
| Total assets at June 30, 2015 | <u>\$ 141,566,862</u> | <u>\$ -</u> | <u>\$ 3,896,389</u> | <u>\$ 145,463,251</u> |

The following table presents assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30, 2016 and 2015:

| <u>Charitable Trusts</u> | <u>Level 3</u> |
|--------------------------|---------------------|
| Balance, June 30, 2014 | \$ 4,089,427 |
| Change in fair value | <u>(193,038)</u> |
| Balance, June 30, 2015 | 3,896,389 |
| Change in fair value | <u>(318,069)</u> |
| Balance, June 30, 2016 | <u>\$ 3,578,320</u> |

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE G - ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables are comprised of the following at June 30, 2016 and 2015:

| | <u>2016</u> | <u>2015</u> |
|---|----------------------|----------------------|
| Self-insurance reserves (see Note I) | \$ 35,141,042 | \$ 39,904,748 |
| IBNP reserve Welfare Benefits Trust | 3,535,000 | 3,716,000 |
| Conditional asset retirement obligation | 310,042 | 2,302,237 |
| Charitable gift annuities | 390,263 | 432,562 |
| Accrued legal and professional fees | 505,231 | 613,170 |
| Other | <u>383,749</u> | <u>831,282</u> |
| | <u>\$ 40,265,327</u> | <u>\$ 47,799,999</u> |

NOTE H - LINE OF CREDIT

In March 2015, the Archdiocese entered into an unsecured line of credit agreement with PNC Bank, which allows for borrowings up to \$3,000,000 at an interest rate equal to the Daily LIBOR plus 150 basis points. The interest rate at June 30, 2016 was 1.9%. In addition, the Archdiocese is required to pay a commitment fee of 15 basis points per annum on the average daily balance of the line of credit that was not disbursed and not cancelled during the previous quarter. There were no borrowings on the line of credit during the year ended June 30, 2016.

NOTE I - COMMITMENTS AND CONTINGENCIES

1. Claims

Presently, the Archdiocese is a party to certain lawsuits, seeking compensatory damages and other types of relief.

Lawsuits and Grand Jury Report - Historically, a number of lawsuits have been brought against the Archdiocese relating to alleged sexual abuse by clergy, most of which have been dismissed by Pennsylvania courts as being beyond the applicable statute of limitations. Nine civil cases alleging sexual abuse by clergy were filed in the Philadelphia Court of Common Pleas in 2011 shortly after the issuance of a February 2011 grand jury report issued by the Philadelphia District Attorney's Office. On September 24, 2014, the court entered summary judgment in favor of the Archdiocese in two of the cases. These two decisions were appealed to the Superior Court of Pennsylvania, and the Superior Court affirmed the trial court's decisions. The plaintiffs in three other cases voluntarily dismissed their cases. The Archdiocese did not have a statute of limitations defense in three of the 2011 cases. Those cases were scheduled to go to trial in January, March and November of 2015. In all three of the cases, the parties settled before trial. The one remaining 2011 case was scheduled for trial in November 2016. In that case, the Archdiocese successfully asserted a statute of limitations defense to the abuse allegations, and settled the remaining claims pursuant to a confidential settlement.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE I - COMMITMENTS AND CONTINGENCIES - Continued

Eight additional cases were filed in Philadelphia in September 2012, and one was filed in Chester County, Pennsylvania. One of the cases filed in September 2012 involves claims by two separate plaintiffs. All of the cases filed in Philadelphia in 2012 were later dismissed voluntarily by the plaintiffs after the Archdiocese successfully moved in the 2011 cases for summary judgment based upon the statute of limitations. In the case filed in Chester County, the court entered summary judgment in favor of the Archdiocese based upon the statute of limitations. No appeal was filed by the plaintiff in that case.

In 2013, the Archdiocese was sued in four cases alleging sexual abuse by a priest or other agent of the Archdiocese. The Archdiocese has settled with three of those plaintiffs. Discovery is ongoing in the other case.

In 2015, the Archdiocese was sued on one case by an individual who alleges that he was sexually abused by a priest while he was a minor. Discovery is ongoing in that matter, as well.

In 2016, the Archdiocese has been named as a defendant in four additional cases. Two cases were filed in Philadelphia and will be subject to a statute of limitations defense by the Archdiocese. One case was filed in Atlantic County, New Jersey and one in London, Ontario. Both of these cases are barred by the statute of limitations under Pennsylvania law, but the plaintiffs are seeking the application of the laws in these other jurisdictions.

