

**Central Administrative Office of the
Catholic Diocese of Arlington**

Financial Statements

as of June 30, 2017 and 2016 and Report Thereon

Central Administrative Office of the Catholic Diocese of Arlington
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June 30, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

Most Reverend Michael F. Burbidge
Bishop of the Catholic Diocese of Arlington
Central Administrative Office of the Catholic Diocese
Arlington, Virginia

We have audited the accompanying financial statements of the Central Administrative Office of the Catholic Diocese of Arlington (the Chancery) (a component of the Catholic Diocese of Arlington), which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chancery as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Arlington, Virginia
October 31, 2017



Central Administrative Office of the Catholic Diocese of Arlington
Statements of Financial Position
As of June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Assets		
Cash and cash equivalents	\$ 9,842,962	\$ 10,629,126
Accounts receivable, net	1,242,465	1,455,091
Accrued interest receivable	202,429	198,797
Bishop's Lenten Appeal pledges receivable	3,907,562	3,291,169
Bequests and major gifts pledges receivable, net	4,966,624	6,861,913
Prepaid expenses and other assets	875,438	1,684,171
Beneficial interest in residuary estates	3,710,000	9,782,000
Investments	258,830,549	225,687,303
Bond reserve and project fund	70,323,517	69,889,472
Demand notes and loans receivable		
Paul VI High School	3,060,796	3,312,865
200 North Glebe Road, Inc.	2,234,286	2,654,286
Property, equipment and land, net	104,071,148	105,623,339
Construction in progress and assets not yet placed in service	10,080,856	4,167,722
Land restricted for high school	14,500,000	14,500,000
Total assets	<u>\$ 487,848,632</u>	<u>\$ 459,737,254</u>
Liabilities and Net Assets		
Liabilities		
Deposits held in custody for others	\$ 3,295,569	\$ 2,748,394
Accounts payable and accrued expenses	5,342,279	7,743,783
Unearned revenue	84,020	881,931
Notes payable, net of discount	89,152	10,867
Amounts held on behalf of other diocesan entities	115,066,986	99,652,564
Annuity payment liability	227,747	212,572
Arlington Diocese Educational Foundation (ADEF) funds		
held for schools	2,572,584	2,463,272
Accrued pension liability, priests	6,702,598	9,594,109
Postretirement health benefit obligation	15,082,986	14,608,267
Bonds payable, net of unamortized bond costs	84,218,277	85,129,972
Total liabilities	<u>232,682,198</u>	<u>223,045,731</u>
Net assets		
Unrestricted		
Current operations	30,929,286	28,485,688
Invested in property, equipment and land	99,788,565	92,774,511
Functioning as endowment	13,391,235	11,745,027
Designated	17,820,695	15,569,383
Total unrestricted	<u>161,929,781</u>	<u>148,574,609</u>
Temporarily restricted	52,758,171	47,738,432
Permanently restricted	40,478,482	40,378,482
Total net assets	<u>255,166,434</u>	<u>236,691,523</u>
Total liabilities and net assets	<u>\$ 487,848,632</u>	<u>\$ 459,737,254</u>

