

Financial Statements and Report of
Independent Certified Public Accountants

**Archdiocese of Philadelphia,
Office of Catholic Education
Administration Account**

June 30, 2018 and 2017

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Report of Independent Certified Public Accountants

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Report on the financial statements

We have audited the accompanying financial statements of the Archdiocese of Philadelphia, Office of Catholic Education Administration Account (“OCE”), which comprise the statements of financial position as of June 30, 2018 and 2017, 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to OCE’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OCE’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Archdiocese of Philadelphia, Office of Catholic Education Administration Account as of June 30, 2018 and 2017, 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 OCE within the Archdiocese of Philadelphia. Our opinion is not modified with respect to this matter.

Grant Thornton LLP

Philadelphia, Pennsylvania

November 26, 2018

Archdiocese of Philadelphia, Office of Catholic Education
Administration Account

STATEMENTS OF FINANCIAL POSITION

June 30,

ASSETS	<u>2018</u>	<u>2017</u>
Cash and cash equivalents, including amounts held by affiliate	\$ 2,937,532	\$ 3,243,171
Accounts receivable	86,543	114,644
Due from other Archdiocesan entities (Note I)	25,123	53,875
Other assets	220,512	218,432
Investments (Note C)	9,904,746	9,439,481
Beneficial interest in perpetual trust	<u>28,891,707</u>	<u>28,909,471</u>
 Total assets	 <u>\$ 42,066,163</u>	 <u>\$ 41,979,074</u>
 LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable	\$ 110,394	\$ 254,768
Accrued vacation	110,896	112,765
Accrued severance	99,601	18,950
Accrued salaries	71,005	70,040
Due to other Archdiocesan entities (Note I)	33,839	311,454
Deferred revenue	<u>8,705</u>	<u>27,247</u>
 Total liabilities	 <u>434,440</u>	 <u>795,224</u>
 Net assets		
Unrestricted	1,237,584	1,329,393
Unrestricted - designated	1,260,539	1,201,053
Temporarily restricted (Note E)	7,251,950	6,845,906
Permanently restricted (Note F)	<u>31,881,650</u>	<u>31,807,498</u>
 Total net assets	 <u>41,631,723</u>	 <u>41,183,850</u>
 Total liabilities and net assets	 <u>\$ 42,066,163</u>	 <u>\$ 41,979,074</u>

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

Archdiocese of Philadelphia, Office of Catholic Education
Administration Account

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year ended June 30, 2018

	Unrestricted	Unrestricted - designated	Temporarily restricted	Permanently restricted	Total
Revenues					
Subsidies					
Office of Catholic Education - Diocesan High Schools					
Operations Account	\$ 5,551,796	\$ -	\$ -	\$ -	\$ 5,551,796
Schools of Special Education	215,000	-	-	-	215,000
Parishes	1,200,000	-	-	-	1,200,000
Contributions					
Archdiocesan Educational Fund	-	-	107,730	-	107,730
Donations	404,914	-	433,255	-	838,169
Contributed services (Note J)	126,378	-	-	-	126,378
Program revenues	1,257,130	-	5,000	-	1,262,130
Investment income	12,918	17,824	101,901	16,138	148,781
Net realized and unrealized (losses) gains on investments	(664)	84,372	472,984	75,778	632,470
Change in beneficial interest in perpetual trust	-	-	-	(17,764)	(17,764)
Distribution of beneficial interest in perpetual trust	-	-	1,452,000	-	1,452,000
Other revenue	2,812	-	-	-	2,812
Funds with deficiencies	9,732	-	(9,732)	-	-
Release of unrestricted-designated funds	42,710	(42,710)	-	-	-
Net assets released from restrictions	2,157,094	-	(2,157,094)	-	-
 Total revenues	 10,979,820	 59,486	 406,044	 74,152	 11,519,502
 Expenses					
Salaries and benefits	5,880,494	-	-	-	5,880,494
Purchased services	2,811,294	-	-	-	2,811,294
Intradiocesan expenses	352,393	-	-	-	352,393
Support expenses	2,027,448	-	-	-	2,027,448
 Total expenses	 11,071,629	 -	 -	 -	 11,071,629
 Change in net assets	 (91,809)	 59,486	 406,044	 74,152	 447,873
Net assets, beginning of year	1,329,393	1,201,053	6,845,906	31,807,498	41,183,850
Net assets, end of year	\$ 1,237,584	\$ 1,260,539	\$ 7,251,950	\$ 31,881,650	\$ 41,631,723

The accompanying notes are an integral part of this financial statement.