Numerous uncertainties exist regarding the financial impact of the presently pending civil cases, including the potential for amendments to Pennsylvania law regarding the statute of limitations in civil cases involving allegations of sexual abuse of minors. In the event of such changes, the Archdiocese could be subject to additional civil cases, damages and/or settlements. The Archdiocese has put its insurance carriers on notice of the outstanding sexual abuse claims.

The Archdiocese intends to vigorously defend itself in the pending civil lawsuits. If these cases are not dismissed under the present statute of limitations or on the basis of other legal defenses, management of the Archdiocese believes that it is reasonably possible that it may sustain losses with respect to some or all of the pending lawsuits in excess of amounts insured or accrued. Although the outcome of the current claims cannot be predicted, the resolution of these matters, individually or in the aggregate, could, absent meaningful insurance coverage, have a significant impact on the financial position, changes in net assets, cash flows and/or liquidity of the Archdiocese, thereby impacting its various activities and ministries.

2. Self-insurance reserves

Self-Insurance - The principal insurance policies providing Property and General Liability coverage have a deductible of \$50,000 and a self-insured retention ("SIR") of \$250,000 per occurrence, respectively. In addition, the former has an annual aggregate deductible of \$2,500,000. The workers' compensation policy is written with self-insurance retention of \$500,000 per claim. There are certain special policies with lower per claim deductibles or SIR's and some policies with guaranteed cost, first dollar coverage.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE I - COMMITMENTS AND CONTINGENCIES - Continued

The Automobile Liability and Physical Damage coverages are written with SIR's of \$50,000 and \$25,000, respectively, and subject to an annual aggregate SIR of \$1,250,000. To the extent of this deductible and these SIR's, the Risk Insurance Trust is self-insured. The Risk Insurance Trust held retrospectively rated workers' compensation insurance coverage for the periods August 1, 1991 through July 1, 1994. The periods subsequent to July 1, 1994 through June 30, 2016 are covered under large deductible or self-insured retention programs. The reserves for self-insured losses are based upon the estimated ultimate claims costs as estimated by an independent actuary.

The estimated ultimate claims cost is calculated as of June 30, 2016 and considers incurred and paid losses and retention amounts to determine loss development factors. The estimated reserve liability is comprised of both a limited case outstanding reserve and estimated development.

3. Other

The Archdiocese is involved in numerous other legal proceedings arising out of and incidental to its operations. In management's opinion, the ultimate liability which may arise from these other legal proceedings would not have a material adverse effect on the financial statements of OFS. In addition, the Archdiocese believes that if liability were established, it would have adequate insurance coverage to meet the resulting obligations.

Under the Archdiocese of Philadelphia's Priest Student Loan Policy, priests are reimbursed for payments made toward student debt that was incurred for their studies at St. Charles Borromeo Seminary. The reimbursements are contingent upon loan payments being made by the priest and are limited annually to a maximum repayment amount predetermined by the Archdiocese. The Archdiocese assumes no liability related to the outstanding balances on these loans until payment is made by the priests. Upon payment, the Archdiocese assumes the liability. The reimbursement cost is split evenly between the Archdiocese and St. Charles Borromeo Seminary. During the years ended June 30, 2016 and 2015, the combined reimbursement totaled \$116,890 and \$104,048, respectively. As of June 30, 2016 and 2015, the potential combined outstanding Priest Student Loans totaled \$613,738 and \$589,148, respectively.

NOTE J - CONCENTRATION OF CREDIT INCLUDING CREDIT RISK

Cash, cash equivalents and investments are exposed to various risks, such as interest rate, market volatility and credit. To minimize such risks, the Archdiocese has a diversified investment portfolio managed by several independent investment managers in a variety of asset classes. The Archdiocese regularly evaluates its investments including performance thereof. The Archdiocese maintains its cash and cash equivalents in various bank deposit accounts which, at times, may exceed federally insured limits. The Archdiocese's cash accounts were placed with high credit quality financial institutions. However, due to inherent risks and potential volatility in investment valuations, the amounts reported in the accompanying financial statements can vary substantially from year to year. It is reasonably possible that changes in investments will occur in the near term and such changes could materially affect the amounts reported in the accompanying financial statements. Credit risk with respect to related party receivables originates from the activities of related parties within the Archdiocese such as parishes, which are supported primarily by Catholic parishioners of the Philadelphia area. Related party receivables include accounts receivable from Archdiocesan parishes and loans provided to parties and other related organizations.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE K - PENSION PLANS

The Archdiocese of Philadelphia Lay Employees Retirement Plan (“LERP”), the Archdiocese of Philadelphia 403(b) retirement plan and the priests’ retirement plans are distinct and autonomous benefit plans separately administered by the Archdiocese in trust for each of the plans’ beneficiaries and are not part of these financial statements. The plans are funded by contributions from the various participating entities, including parishes. The plans’ administrator is OFS.