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

Central Administrative Office of the Catholic Diocese of Arlington
Statement of Activities
For the year ended June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating revenues and support				
Bishop's Lenten Appeal	\$ 17,735,334	\$ -	\$ -	\$ 17,735,334
Operational assessment	7,602,149	-	-	7,602,149
Investment income for operations	2,350,000	252,500	-	2,602,500
Transmittal fees	72,487	-	-	72,487
Contributions, bequests and major gifts	262,351	8,799,838	100,000	9,162,189
Program revenue	3,273,298	-	-	3,273,298
Reclassification of donor restricted net assets	-	-	-	-
Satisfaction of temporary restrictions	10,227,696	(10,227,696)	-	-
Total operating revenues and support	<u>41,523,315</u>	<u>(1,175,358)</u>	<u>100,000</u>	<u>40,447,957</u>
Operating expenses				
Program services				
Pastoral	11,015,324	-	-	11,015,324
Religious personnel development	3,639,559	-	-	3,639,559
Education	7,597,235	-	-	7,597,235
Social services	4,067,032	-	-	4,067,032
Supporting services				
Diocesan administration and parochial support	12,984,313	-	-	12,984,313
Bishop's Lenten Appeal	938,482	-	-	938,482
Total operating expenses	<u>40,241,945</u>	<u>-</u>	<u>-</u>	<u>40,241,945</u>
Change in net assets from operations	<u>1,281,370</u>	<u>(1,175,358)</u>	<u>100,000</u>	<u>206,012</u>
Other changes in net assets				
Investment income less amount included in operations, net	5,509,021	6,843,389	-	12,352,410
Bond interest and related expenses	(340,613)	-	-	(340,613)
Unrealized gain on swap agreement	719,222	-	-	719,222
Insurance programs	3,344,044	-	-	3,344,044
Change in unfunded pension liability, priests	2,438,523	-	-	2,438,523
Change in unfunded postretirement health obligation	(474,719)	-	-	(474,719)
Net property gains	5,482	-	-	5,482
Diocesan rental income	1,524,751	-	-	1,524,751
Diocesan rental expense	(1,300,201)	-	-	(1,300,201)
Satisfaction of temporary restrictions	648,292	(648,292)	-	-
Total other changes in net assets	<u>12,073,802</u>	<u>6,195,097</u>	<u>-</u>	<u>18,268,899</u>
Change in net assets	13,355,172	5,019,739	100,000	18,474,911
Net assets, beginning of year	148,574,609	47,738,432	40,378,482	236,691,523
Net assets, end of year	<u>\$161,929,781</u>	<u>\$ 52,758,171</u>	<u>\$ 40,478,482</u>	<u>\$ 255,166,434</u>

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

Central Administrative Office of the Catholic Diocese of Arlington
Statement of Activities
For the year ended June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Operating revenues and support				
Bishop's Lenten Appeal	\$ 16,817,477	\$ -	\$ -	\$ 16,817,477
Operational assessment	7,525,121	-	-	7,525,121
Investment income for operations	2,000,000	-	-	2,000,000
Transmittal fees	159,471	-	-	159,471
Contributions, bequests and major gifts	5,703,775	9,856,162	1,325,000	16,884,937
Program revenue	2,982,198	-	-	2,982,198
Reclassification of donor restricted net assets	-	(1,250,000)	1,250,000	-
Satisfaction of temporary restrictions	10,076,358	(10,076,358)	-	-
Total operating revenues and support	<u>45,264,400</u>	<u>(1,470,196)</u>	<u>2,575,000</u>	<u>46,369,204</u>
Operating expenses				
Program services				
Pastoral	9,581,930	-	-	9,581,930
Religious personnel development	3,462,615	-	-	3,462,615
Education	7,932,195	-	-	7,932,195
Social services	4,441,631	-	-	4,441,631
Supporting services				
Diocesan administration and parochial support	12,844,532	-	-	12,844,532
Bishop's Lenten Appeal	952,677	-	-	952,677
Total operating expenses	<u>39,215,580</u>	<u>-</u>	<u>-</u>	<u>39,215,580</u>
Change in net assets from operations	<u>6,048,820</u>	<u>(1,470,196)</u>	<u>2,575,000</u>	<u>7,153,624</u>
Other changes in net assets				
Investment income less amount included in operations, net	(4,133,107)	(723,592)	-	(4,856,699)
Bond interest and related expenses	(562,843)	-	-	(562,843)
Unrealized loss on swap agreement	(769,032)	-	-	(769,032)
Insurance programs	752,206	-	-	752,206
Change in unfunded pension liability, priests	(2,743,913)	-	-	(2,743,913)
Change in unfunded postretirement health obligation	(2,883,617)	-	-	(2,883,617)
Net property gains	11,500	-	-	11,500
Diocesan rental income	1,536,549	-	-	1,536,549
Diocesan rental expense	(1,298,545)	-	-	(1,298,545)
Satisfaction of temporary restrictions	1,932,571	(1,932,571)	-	-
Total other changes in net assets	<u>(8,158,231)</u>	<u>(2,656,163)</u>	<u>-</u>	<u>(10,814,394)</u>
Change in net assets	(2,109,411)	(4,126,359)	2,575,000	(3,660,770)
Net assets, beginning of year	150,684,020	51,864,791	37,803,482	240,352,293
Net assets, end of year	<u>\$148,574,609</u>	<u>\$ 47,738,432</u>	<u>\$ 40,378,482</u>	<u>\$ 236,691,523</u>