Archdiocese of Philadelphia, Office of Catholic Education
Administration Account

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year ended June 30, 2017

	Unrestricted	Unrestricted - designated	Temporarily restricted	Permanently restricted	Total
Revenues					
Subsidies					
Office of Catholic Education - Diocesan High Schools					
Operations Account	\$ 4,989,500	\$ -	\$ -	\$ -	\$ 4,989,500
Schools of Special Education	215,000	-	-	-	215,000
Parishes	959,615	-	-	-	959,615
Contributions					
Archdiocesan Educational Fund	188,680	-	320,175	-	508,855
Donations	586,452	-	399,590	-	986,042
Contributed services (Note J)	109,453	-	-	-	109,453
Program revenues	1,438,030	-	196	-	1,438,226
Investment income	20,668	20,528	116,618	18,169	175,983
Net realized and unrealized (losses) gains on investments	(96)	132,262	736,116	118,203	986,485
Change in beneficial interest in perpetual trust	-	-	-	656,687	656,687
Distribution of beneficial interest in perpetual trust	-	-	1,425,000	-	1,425,000
Funds with deficiencies	144,734	-	(144,734)	-	-
Release of unrestricted-designated funds	40,012	(40,012)	-	-	-
Net assets released from restrictions	2,430,114	-	(2,430,114)	-	-
Total revenues	11,122,162	112,778	422,847	793,059	12,450,846
Expenses					
Salaries and benefits	5,151,717	-	-	-	5,151,717
Purchased services	2,704,076	-	-	-	2,704,076
Intradiocesan expenses	345,958	-	-	-	345,958
Support expenses	2,419,600	-	-	-	2,419,600
Total expenses	10,621,351	-	-	-	10,621,351
Change in net assets	500,811	112,778	422,847	793,059	1,829,495
Net assets, beginning of year	828,582	1,088,275	6,423,059	31,014,439	39,354,355
Net assets, end of year	\$ 1,329,393	\$ 1,201,053	\$ 6,845,906	\$ 31,807,498	\$ 41,183,850

The accompanying notes are an integral part of this financial statement.

Archdiocese of Philadelphia, Office of Catholic Education
Administration Account

STATEMENTS OF CASH FLOWS

Year ended June 30,

	2018	2017
Cash flows from operating activities		
Change in net assets	\$ 447,873	\$ 1,829,495
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Net realized and unrealized gains on investments	(632,470)	(986,485)
Change in beneficial interest in perpetual trust	17,764	(656,687)
Changes in operating assets and liabilities		
Accounts receivable	28,101	555,566
Due from other Archdiocesan entities	28,752	(23,215)
Other assets	(2,080)	(155,677)
Accounts payable	(144,374)	35,097
Accrued vacation	(1,869)	(3,573)
Accrued severance	80,651	(2,873)
Accrued salaries	965	16,904
Due to other Archdiocesan entities	(277,615)	279,489
Deferred revenue	(18,542)	22,022
	(472,844)	910,063
Net cash (used in) provided by operating activities		
Cash flows from investing activities		
Purchase of investments	(405,716)	(737,713)
Proceeds from sale of investments	572,921	792,780
	167,205	55,067
Net cash provided by investing activities		
Net (decrease) increase in cash and cash equivalents, including amounts held by affiliate	(305,639)	965,130
Cash and cash equivalents, including amounts held by affiliate, beginning of year	3,243,171	2,278,041
Cash and cash equivalents, including amounts held by affiliate, end of year	\$ 2,937,532	\$ 3,243,171

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

NOTE A - NATURE OF OPERATIONS

The accompanying financial statements of the Archdiocese of Philadelphia, Office of Catholic Education Administration Account (“OCE”) include the Office of Catholic Education and the departments of elementary and secondary schools, the Office of Catechetical Formation and Educational Financial Services. The financial statements exclude certain entities of the Archdiocese of Philadelphia, which relate to OCE but are considered separate reporting entities. These entities are as follows:

- High School Operations Account (“DHS”)
- Individual High School Presidents’ Accounts (“DHS”)
- Schools of Special Education
- Office for Financial Services
- Trustee Account of the Archdiocese of Philadelphia for Estates and Trusts
- Archdiocesan Educational Fund