1. Priests’ retirement plans

For financial reporting purposes within these financial statements, the priests’ retirement plans are accounted for as multiemployer plans. Expenses are recognized as contributions are made in accordance with established provisions followed by all parishes and participating entities within the territory of the Archdiocese. The contributions by OFS to the priests’ retirement plans totaled \$710,464 and \$755,776, respectively, for the years ended June 30, 2016 and 2015.

The actuarially determined present value of accumulated plan benefits at June 30, 2016 and 2015 for priests’ pension, retiree health insurance, retiree auto insurance and life insurance totaled \$98,000,000 and \$93,200,000 respectively. At June 30, 2016 and 2015, the net assets available to provide for these benefits totaled \$85,700,000 and \$81,800,000, respectively. During the year ended June 30, 2015, \$62,500,000 was distributed from the proceeds resulting from the sale of the nursing homes to the priests’ retirement plans.

2. Lay Employees Retirement Plan - frozen effective June 30, 2014

Through June 30, 2014, the eligible lay employees of OFS were covered under the LERP, which is a defined benefit pension plan that covered substantially all lay employees, once age and service requirements were met, of the Archdiocese, its related ecclesiastical entities, institutions and parishes. For financial reporting purposes within these financial statements, the LERP is accounted for as a multiemployer plan. On June 30, 2014, the Archdiocese froze the LERP. All active employees as of the freeze date retained benefits they had earned through June 30, 2014. After the date of the freeze, accrued pension benefits do not increase for additional service or increases in pay. The plan is administered by the trustees of the plan.

In the fourth quarter of the year ended June 30, 2015, the LERP offered a Lump Sum Distribution (“LSD”) to former employees who are vested in the LERP and terminated service on or before November 1, 2014, former Nursing Home employees who are vested in the LERP and terminated service on or before November 3, 2014, and active employees who are vested in the LERP and reached the age of 62 years on or before June 1, 2015 (“Eligible Participants”). Eligible Participants had the option to voluntarily choose to receive a LSD payment equal to the present value of their normal retirement benefit multiplied by the funded status of the LERP as of June 30, 2014, which was 85.1%. The 85.1% was based on information that was available at the time of the distribution. Total payments of \$101,830,922 were made in June 2015 to eligible participants electing a lump sum. Subsequent to June 30, 2015, a second LSD was offered to Eligible Participants. This resulted in an additional LSD of \$5,276,088.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE K - PENSION PLANS - Continued

OFS made annual contributions to the plan at an average rate of 4.0% and 4.0%, respectively, of the salaries of the eligible employees for the years ended June 30, 2016 and 2015. The contributions by OFS were \$263,682 and \$277,149, respectively, for the years ended June 30, 2016 and 2015. During the year ended June 30, 2016, OFS contributed an additional \$7,566,425 comprised of remaining proceeds from the sale of the nursing homes.

Preliminary estimates of the actuarially determined present value of accumulated plan benefits at June 30, 2016 totaled approximately \$629,000,000. The actuarially determined present value of accumulated plan benefits at June 30, 2015 totaled approximately \$639,000,000. At June 30, 2016 and 2015, the assets available to provide for these benefits totaled approximately \$445,000,000 and \$477,000,000, respectively.

3. Archdiocese of Philadelphia 403(b) Retirement Plan

Effective July 1, 2014, the Archdiocese established a 403(b) defined contribution plan. Under the 403(b) plan and subject to statutory limits, all employees at least 18 years of age are immediately eligible to make voluntary deferred salary contributions into the 403(b) plan.

Employer contributions, which cover employees meeting the eligibility requirements below, are discretionary. The following are the eligibility requirements for the employer contributions:

Grandfathered Employees - Any employee who was accruing benefits as an active participant in the LERP as of its freeze date of June 30, 2014 is a grandfathered employee and is eligible to receive employer contributions.

Non-Grandfathered Employees - Non-grandfathered employees are eligible to receive the employer contributions generally upon completion of 1,000 hours of service in the relevant measurement period.