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

Central Administrative Office of the Catholic Diocese of Arlington
Statements of Cash Flows
For the years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Change in net assets	18,474,911	(3,660,770)
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities		
Depreciation of property	2,872,107	2,804,265
Gain on sale of assets	(5,482)	(11,500)
Bond amortization	12,047	161,508
Contributed real property	-	(4,885,000)
Contributions for long-term purposes	(4,001,188)	(1,250,000)
(Decrease) increase in allowance for uncollectible accounts receivable	(121,920)	53,358
(Decrease) in discount and allowance on major gifts pledges receivable	(142,388)	(124,051)
Unrealized and realized (gains) losses on investments, net	(13,297,775)	4,818,523
Unrealized (gain) loss on interest rate swap	(719,223)	769,032
(Decrease) in amounts held on behalf of other diocesan entities	(248,297)	(288,184)
Decrease in accounts receivable	334,546	193,788
(Increase) in accrued interest receivable	(3,632)	(40,152)
(Increase) decrease in BLA pledges receivable	(616,393)	5,718
Decrease in bequests and major gift pledges receivable	2,037,677	2,095,576
Decrease in beneficial interest in residuary estates	6,072,000	4,718,000
Decrease (increase) in prepaid expenses and other assets	1,527,956	(1,220,027)
Increase in deposits held in custody for others	154,177	27,977
(Decrease) increase in accounts payable and accrued expenses	(1,735,070)	630,968
(Decrease) increase in unearned revenue	(797,911)	404,271
(Decrease) increase in accrued pension liability, priests	(2,891,511)	913,751
Increase in postretirement health benefit obligation	474,719	2,883,617
(Decrease) in annuity payment liability	(6,015)	(14,104)
Net cash and cash equivalents provided by operating activities	<u>7,373,335</u>	<u>8,986,564</u>
Cash flows from investing activities		
Purchases of equipment and payments made for construction in progress	(8,245,469)	(4,867,688)
Proceeds from sale of property	11,500	-
Decrease in 200 North Glebe Road loan receivable	420,000	800,000
Decrease in Paul VI High School loan receivable	252,069	245,895
Purchases of investments	(187,153,929)	(210,649,699)
Sales of investments	180,269,178	195,628,374
Net cash and cash equivalents (used in) investing activities	<u>(14,446,651)</u>	<u>(18,843,118)</u>
Cash flows from financing activities		
Proceeds from bond financings	-	70,000,000
Bond proceeds placed in restricted cash	-	(69,875,565)
Payments for debt issuance costs	-	(227,257)
Repayment of bonds and notes payable	(939,535)	(4,278,048)
Contributions received for permanent endowment	4,001,188	1,250,000
Cash received from other diocesan entities for long-term investment	3,490,447	11,844,307
Cash returned to other diocesan entities from investments	(609,673)	(488,179)
Payments to beneficiaries of split-interest agreements	(110,275)	(73,197)
Cash received from donors, split-interest agreements, including held for others	455,000	1,019,270
Net cash and cash equivalents provided by financing activities	<u>6,287,152</u>	<u>9,171,331</u>
Net (decrease) increase in cash and cash equivalents	(786,164)	(685,223)
Cash and cash equivalents, at beginning of year	10,629,126	11,314,349
Cash and cash equivalents, at end of year	<u>\$ 9,842,962</u>	<u>\$ 10,629,126</u>

Continued

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

Central Administrative Office of the Catholic Diocese of Arlington
Statements of Cash Flows
For the years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Supplemental cash flow information		
Interest paid on debt, including capitalized interest	\$ 1,274,305	\$ 473,109
Supplemental schedule of non-cash investing and financing activities		
Equipment purchases in accounts payable	\$ 422,961	\$ 1,089,395
Contributed investment, real property	\$ -	\$ 4,885,000

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

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

1. Nature of operations

The content of these financial statements is limited to the Central Administrative Office of the Catholic Diocese of Arlington (the Chancery). The Catholic Diocese of Arlington (the Diocese) consists of the 21 counties of the northern tier of Virginia, including the Northern Neck. The Chancery consists of various offices in order to organize events, monitor activities, coordinate efforts, and support the parishes and schools throughout the Diocese. The offices are classified into the following programs:

- Pastoral includes all offices primarily concerned with evangelization and communicating the Faith, such as the Office for Family Life, Office of Youth Ministry, Tribunal, Spanish Apostolate, Multicultural Ministries, Campus Ministries, the San Damiano Spiritual Life Center, and the St. Rose of Lima Priests' Retirement Villa.
- Religious Personnel Development includes offices associated with the formational and educational needs of priests and deacons and related activities, including the Office of Vocations.
- Education includes offices associated with Catholic school administration and oversight of parish-based religious education programs.
- Social Services includes diocesan support of Catholic Charities of the Diocese of Arlington, the Campaign for Human Development, Rice Bowl, Office for Protection of Children and Young People and other charitable contributions.
- Diocesan Administration and Parochial Support includes offices concerned with the overall diocesan administration including the Chancery, Communications, Planning, Construction and Facilities, Finance and Accounting, Human Resources and Employee Benefits, Development and Information Services. These offices also provide services in support of the parishes and schools of the Diocese.
- Bishop's Lenten Appeal (BLA) includes all expenses associated with the annual fundraising drive.

In fiscal year 2013, the Chancery launched the *Partners United in the Heart of Christ-Leadership Gift Initiative 2015* (LGI), a targeted major gift campaign. The goal of the LGI is to raise a minimum of \$55 million by the year 2015 in support of the most critical needs of the diocese in the areas of Catholic education, New Evangelization, support for our retired priests, Catholic Charities programs and various capital improvements.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

2. Basis of presentation and summary of significant accounting policies

Basis of presentation and combination

The financial statements include the accounts of the Chancery and centralized administrative and diocesan functions under the control of the Bishop of Arlington (the Diocesan Bishop). They do not include the accounts for the Catholic Charities of the Diocese of Arlington (Catholic Charities), the Arlington Catholic Herald, 200 North Glebe Road, Inc., Arlington Diocesan Investment and Loan Corporation (DIAL Corp), The Foundation for the Catholic Diocese of Arlington, Inc. (The Foundation), or the Diocese of Arlington Scholarship Foundation, Inc. (Scholarship Foundation), over which the Diocesan Bishop exercises control, and are reported separately. All intercompany transactions and balances have been eliminated.

The financial statements also do not include the accounts of organizations within the Diocese such as parishes, parish schools, diocesan high schools, cemeteries, homes, and offices and other institutions owned and operated by religious orders of men and women. These organizations may or may not be separate corporations under civil law; however, each is an operating entity distinct from the Chancery, maintains separate accounts and carries on its own services and programs. Transactions between the Chancery and such organizations are recorded on bases agreed upon by the parties.

All properties of parishes and other diocesan-owned entities are legally titled to the Diocesan Bishop and his successors in office. The cost of new properties for future parish sites and diocesan high schools is included in these financial statements. At the time approval is given to proceed with formal planning of construction of a new parish, the parish is granted free use of the property by the Diocesan Bishop. Although civil ownership resides with the Diocese, the parish, a separate canonical entity, receives ownership of the property at the time of donation from the Chancery. Proceeds of the sale of any excess property shall accrue to the Diocese.

Basis of accounting

The Chancery's financial statements are presented on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America.

Classification of net assets

The Chancery's net assets have been grouped into the following three categories:

Unrestricted Net Assets - Net assets that are not subject to donor-imposed restrictions.

Temporarily Restricted Net Assets - Assets whose use is subject to explicit or implicit donor-imposed restrictions that either expire by the passage of time or can be fulfilled and removed by actions of the Chancery pursuant to these donor restrictions.

Permanently Restricted Net Assets - Net assets that are subject to explicit or implicit donor-imposed restrictions that require the original contribution be maintained in perpetuity by the Chancery, but permits the use of the investment earnings for general or specific purposes.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

Unrealized and realized gains and losses and dividends and interest from investing in income-producing assets may be included in any of these net classifications depending on donor restrictions related to the principal investment.

Unrestricted net assets

To ensure observances of internally designated limitations and restrictions placed on the use of the resources available to the Chancery, the net assets of the Chancery are maintained in distinct subgroups, whereby, resources for various purposes are classified for accounting and reporting purposes into funds determined in accordance with the internally designated nature and purpose of such funds as follows:

Current operations include all resources available for support of Chancery operations.