OCE is considered to be a component of the Archdiocese of Philadelphia and not a separate legal entity. Effective September 1, 2012, the Archdiocese of Philadelphia entered into an agreement with Faith in the Future Foundation (“FIF”). The agreement is for the period of five school years and shall automatically renew for successive three-year periods unless prior written notification is provided 90 days before the scheduled expiration date. This agreement was extended through 2022 in February of 2016. Pursuant to the aforementioned agreement, FIF assumes strategic and operational management of the 17 Catholic secondary schools and the four individual Schools of Special Education and provides certain financial assistance to the schools. OCE has primary responsibility for, and FIF has oversight and approval responsibility over, school operations. The five senior management positions of OCE report directly to FIF’s Chief Executive Officer. The Secretary for Elementary Education and Deputy Secretary for Catechetical Formation report directly to the Auxiliary Bishop for Education.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis. Net assets and their revenues, expenses, gains and losses are classified into three categories, based on the existence or absence of donor-imposed restrictions. The categories are temporarily restricted, permanently restricted and unrestricted net assets.

Temporarily restricted net assets include gifts, trusts, income and gains which have either a time or use restriction but which may ultimately be expended. Since endowment investment income and net realized and unrealized gains and losses may eventually be spent by OCE, such earnings are recorded in the financial statements as temporarily restricted net assets, unless donor restricted for the corpus, until transferred to unrestricted net assets.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Permanently restricted net assets include the historical dollar amounts of gifts, which require by donor restriction that the corpus be invested in perpetuity and only the investment income be made available for operations in accordance with donor restrictions. Investment income and net realized and unrealized gains and losses, if permanently restricted by the donor, are included in permanently restricted net assets.

Within the category of unrestricted net assets, management has elected to separately report as Designated Funds, funds which have internal purpose designations determined by the Archbishop or his designee. Although the funds are legally unrestricted, the management of OCE follows this designation in the use of these funds.

Unrestricted net assets are free from donor-imposed restrictions and are all the remaining net assets of OCE.

2. Revenue Recognition

Various programs for the benefit of the schools are operated by OCE. Revenues from the programs are reported gross in the statements of activities and changes in net assets, and expenses are reported in the appropriate category of administration expenses when the services are performed.

Cash contributions are recorded as revenue when received. Unconditional promises to give are recorded at their fair value when OCE is notified of these gifts. Conditional promises to give are recognized when the conditions are substantially met.

Gifts of cash and other assets are recorded as restricted support 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 accompanying statements of activities and changes in net assets as net assets released from restrictions.

3. Uses of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("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.

4. Cash and Cash Equivalents, Including Amounts Held by Affiliate

Cash and cash equivalents, including amounts held by affiliate represent demand deposits and other investments with a maturity date of three months or less. The carrying amount approximates fair value.

OCE maintains cash balances with financial institutions that at times may exceed Federal Deposit Insurance Corporation limits. Management does not believe the credit risk related to these deposits is significant.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. Investments

Trustee Accounts are invested with two publicly traded SEI Catholic Values public mutual funds. The Catholic Values Equity Fund and the Catholic Values Fixed Income Fund (“Catholic Values Funds”) provide Catholic institutions with high-quality products that align with their core values, without sacrificing diversification or return potential. Specifically, the funds align with the investment directives set forth by the United States Conference of Catholic Bishops (“USCCB”). The Archdiocese of Philadelphia appointed SEI Private Trust Company (“SEI”) to act as custodian (the “Custodian”) of the Trustee Accounts. The investment in the Trustee Accounts and other investments are reported at fair value.

Unrealized gains and losses are included in the statements of activities and changes in net assets as net appreciation or depreciation in the fair value of investments.

6. Beneficial Interest in Perpetual Trust

OCE is the sole beneficiary of the income of a trust established by Francis W. Sullivan held in perpetuity by a third party. The supporting perpetual trust requires the income to be paid to OCE. The beneficial interest in perpetual trust is recorded at the fair value of the assets. At June 30, 2018 and 2017, the allocable fair value of the net assets of the trust was \$28,891,707 and \$28,909,471, respectively. The underlying investments of the beneficial interest in perpetual trust consist of cash, government obligations, corporate obligations, mutual funds, mortgage-backed securities and equity securities. OCE receives statements from the trustees which detail the fair value of each investment in the perpetual trust.