Vesting in employer contributions is immediate for grandfathered employees who have completed 12 months of service as of June 30, 2014. Vesting in employer contributions for all other employees will take place after the completion of 12 months of service.

In fiscal years 2016 and 2015, the employer contribution rate was 4.5% of base salary for eligible employees. The contributions by OFS into the 403(b) plan totaled \$307,033 and \$283,199 for the years ended June 30, 2016 and 2015, respectively.

NOTE L - RELATED PARTY AMOUNTS AND TRANSACTIONS

OFS entered into transactions with the following related parties:

During the years ended June 30, 2016 and 2015, OFS recorded \$1,775,739 and \$2,188,085, respectively, in contributed rent related to the use of facilities owned by OFS but used without charge by Catholic Social Services/CHCS. During the years ended June 30, 2016 and 2015, OFS recorded \$66,655 and \$124,313, respectively, in contributed rent related to the use of facilities owned by OFS but used without charge by the World Meeting of Families of Philadelphia.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE L - RELATED PARTY AMOUNTS AND TRANSACTIONS - Continued

All parish assessments, Risk Insurance Trust billings and collections and other Archdiocesan entities' billings and collections are performed by Porter & Curtis, a commercial insurance broker and risk management services provider located in Media, Pennsylvania. All billings and collections associated with the Welfare Benefits Trust medical benefits program are performed by Independence Blue Cross. Billings and collections of loans are performed by OFS on behalf of the Deposit and Loan Program Trust.

| | 2016 | | 2015 | |
|---------------------------------------|---------------|---------------|---------------|---------------|
| | Billed | Collected | Billed | Collected |
| Parish assessment | \$ 19,165,000 | \$ 21,218,499 | \$ 18,126,926 | \$ 19,265,282 |
| Risk Insurance Program ¹ | 21,777,923 | 22,247,761 | 25,549,042 | 25,367,989 |
| Welfare Benefits Program ¹ | 55,434,359 | 55,142,501 | 60,277,236 | 60,779,394 |
| Parish loans and interest | 1,611,883 | 8,603,683 | 1,657,518 | 7,488,413 |

¹ These billed amounts are reflected on the statements of activities and changes in net assets under the caption, "Premium income from insurance programs."

Archdiocesan parishes and agencies deposit funds with OFS for investment purposes. Related deposit funds totaled \$130,431,479 and \$131,467,066 as of June 30, 2016 and 2015, respectively. Deposited funds earned an interest rate of 1.25% for the years ended June 30, 2016 and 2015. Interest paid on the deposited funds amounted to \$1,679,014 and \$1,588,170 during the years ended June 30, 2016 and 2015, respectively. Total interest expense for the years ended June 30, 2016 and 2015 was as follows:

| | 2016 | 2015 |
|---|---------------------|---------------------|
| Interest paid on deposits | \$ 1,679,014 | \$ 1,588,170 |
| Interest accretion on conditional asset retirement obligation | <u>11,925</u> | <u>11,466</u> |
| | <u>\$ 1,690,939</u> | <u>\$ 1,599,636</u> |

Loans are made to parishes and other Archdiocesan entities through the Deposit and Loan Program Trust (see Note C). Except in arrangements which have been specifically negotiated, the interest rate was generally 4.5%. Interest earned on these loans amounted to \$1,515,396 and \$1,760,091 for the years ended June 30, 2016 and 2015, respectively.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE L - RELATED PARTY AMOUNTS AND TRANSACTIONS - Continued

OFS receives funds from certain Archdiocesan offices, agencies and related ecclesiastical organizations, which are reflected as contributions on the statements of activities and changes in net assets. Such funds amounted to:

| | <u>2016</u> | <u>2015</u> |
|------------------------------------|-------------------|-------------------|
| Heritage of Faith ~ Vision of Hope | \$ 215,751 | \$ 201,171 |
| Other | <u>202,941</u> | <u>178,949</u> |
| | <u>\$ 418,692</u> | <u>\$ 380,120</u> |

Certain parishes, for a variety of reasons, which are struggling financially as they minister to the needs of their parishioners, receive assistance through the IPCC. This subsidy is used by the parishes to meet operating expenses, fund parish programs and carry out capital improvements. OFS provided subsidized support for IPCC parishes. This support is reflected as “interparochial assistance” in the accompanying statements of activities and changes in net assets.