Invested in property, equipment and land includes depreciated amounts invested in real property, computer hardware and software, office equipment and furniture, and property held for future projects and parish sites, as well as construction in progress, net of outstanding bonds and accounts payable used for these investments.

Functioning as endowment are quasi-endowment funds available for investment as the Diocesan Bishop designates and includes original patrimony of the Diocese. Income from these investments can be used at the discretion of the Diocesan Bishop.

Designated includes monies for the priests' mutual aid fund, medical and property insurance fund, scholarship fund, the Rosa Bente Lee, T. Uhl fund and the Bishop Keating fund.

Cash and cash equivalents

Cash and short-term investments with maturities at dates of purchase of three months or less are classified as cash equivalents, except that any such investments with cash held in trusts or by external endowment investment managers are classified with the deposits and investments, respectively. Cash equivalents are carried at cost which approximates fair value.

Restricted cash

The Chancery maintains in interest bearing checking accounts project funds and required bond reserves related to the Loudoun County Educational Facilities Revenue Bond, Series 2016 for construction of the new facility for Paul VI High School (Note 11).

Accounts and loans receivable

Accounts and loans receivable are stated at the amount management expects to collect from outstanding balances. The Chancery provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and credit to accounts and loans receivable.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

Property, equipment and land

Property, equipment and land are carried at cost or, in the case of donated or bequeathed property, at fair value at date of donation. Property, equipment and land include real property, equipment, land and the original buildings and grounds of four regional high schools and other affiliated organizations under the control of the Diocesan Bishop. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, generally over 3 to 50 years. The cost of repairs and maintenance is expensed as incurred. It is the general policy of the Chancery to capitalize all expenditures for property and equipment in excess of \$5,000.

Investments and investment valuation

Investments are stated at fair value, as described in Note 8, *Fair value measurements*. Investments consist of money market funds, U.S. Government and sponsored enterprises securities, corporate bonds and equities, and alternative investments.

Investment income and expense

Realized gains and losses on investment transactions are recorded on the average cost method and are included in investment income in the statement of activities. Changes in unrealized appreciation and depreciation for the year are similarly reported. Interest and dividend income are recorded on the accrual basis.

Investment pools

The Chancery maintains master investment accounts for long-term assets, including certain reserves held on behalf of DIAL Corp and endowments, including those amounts held on behalf of Catholic Charities and The Foundation. Realized and unrealized gains and losses from securities in the master investment accounts are allocated monthly to the individual participants based on the relationship of the market value of each participant to the total market value of the master investment accounts, as adjusted for additions to or deductions from those accounts.

Derivative instruments

A derivative financial instrument is used to manage a variable interest rate on long-term debt. The Chancery has entered into an interest rate swap agreement to reduce the impact of changes in the variable interest rate. The Chancery recognizes the interest rate swap agreement as a net asset or liability at fair value on the statements of financial position. Changes in fair value on this agreement are recorded in the statement of activities as non-operating gains or losses.

Unearned revenue

Income from program activities received in advance is deferred and recognized in the period the event is held.

Contributions

Contributions are recognized when the donor makes an unconditional promise to transfer assets. These contributions are recorded as unrestricted, temporarily restricted, or permanently restricted revenue depending on the existence or nature of any donor restrictions.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

Contributions that are restricted by the donor are reported as increases in unrestricted net assets in the fiscal year in which the restrictions expire or are satisfied. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When restrictions are satisfied, temporarily restricted net assets are released to unrestricted net assets.

Contributions received by the Chancery on behalf of other related entities are not recorded as contributions on the Chancery's statement of activities. Rather these amounts are agency transactions since the other related entities carry the variance power and not the Chancery.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

Concentration of credit risk

Financial instruments which potentially subject the Chancery to a concentration of credit risk principally consist of cash and cash equivalents, accounts receivable, and investments. The Chancery maintains cash and investments with several financial institutions. The Chancery performs periodic evaluations of these institutions for relative credit standing. The total deposits at these institutions at times exceed the amount guaranteed by federal agencies and therefore bear some risk since they are not collateralized. Cash on deposit with financial institutions exceeded the federally insured limit by \$74,052,678 and \$72,687,090 as of June 30, 2017 and 2016, respectively. This includes restricted cash of \$70,323,517 and \$69,889,472 as of June 30, 2017 and 2016, respectively, that is required to be kept on hand in one financial institution, relating to the PVI Catholic High School project and reserve funds. The Chancery also invests excess funds in overnight investment agreements which are not federally insured but are collateralized by U.S. treasuries or mortgage-backed securities of U.S. government-sponsored enterprises. Amounts held in overnight investments as of June 30, 2017 and 2016 were \$5,683,234 and \$6,946,183 respectively. Pledges receivable, which have been adjusted for doubtful accounts, are due from individuals, corporations, and foundations. The amount due from one contributor comprises 38% of the total bequest and major gifts pledges receivable balance at June 30, 2017. To date, no permanent losses or impairments have been experienced due to concentration in these areas.