7. New Accounting Pronouncements

Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) No. 2014-09, *Revenue (Topic 606): Revenue from Contracts with Customers*, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts, whether or not written, with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services by applying five steps listed in the guidance. ASU 2014-09 also requires disclosure of both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from customers. The new guidance is effective for fiscal years beginning after December 15, 2018. Entities have the option of using either a full retrospective or a modified retrospective approach. Early adoption is permitted. OCE has not yet determined the effect the adoption of ASU 2014-09 may have on the financial statements.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, 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. OCE is evaluating the pronouncement at this time.

ASU No. 2018-08, *Not-for-profit Entities: Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, intends to clarify and improve the scope and accounting guidance for contributions received and contributions made. The amendment provides (1) a framework for determining whether a transaction should be accounted for as a contribution or as an exchange transaction, including how to evaluate whether a resource provider is receiving commensurate value in an exchange transaction, and (2) guidance to assist entities in determining whether a contribution is either conditional or unconditional. Guidance applies to both recipients and resource providers. For contributions received, the new standard is effective for annual financial statements beginning after December 15, 2018.

NOTE C - INVESTMENTS

The investments in the Trustee Accounts are reported at fair value and consist of the following:

Catholic Values Equity Fund (or "fund") - Invests in common stocks and is managed by SEI.

Catholic Values Fixed Income Fund (or "fund") - Invests in mutual funds, corporate obligations, United States Treasury obligations and municipal obligations and is managed by SEI.

Account holders have the option of six asset classifications in which to invest. The options include a short-duration U.S. government bond fund, a 100% fixed income bond fund and four equity funds with varying fixed income to equity mixes of 30/70, 50/50, 60/40 or 70/30. The Investment Committee of the Archdiocese of Philadelphia ("Investment Committee") has primary responsibility for determining fixed income to equity mix. The asset mix of the mutual funds is SEI's responsibility.

At June 30, 2018 and 2017, OCE held the following categories of investments:

	2018	2017
Catholic Values Equity Fund	\$ 6,169,557	\$ 5,784,755
Catholic Values Fixed Income Fund	<u>3,735,189</u>	<u>3,654,726</u>
Total investments	<u>\$ 9,904,746</u>	<u>\$ 9,439,481</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE C - INVESTMENTS - Continued

OCE is the beneficiary of an individual trust held in perpetuity by a third party. At June 30, 2018 and 2017, the allocable fair value of this trust was \$28,891,707 and \$28,909,471, respectively. During 2018 and 2017, OCE recognized \$(17,764) and \$656,687, respectively, of permanently restricted (depreciation) appreciation related to this trust.

NOTE D - EMPLOYEE BENEFIT PLANS

1. Lay Employees' Retirement Plan - Frozen Effective June 30, 2014

Through June 30, 2014, the eligible lay employees of OCE were covered under the Archdiocese of Philadelphia Lay Employees' Retirement Plan (the "Plan"), which is a defined benefit pension plan covering substantially all lay employees of the Archdiocese of Philadelphia, based on age and service requirements. On June 30, 2014, the Archdiocese froze the Plan. 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. OCE made annual contributions to the Plan at an average rate of 5.9% of the salaries of eligible staff for the years ended June 30, 2018 and 2017. The amount expensed by OCE for contributions to the Plan was \$228,161 and \$169,842 for the years ended June 30, 2018 and 2017, respectively. The expense of such contributions is included in employee benefits. Separate accounts for vested benefits and pension fund assets are not maintained for each institution.

At June 30, 2018, the assets available to fund Plan benefits were 86.6% of the actuarially determined present value of the accumulated Plan benefits. The assets available to fund Plan benefits were 82.1% of the preliminary estimate of the actuarially determined present value of the accumulated Plan benefits at June 30, 2017.

2. Archdiocese of Philadelphia 403(b) Retirement Plan

Effective July 1, 2014, the Archdiocese of Philadelphia 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 Lay Employees' Retirement Plan as of its freeze date of June 30, 2014 is a grandfathered employee and will be 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.

(Continued)

Archdiocese of Philadelphia, Office of Catholic Education
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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE D - EMPLOYEE BENEFIT PLANS - Continued

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 2018 and 2017, OCE's contribution rate was 4.5% of base salary for eligible employees, and there was a 0.35% and 0.50% charge for administration in 2018 and 2017, respectively. The contributions into the 403(b) plan totaled \$201,038 and \$170,783 for the years ended June 30, 2018 and 2017, respectively.