| | <u>2016</u> | <u>2015</u> |
|-----------------------------------|---------------------|---------------------|
| Assessment | \$ 915,034 | \$ 748,375 |
| Priests’ retirement | 96,554 | 48,000 |
| Priests’ health insurance | 122,400 | 74,070 |
| Risk insurance | 265,658 | 188,469 |
| General and extraordinary subsidy | <u>332,495</u> | <u>393,251</u> |
| | <u>\$ 1,732,141</u> | <u>\$ 1,452,165</u> |

NOTE M - SELF-INSURED UNEMPLOYMENT COMPENSATION

Prior to the year ended June 30, 2015, the unemployment compensation for various parties within the Archdiocese was funded by two self-insured funds. The two funds were the PA Unemployment Comp - School Fund and the PA Unemployment Comp - Lay Employee Fund. During the year ended June 30, 2016, the two funds were pooled together to provide a pooled insurance fund that manages the unemployment compensation process for Special Education Schools, Parish Schools, select non-Archdiocesan schools, OFS, the Cemeteries Office, St. Charles Borromeo Seminary, and the administrative offices within the Office of Catholic Education (“Members”).

The Pennsylvania Catholic Conference (“PACC”) handles the claims administration and billings for the fund. Twice yearly, in February and May, PACC bills the Members. The funds collected by PACC from the billings are deposited to a bank account maintained by PACC. On a monthly basis, PACC processes claims and then electronically remits payments to the state. Annually, excess funds in the bank account are returned to the School and Lay Employees Fund. For the years ended June 30, 2016 and 2015, the School and Lay Employees Trust Members were billed \$2,714,342 and \$3,854,648, respectively, and incurred claims totaling \$710,233 and \$953,341, respectively. As of June 30, 2016 and 2015, the School and Lay Employees Trust net asset balance totaled \$5,965,474 and \$3,955,371, respectively.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE N - OTHER INCOME

Other income recognized by OFS is comprised of the following for the years ended June 30, 2016 and 2015:

| | <u>2016</u> | <u>2015</u> |
|--|---------------------|---------------------|
| Allocations from Catholic Charities Appeal | \$ 2,633,152 | \$ 2,512,307 |
| Rental income | 1,951,684 | 2,406,215 |
| Other | <u>153,681</u> | <u>168,769</u> |
| | <u>\$ 4,738,517</u> | <u>\$ 5,087,291</u> |

NOTE O - TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes at June 30, 2016 and 2015:

| | <u>2016</u> | <u>2015</u> |
|--------------------------------------|----------------------|----------------------|
| Archdiocesan ministries support | \$ 4,484,689 | \$ 4,234,851 |
| Retired priest and religious support | 5,876,033 | 6,266,806 |
| Renovations | <u>4,442,974</u> | <u>4,549,567</u> |
| | <u>\$ 14,803,696</u> | <u>\$ 15,051,224</u> |

Permanently restricted net assets at June 30, 2016 and 2015 are restricted to:

| | <u>2016</u> | <u>2015</u> |
|---|----------------------|----------------------|
| Investments to be held in perpetuity, the income from which is expendable to support operations of OFS (reported as other operating income) | | |
| Archdiocesan ministries support | \$ 21,263,670 | \$ 22,368,938 |
| Archdiocesan operations support | 2,267,075 | 2,440,584 |
| Educational assistance | <u>10,817</u> | <u>11,083</u> |
| | <u>\$ 23,541,562</u> | <u>\$ 24,820,605</u> |

NOTE P - NET ASSETS RELEASED FROM RESTRICTIONS

During the years ended June 30, 2016 and 2015, net assets were released from donor restrictions by incurring expenses satisfying the specific restricted purpose related to retired priest and religious support, as well as the other purposes listed in Note O, in the amount of \$1,109,913 and \$658,527, respectively. During the year ended June 30, 2015, OFS reclassified certain temporarily restricted net assets to permanently restricted net assets pursuant to a decree from the Philadelphia Orphans' Court.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE Q - ENDOWMENTS

OFS' endowments consist of donor-restricted endowment funds established for a variety of purposes. The endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. During the year ended June 30, 2015, OFS reclassified certain temporarily restricted net assets to permanently restricted net assets pursuant to an order from the Philadelphia Orphans' Court approving a request made by the Archdiocese.

1. Interpretation of Relevant Law

In accordance with Commonwealth of Pennsylvania Act 141, OFS 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 is classified in permanently restricted net assets. Pennsylvania law permits the Archdiocese to release a percentage, which is elected annually, of the market value of its endowment funds into unrestricted income. The spending rate percentage, between 2% and 7%, is applied to the three-year average of the market value of the endowment funds' assets.