Income taxes

The Chancery is exempt from federal and state income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code and related provisions of the Commonwealth of Virginia. They are not subject to the filing requirements of the Form 990. The Chancery may be subject to tax to the extent it has taxable unrelated business income. The Chancery has no unrelated business income and accordingly, no provision for income taxes is provided in the accompanying financial statements. The Chancery believes that it has appropriate support for any tax provisions taken, and as such, does not have any uncertain tax positions that are material to the financial statements.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year financial statement presentation. The reclassification of prior year amounts did not affect previously reported change in net assets or net asset balances.

Subsequent events

In preparing these financial statements, the Chancery has evaluated events and transactions for potential recognition or disclosure through October 31, 2017, the date the financial statements were available to be issued.

3. Accounts receivable

The Chancery bills the parishes, schools, other related entities and individuals for various items paid by the Chancery or covered under the diocesan structure. These include the retirement programs for priests and lay employees, diocesan tuition assistance program, unemployment compensation, and health and property insurance. The Chancery also bills the parishes on a monthly basis for the operational assessment, a percentage of the parish offertory income to help offset the administration of diocesan programs. Accounts receivable are not collateralized.

Accounts receivable are as follows as of June 30:

	<u>2017</u>	<u>2016</u>
Parishes	\$ 389,520	\$ 332,590
Schools	584,021	627,582
Other diocesan entities	89,579	91,981
Employee advances	7,223	7,534
Due from brokers	52,848	75,040
Miscellaneous	<u>172,204</u>	<u>495,214</u>
Total accounts receivable	1,295,395	1,629,941
Less: allowance for doubtful accounts	<u>(52,930)</u>	<u>(174,850)</u>
Total accounts receivable, net	<u>\$ 1,242,465</u>	<u>\$ 1,455,091</u>

4. Bishop's Lenten Appeal pledges receivable

As of June 30, 2017 and 2016, contributors to the Bishop's Lenten Appeal (BLA) have unconditionally promised to give \$3,907,562 and \$3,291,169, respectively. As the Bishop's Lenten Appeal is an annual campaign, the pledges are due within one year.

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5. Bequests and major gifts pledges receivable and Beneficial interest in residuary estates

Unconditional promises to give are as follows as of June 30:

	<u>2017</u>	<u>2016</u>
Receivables due in one year or less	\$ -	\$ 50,000
Receivables due in one to five years	<u>5,122,607</u>	<u>7,110,285</u>
Total unconditional promises to give	5,122,607	7,160,285
Less: allowance for doubtful accounts	(26,100)	-
Less: discount to present value	<u>(129,883)</u>	<u>(298,372)</u>
 Pledges receivable, net	 <u>\$ 4,966,624</u>	 <u>\$ 6,861,913</u>

Pledges receivable include amounts related to the LGI campaign (Note 1). Unconditional promises to give due in more than one year are discounted at rates ranging from 2% to 2.63%.

Beneficial interest in residuary estates

Beneficial interest in residuary estates as of June 30, 2017 and 2016 includes amounts due from several estates of which the Chancery has been notified it is a beneficiary.