NOTE E - TEMPORARILY RESTRICTED NET ASSETS

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

	2018	2017
Tuition assistance/scholarships	\$ 5,470,471	\$ 5,206,019
Programs/grants	1,631,731	1,582,717
Scholarships/programs	47,948	36,737
Accumulated earnings in excess of spending of endowments:		
Tuition assistance/scholarships	84,002	9,100
Other	17,798	11,333
	\$ 7,251,950	\$ 6,845,906

During 2018 and 2017, net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose of \$2,157,094 and \$2,430,114, respectively.

NOTE F - PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets are available for the following purposes at June 30:

	2018	2017
Programs/grants (through beneficial interest in perpetual trust)	\$ 28,891,707	\$ 28,909,471
Endowment net assets		
Tuition assistance/scholarships	2,921,922	2,830,006
Other	68,021	68,021
	\$ 31,881,650	\$ 31,807,498

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE G - ENDOWMENTS

OCE's endowments consist of donor-restricted endowment funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

1. Interpretation of Relevant Law

In accordance with Commonwealth of Pennsylvania Act 141, and unless directed otherwise by the donor, OCE classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment; (b) the original value of subsequent gifts to the permanent endowment; and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by OCE in a manner consistent with the standard of prudence prescribed by relevant law. OCE does not release any portion of the permanently restricted funds. Pennsylvania law permits the Archdiocese of Philadelphia 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

OCE has adopted investment policies established by the Archdiocese of Philadelphia's Investment Committee 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. 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. OCE expects its endowment funds, over time, to provide an average rate of return of approximately 5% 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 temporarily restricted net assets, unless subject to donor restrictions for the corpus. Commonwealth of Pennsylvania law permits OCE to adopt a spending policy for endowment earnings, subject to certain limitations. OCE 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 of Philadelphia's spending policy for the years ended June 30, 2018 and 2017 allowed for a 3% draw of the three-year average market value of the permanently restricted endowments, unless directed otherwise by the donor.

(Continued)

Archdiocese of Philadelphia, Office of Catholic Education
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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE G - ENDOWMENTS - Continued

As of June 30, 2018 and 2017, \$2,989,943 and \$2,898,027, respectively, in donor-restricted endowment funds were recorded within permanently restricted net assets.

Changes in endowment net assets for the year ended June 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2017	\$ -	\$ 20,433	\$ 2,898,027	\$ 2,918,460
Investment income	-	25,634	16,138	41,772
Net appreciation (realized and unrealized gains)	<u>-</u>	<u>120,264</u>	<u>75,778</u>	<u>196,042</u>
Total investment return	-	145,898	91,916	237,814
Appropriation of endowment assets for expenditure	-	(54,800)	-	(54,800)
Funds with deficiencies	<u>-</u>	<u>(9,732)</u>	<u>-</u>	<u>(9,732)</u>
Endowment net assets, June 30, 2018	<u>\$ -</u>	<u>\$ 101,799</u>	<u>\$ 2,989,943</u>	<u>\$ 3,091,742</u>

Changes in endowment net assets for the year ended June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2016	\$ -	\$ 8,668	\$ 2,761,655	\$ 2,770,323
Investment income	-	28,854	18,169	47,023
Net appreciation (realized and unrealized gains)	<u>-</u>	<u>187,445</u>	<u>118,203</u>	<u>305,648</u>
Total investment return	-	216,299	136,372	352,671
Appropriation of endowment assets for expenditure	-	(59,800)	-	(59,800)
Funds with deficiencies	<u>-</u>	<u>(144,734)</u>	<u>-</u>	<u>(144,734)</u>
Endowment net assets, June 30, 2017	<u>\$ -</u>	<u>\$ 20,433</u>	<u>\$ 2,898,027</u>	<u>\$ 2,918,460</u>

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE H - INCOME TAXES

As part of the Archdiocese of Philadelphia, OCE has received exempt status from federal taxation under Section 501(c)(3) of the Internal Revenue Code.

OCE follows the accounting guidance for uncertainties in income tax positions which requires that a tax position be recognized or derecognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. OCE does not believe its financial statements include any material uncertain tax positions.