2. Return Objectives and Risk Parameters

OFS has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Under this policy, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of plus 3% over the consumer price index while assuming a moderate level of investment risk. OFS expects its endowment funds, over time, to provide an average rate of return of between 6% and 7% annually. Actual returns in any given year may vary from that amount.

3. Spending Policy

In accordance with state law, net realized and unrealized gains on permanently restricted investments are included as permanently restricted net assets, even absent donor restrictions on the use of gains. Commonwealth of Pennsylvania law permits OFS to adopt a spending policy for endowment earnings, subject to certain limitations. OFS follows the total return concept of endowment investment and spending. Under this concept, a prudent amount of appreciation earned on the investments may be spent in the event that the interest and dividends earned are insufficient to meet that period's spending rate. The Archdiocese's spending policy for the years ended June 30, 2016 and 2015 allowed for a 5% draw of the three-year average market value of the permanently restricted endowments, estates and trusts.

As of June 30, 2016 and 2015, \$23,541,562 and \$24,820,605, respectively, in donor-restricted endowment funds were recorded within permanently restricted net assets.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2016 and 2015

NOTE Q - ENDOWMENTS - Continued

Changes in endowment net assets for the years ended June 30, 2016 and 2015:

| <u>2016</u> | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Endowment net assets, beginning of year | \$ - | \$ - | \$ 24,820,605 | \$ 24,820,605 |
| Investment income | - | - | 267,248 | 267,248 |
| Net depreciation (realized and unrealized losses) | <u>-</u> | <u>-</u> | <u>(868,923)</u> | <u>(868,923)</u> |
| Total investment return | - | - | (601,675) | (601,675) |
| Appropriation of endowment assets for expenditure | <u>-</u> | <u>-</u> | <u>(677,368)</u> | <u>(677,368)</u> |
| | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 23,541,562</u> | <u>\$ 23,541,562</u> |
| <u>2015</u> | <u>Unrestricted</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
| Endowment net assets, beginning of year | \$ - | \$ - | \$ 21,590,867 | \$ 21,590,867 |
| Investment income | - | - | 394,371 | 394,371 |
| Net appreciation (realized and unrealized gains) | <u>-</u> | <u>-</u> | <u>28,439</u> | <u>28,439</u> |
| Total investment return | - | - | 422,810 | 422,810 |
| Reclassification of net assets (Note Q) | - | - | 3,205,720 | 3,205,720 |
| Appropriation of endowment assets for expenditure | <u>-</u> | <u>-</u> | <u>(398,792)</u> | <u>(398,792)</u> |
| | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 24,820,605</u> | <u>\$ 24,820,605</u> |

NOTE R - SUBSEQUENT EVENTS

OFS has evaluated, through October 17, 2016, the date the financial statements were available to be issued, all subsequent events or transactions that may require recognition in the financial statements. OFS is not aware of any subsequent event which would require recognition or disclosure in the financial statements.