Estimated amounts due as of June 30 are as follows:

	<u>2017</u>	<u>2016</u>
Residuary interests in cash and real property, for unrestricted use, \$1,612,000 board designated at June 30, 2016	\$ 170,000	\$ 2,282,000
Residuary interest in Rosa Bente Lee Trust, for permanent endowment, with investment earnings available for general purposes	<u>3,540,000</u>	<u>7,500,000</u>
 Beneficial interest in residuary estates	 <u>\$ 3,710,000</u>	 <u>\$ 9,782,000</u>

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6. Investments

Investments are stated at fair value. The cost of investments and related fair values at June 30, 2017 and 2016 consist of the following:

	2017		2016	
	Cost	Fair Value	Cost	Fair Value
Short-term investments	\$ 11,274,731	\$ 11,274,731	\$ 13,949,831	\$ 13,949,831
U.S. Government and sponsored enterprises securities	4,827,667	4,735,304	2,897,649	2,861,957
Corporate, municipal and foreign bonds and other fixed instruments	51,081,850	53,764,540	46,574,252	49,716,417
Equities, including publicly traded REITs	145,547,392	170,312,327	132,404,415	143,323,519
Real property held for investment	7,812,383	7,812,383	7,793,599	7,793,599
Alternative investments	10,186,033	10,931,264	7,604,367	8,041,980
	\$ 230,730,056	\$ 258,830,549	\$ 211,224,113	\$ 225,687,303

Included in investments at June 30, 2017 and 2016 is \$474,939 and \$424,449, respectively, representing the fair market value of assets held under split interest agreements for which the Chancery is the trustee. Monthly, quarterly or semiannual distributions are made to the donors. The ultimate beneficiaries are the Chancery, Catholic Charities and parishes. The proceeds are expected to be received in five to seventeen years, based on published actuarial tables, and are calculated using discount rates which represent the risk-free rates in existence at the date of the gifts. Amounts due to annuitants and related parties are disclosed as annuity payment liability in the accompanying statements of financial position. A portion of the amounts held in trust are recorded as deposits held in custody for others in the accompanying statement until which time the beneficial interests become irrevocable.

Investments are held for the following purposes:

	2017	2016
Current operations and programs	\$ 59,910,529	\$ 54,338,024
Long-term purposes, including endowments	77,921,266	66,671,626
Assets held on behalf of other diocesan entities, including DIAL Corp	116,652,628	100,594,044
Arlington Diocese Educational Fund (ADEF)	4,346,126	4,083,609
Total	\$ 258,830,549	\$ 225,687,303

Investments in the amount of \$217,123,053 and \$187,023,397 as of June 30, 2017 and 2016, respectively, are held in a pool under a trust agreement with a bank in which participants share in allocated investment income and loss.

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Investment income is reported on the statement of activities as follows:

	<u>2017</u>	<u>2016</u>
For Operations	\$ 2,602,500	\$ 2,000,000
In Other changes in net assets	<u>12,352,410</u>	<u>(4,856,699)</u>
Net investment gains (losses) - Chancery	<u>\$ 14,954,910</u>	<u>\$ (2,856,699)</u>

Investment income represented in operating revenue represents the amount included in the approved budget based on a spending rate formula.

Total net investment income for the years ended June 30, 2017 and 2016, respectively, consists of the following:

	<u>2017</u>	<u>2016</u>
Chancery		
Interest, dividends and other investment income	\$ 2,450,370	\$ 2,606,518
Realized gains, net	6,165,850	708,136
Unrealized gains (losses), net	7,131,925	(5,526,659)
Less - investment management expenses	<u>(793,235)</u>	<u>(644,694)</u>
Net investment gains (losses) - Chancery	\$ 14,954,910	\$ (2,856,699)
Funds held for diocesan entities		
Investment income allocated to diocesan entities	<u>\$ 14,500,496</u>	<u>\$ (2,850,963)</u>
Total net investment gains (losses) - Chancery and funds held for diocesan entities	<u>\$ 29,455,406</u>	<u>\$ (5,707,662)</u>

The Chancery invests in a variety of investment securities and therefore, is subject to various risks such as interest rate, credit and overall market volatility risk. Due to continuing market risk and fluctuations, it is reasonably possible that significant changes in investment values will occur in the near term that could materially affect the amounts reported in the statement of financial position and the results of operations.

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7. Fair value of financial instruments

Estimated fair values of the Chancery's financial instruments (all of which are held for nontrading purposes) are as follows:

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 9,842,962	\$ 9,842,962	\$ 10,629,126	\$ 10,629,126
Beneficial interest in residuary estates	\$ 3,710,000	\$ 3,710,000	\$ 9,782,000	\$ 9,782,000
Investments	\$ 258,830,549	\$ 258,830,549	\$ 225,687,303	\$ 225,687,303
Interest rate swap agreement	\$ 43,435	\$ 43,435	\$ (675,788)	\$ (675,788)
Demand notes and loans receivable	\$ 5,295,082	\$ 5,087,165	\$ 5,967,151	\$ 5,799,636
Bonds payable, net of unamortized bond costs	\$ 84,218,277	\$ 84,218,277	\$ 85,129,972	\$ 85,129,972

The carrying amount for cash and cash equivalents approximates fair value.