NOTE I - RELATED PARTY TRANSACTIONS

As of June 30, amounts due from related organizations consisted of the following:

	2018	2017
Individual high schools	\$ -	\$ 10,135
Combined Diocesan High Schools	25,123	43,740
	\$ 25,123	\$ 53,875

As of June 30, amounts due to related organizations consisted of the following:

	2018	2017
Office for Communications	\$ 1,869	\$ 90,000
Office of Child and Youth Protection	14,052	50,013
Office for General Services	1,497	664
Diocesan High Schools	16	114,629
Office for Financial Services	16,405	56,148
	\$ 33,839	\$ 311,454

OCE receives subsidies from the Diocesan High Schools Operations Account. Subsidies totaled \$5,551,796 (\$4,651,796 for administration costs and \$900,000 for marketing expense) and \$4,989,500 (\$4,201,500 for administration costs and \$788,000 for marketing expense) for the years ended June 30, 2018 and 2017, respectively.

OCE charged the Schools of Special Education \$215,000 for each of the years ended June 30, 2018 and 2017, for management services, which amounts are included in subsidies revenue.

Cash and cash equivalents include \$462,158 and \$525,382 at June 30, 2018 and 2017, respectively, held in trust funds maintained by the Office for Financial Services of the Archdiocese of Philadelphia. There are no conditions restricting the withdrawal of these funds.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE J - CONTRIBUTED SERVICES

The value of contributed services performed by members of religious groups is based on the lay equivalent salaries of personnel performing similar duties, less the stipend allowances and housing allowances paid for the religious personnel. The value of contributed services is included as revenue and, correspondingly, charged to expenditures.

The following is a schedule of contributed services as of June 30:

	2018	2017
Salaries and benefits - lay equivalent value of religious services	\$ 307,929	\$ 302,160
Expended for religious services	(181,551)	(192,707)
Salaries, related employee benefits and faculty house expenses	\$ 126,378	\$ 109,453

NOTE K - FAIR VALUE MEASUREMENTS

FASB 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.
- 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 Unobservable 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.

Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair value calculations may not be indicative of net realizable value or reflective of future fair values. Furthermore, although OCE 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.

(Continued)

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE K - FAIR VALUE MEASUREMENTS - Continued

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

	<u>Quoted prices in active markets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>	<u>Total fair value</u>
<u>2018</u>				
Assets				
Investments:				
SEI mutual funds	\$ 9,904,746	\$ -	\$ -	\$ 9,904,746
Beneficial interest in perpetual trust	<u>-</u>	<u>-</u>	<u>28,891,707</u>	<u>28,891,707</u>
Total of assets at June 30, 2018	<u>\$ 9,904,746</u>	<u>\$ -</u>	<u>\$ 28,891,707</u>	<u>\$ 38,796,453</u>
<u>2017</u>				
Assets				
Investments:				
SEI mutual funds	\$ 9,439,481	\$ -	\$ -	\$ 9,439,481
Beneficial interest in perpetual trust	<u>-</u>	<u>-</u>	<u>28,909,471</u>	<u>28,909,471</u>
Total of assets at June 30, 2017	<u>\$ 9,439,481</u>	<u>\$ -</u>	<u>\$ 28,909,471</u>	<u>\$ 38,348,952</u>

The following table presents assets under the beneficial interest in perpetual trust measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Beginning balance	\$ 28,909,471	\$ 28,252,784
Change in fair value of assets	1,434,236	2,081,687
Distribution from perpetual trust	<u>(1,452,000)</u>	<u>(1,425,000)</u>
	<u>\$ 28,891,707</u>	<u>\$ 28,909,471</u>

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2018 and 2017

NOTE L - FUNCTIONAL EXPENSES

OCE provides services to schools and entities included in Note A. Expenses related to providing these services are as follows for the years ended June 30:

	2018	2017
Program		
Tuition assistance/scholarships	\$ 1,127,105	\$ 1,382,857
Music and ministry programs	1,049,818	1,038,184
Sports	62,265	59,067
Administrative	8,832,441	8,141,243
	\$ 11,071,629	\$ 10,621,351

NOTE M - LEASE COMMITMENTS

OCE has entered into lease agreements with respect to equipment. The following is a schedule of future minimum lease payments for operating leases with noncancellable lease terms in excess of one year:

Year ending June 30,		
2019		\$ 26,532
2020		16,106
2021		16,106
2022		12,678
2023		853
		\$ 72,275

Lease expenses for the years ended June 30, 2018 and 2017 totaled \$31,206 and \$30,440, respectively.

NOTE N - SUBSEQUENT EVENTS

OCE evaluated its June 30, 2018 financial statements for subsequent events through November 26, 2018, the date the financial statements were available to be issued. OCE is not aware of any subsequent event which would require recognition or disclosure in the financial statements.