SUPPLEMENTAL INFORMATION

COMBINING STATEMENT OF FINANCIAL POSITION

June 30, 2016

| | Total General Fund | Deposit and Loan Program Trust | Risk Insurance Trust | Welfare Benefits Trust | Eliminations | OFS Total |
|--|--------------------------|--------------------------------------|----------------------------|------------------------------|------------------------|-----------------------|
| Assets | | | | | | |
| Cash and cash equivalents | \$ 5,800,032 | \$ 7,969,616 | \$ 10,995,858 | \$ 12,909,559 | \$ - | \$ 37,675,065 |
| Due from Archdiocesan entities, net | | | | | | |
| Assessments and other amounts due, less allowance for doubtful accounts of \$36,268,029 | 2,072,195 | - | 1,835,195 | 304,584 | - | 4,211,974 |
| Loans receivable, less allowance for doubtful accounts of \$9,867,986 | - | 42,455,906 | - | - | - | 42,455,906 |
| Notes receivable from related parties | 3,865,444 | 43,532,482 | - | - | (43,532,482) | 3,865,444 |
| Interest receivable from related parties | - | 755,884 | - | - | - | 755,884 |
| Other related party receivables | 14,935,242 | - | 27,855 | - | (13,913,576) | 1,049,521 |
| Other accounts receivable | - | - | - | - | - | - |
| Prepaid expenses | 27,178 | - | 1,627,626 | 693,751 | - | 2,348,555 |
| Real estate and physical plant held for sale | 5,491,317 | - | - | - | - | 5,491,317 |
| Investments | 44,296,146 | 53,831,483 | 30,139,432 | - | - | 128,267,061 |
| Beneficial interest in supporting charitable trusts | 2,029,270 | - | - | - | - | 2,029,270 |
| Real estate and physical plant, less accumulated depreciation of \$30,436,313 | 14,971,827 | - | - | - | - | 14,971,827 |
| Total assets | \$ 93,488,651 | \$ 148,545,371 | \$ 44,625,966 | \$ 13,907,894 | \$ (57,446,058) | \$ 243,121,824 |
| Liabilities | | | | | | |
| Accounts payable | \$ 3,287,640 | \$ (11,573) | \$ 523,309 | \$ 387,385 | \$ (25,439) | \$ 4,161,322 |
| Accrued expenses and other payables | 1,504,285 | - | 35,226,042 | 3,535,000 | - | 40,265,327 |
| Deferred revenue | 68,372 | - | - | 114,536 | - | 182,908 |
| Deposits - parishes, institutions and related organizations | - | 144,319,616 | - | - | (13,888,137) | 130,431,479 |
| Notes payable to related parties | 43,532,482 | - | - | - | (43,532,482) | - |
| Total liabilities | 48,392,779 | 144,308,043 | 35,749,351 | 4,036,921 | (57,446,058) | 175,041,036 |
| Net assets | | | | | | |
| Unrestricted | 6,750,614 | 4,237,328 | 8,876,615 | 9,870,973 | - | 29,735,530 |
| Temporarily restricted | 14,803,696 | - | - | - | - | 14,803,696 |
| Permanently restricted | 23,541,562 | - | - | - | - | 23,541,562 |
| Total net assets | 45,095,872 | 4,237,328 | 8,876,615 | 9,870,973 | - | 68,080,788 |
| Total liabilities and net assets | \$ 93,488,651 | \$ 148,545,371 | \$ 44,625,966 | \$ 13,907,894 | \$ (57,446,058) | \$ 243,121,824 |

COMBINING STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year ended June 30, 2016

| | Unrestricted | | | | | Temporarily Restricted | | | | | Permanently Restricted | | | Grand Total | |
|--|--------------------|--------------------------------|----------------------|------------------------|--------------------|------------------------|---------------|----------------|--------------|-----------------------|------------------------|------------------|-----------------------|--------------------|--------------------|
| | Total General Fund | Deposit and Loan Program Trust | Risk Insurance Trust | Welfare Benefits Trust | Eliminations | Total | General Fund | Custodian Fund | Plant Fund | Estates & Trusts Fund | Total | General Fund | Estates & Trusts Fund | | Total |
| Revenues, gains, losses and other support | | | | | | | | | | | | | | | |
| Parish assessments | \$ 19,165,000 | \$ - | \$ - | \$ - | \$ - | \$ 19,165,000 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 19,165,000 |
| Contributions from related parties | 5,262,294 | - | - | - | (4,843,602) | 418,692 | - | - | - | - | - | - | - | - | 418,692 |
| Collections, bequests and donations | 1,777,896 | - | - | - | (647,880) | 1,130,016 | 239,750 | - | - | 144,337 | 384,087 | - | - | - | 1,514,103 |
| Tuition income | 45,550 | - | - | - | - | 45,550 | - | - | - | - | - | - | - | - | 45,550 |
| Investment income | 132,324 | 476,735 | 287,664 | - | - | 896,723 | 4,009 | - | - | 85,019 | 89,028 | - | 267,248 | 267,248 | 1,252,999 |
| Interest income | 361,132 | 1,515,396 | - | - | (244,050) | 1,632,478 | - | - | - | 73,278 | 73,278 | - | - | - | 1,705,756 |
| Fees for services | 4,638,497 | - | - | - | (1,554,304) | 3,084,193 | - | - | - | - | - | - | - | - | 3,084,193 |
| Intradiocesan income | 4,970,905 | - | - | - | - | 4,970,905 | - | - | - | - | - | - | - | - | 4,970,905 |
| Other income | 4,731,995 | 8 | 6,514 | - | - | 4,738,517 | - | - | - | - | - | - | - | - | 4,738,517 |
| Archdiocesan collections | - | - | - | - | - | - | - | - | - | 10,000 | 10,000 | - | - | - | 10,000 |
| Net gain on sale of real estate and physical plant | 10,783,408 | - | - | - | - | 10,783,408 | - | - | - | - | - | - | - | - | 10,783,408 |
| Net assets released from restrictions | 1,109,913 | - | - | - | - | 1,109,913 | (1,901) | 2,290 | - | (432,934) | (432,545) | - | (677,368) | (677,368) | - |
| Net realized and unrealized (depreciation) appreciation on investments and beneficial interest in supporting charitable trusts | (92,352) | 456,414 | 252,154 | - | - | 616,216 | (170,857) | - | - | (200,519) | (371,376) | (171,912) | (697,011) | (868,923) | (624,083) |
| Premium income from insurance programs | - | - | 21,777,923 | 55,434,359 | - | 77,212,282 | - | - | - | - | - | - | - | - | 77,212,282 |
| Total revenues, gains, losses and other support | 52,886,562 | 2,448,553 | 22,324,255 | 55,434,359 | (7,289,836) | 125,803,893 | 71,001 | 2,290 | - | (320,819) | (247,528) | (171,912) | (1,107,131) | (1,279,043) | 124,277,322 |
| Expenses | | | | | | | | | | | | | | | |
| Subsidies | 4,509,955 | - | - | - | (3,445,116) | 1,064,839 | - | - | - | - | - | - | - | - | 1,064,839 |
| Salaries and wages | 10,121,301 | - | - | - | - | 10,121,301 | - | - | - | - | - | - | - | - | 10,121,301 |
| Payroll taxes and fringe benefits | 6,914,964 | - | - | - | - | 6,914,964 | - | - | - | - | - | - | - | - | 6,914,964 |
| Purchased services | 9,536,235 | 88,092 | - | - | - | 9,624,327 | - | - | - | - | - | - | - | - | 9,624,327 |
| Intradiocesan expenses | 98,526 | - | - | - | - | 98,526 | - | - | - | - | - | - | - | - | 98,526 |
| Support expense | 6,850,213 | (1,477,138) | - | - | (1,558,180) | 3,814,895 | - | - | - | - | - | - | - | - | 3,814,895 |
| Interparochial assistance | 1,732,141 | - | - | - | - | 1,732,141 | - | - | - | - | - | - | - | - | 1,732,141 |
| Depreciation expense | 1,729,380 | - | - | - | - | 1,729,380 | - | - | - | - | - | - | - | - | 1,729,380 |
| Interest expense | 11,925 | 1,923,064 | - | - | (244,050) | 1,690,939 | - | - | - | - | - | - | - | - | 1,690,939 |
| Withdrawals expense | 2,223,484 | - | - | - | (2,042,490) | 180,994 | - | - | - | - | - | - | - | - | 180,994 |
| Insurance program expenses | - | - | 24,368,911 | 52,203,013 | - | 76,571,924 | - | - | - | - | - | - | - | - | 76,571,924 |
| Total expenses | 43,728,124 | 534,018 | 24,368,911 | 52,203,013 | (7,289,836) | 113,544,230 | - | - | - | - | - | - | - | - | 113,544,230 |
| Change in net assets before other item | 9,158,438 | 1,914,535 | (2,044,656) | 3,231,346 | - | 12,259,663 | 71,001 | 2,290 | - | (320,819) | (247,528) | (171,912) | (1,107,131) | (1,279,043) | 10,733,092 |
| Other item | | | | | | | | | | | | | | | |
| Non-recurring contribution to Lay Employees Retirement Plan | 7,566,425 | - | - | - | - | 7,566,425 | - | - | - | - | - | - | - | - | 7,566,425 |
| Change in net assets | 1,592,013 | 1,914,535 | (2,044,656) | 3,231,346 | - | 4,693,238 | 71,001 | 2,290 | - | (320,819) | (247,528) | (171,912) | (1,107,131) | (1,279,043) | 3,166,667 |
| Net assets | | | | | | | | | | | | | | | |
| Beginning of year | 5,158,601 | 2,322,793 | 10,921,271 | 6,639,627 | - | 25,042,292 | 6,501,284 | - | 1,497,738 | 7,052,202 | 15,051,224 | 2,222,938 | 22,597,667 | 24,820,605 | 64,914,121 |
| End of year | \$ 6,750,614 | \$ 4,237,328 | \$ 8,876,615 | \$ 9,870,973 | \$ - | \$ 29,735,530 | \$ 6,572,285 | \$ 2,290 | \$ 1,497,738 | \$ 6,731,383 | \$ 14,803,696 | \$ 2,051,026 | \$ 21,490,536 | \$ 23,541,562 | \$ 68,080,788 |