Beneficial interest in residuary estates is measured using the fair value of the assets held in the trusts reported by the trustees.

The fair value of demand notes and loans receivable are based on quoted market rates of debt securities with similar repayment terms.

The carrying value of bonds payable, which accrue interest at a floating market rate, approximates the market value.

Investments and interest rate swap agreements are carried at fair value as described in Note 8.

8. Fair value measurements

The Chancery measures fair value using a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Accordingly, the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest

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priority to unobservable inputs (Level 3). The Chancery may use valuation techniques consistent with the market, income and cost approaches to measure fair value.

The inputs used to measure fair value are categorized into the following three categories:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities such as stocks and government bonds.
- Level 2 Inputs – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Inputs – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair values of assets measured on a recurring basis by level at June 30, 2017 are as follows:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets				
Investments				
Short-term investments	\$ 11,274,731	\$ 11,274,731	\$ -	\$ -
U.S. Government and sponsored enterprises securities	4,735,304	3,164,005	1,571,299	-
Corporate, municipal and foreign bonds and other fixed instruments	53,764,540	-	53,764,540	-
Equities, including publicly traded REITs	170,312,327	170,312,327	-	-
Real property held for investment	7,812,383	-	7,812,383	-
Alternative investments	10,931,264	-	-	10,931,264
Total	<u>\$ 258,830,549</u>	<u>\$ 184,751,063</u>	<u>\$ 63,148,222</u>	<u>\$ 10,931,264</u>

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Fair values of assets measured on a recurring basis by level at June 30, 2016 are as follows:

Assets	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments				
Short-term investments	\$ 13,949,831	\$ 13,949,831	\$ -	\$ -
U.S. Government and sponsored enterprises securities	2,861,957	2,527,078	334,879	-
Corporate, municipal and foreign bonds and other fixed instruments	49,716,417	-	49,716,417	-
Equities, including publicly traded REITs	143,323,519	143,323,519	-	-
Real property held for investment	7,793,599	-	7,793,599	-
Alternative investments	8,041,980	-	-	8,041,980
Total	<u>\$ 225,687,303</u>	<u>\$ 159,800,428</u>	<u>\$ 57,844,895</u>	<u>\$ 8,041,980</u>

The following is a description of what is included in the categories of investments, along with the valuation methodologies used for measuring assets at fair value.

Short-term investments – These include money market and money market mutual funds, investing primarily in cash, U.S. Treasury obligations, or short-term, high quality fixed income securities.

U.S. Government and sponsored enterprises securities – U.S. Treasury notes and bonds are valued by independent pricing services based on active market data and are categorized as Level 1. U.S. government-sponsored enterprises securities and mortgage-backed securities, categorized as Level 2, are valued by independent pricing services based on inputs that may include issuer type, coupon, cash flows, benchmark yields, reported trades, and bids and offers.

Corporate, municipal and foreign bonds and other fixed instruments – These investments consist primarily of holdings in three diversified bond funds, two fixed bond funds and one high yield bond fund. Both bond funds invest primarily in U.S. Government, agency, corporate and mortgage-backed securities. The fair value of the bond fund investments are estimated using the net asset value per share of investments provided by the fund manager. Holdings also include fixed rate corporate and foreign bonds that are valued based on yields currently available for comparable securities. All investments are categorized as Level 2.

Equity securities, including publicly traded REITs – These investments are individual securities and are valued based on their published closing price in an active market.

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Real property held for investment – Real estate investment properties, categorized as Level 2, are valued using a market approach based primarily on current appraised values and other information for similar property.

Alternative investments – Comprised of separate private equity interests focusing on venture and/or buy-out strategies, investments in real assets leased to the U.S. government, a diversified portfolio with concentrations in timber, energy and real estate, and investment in a private investment partnership. The private investment partnership seeks to attain current income and capital appreciation promoting strategies that are in accordance with Catholic social teaching. These investments are classified within Level 3 as the value of these interests is primarily based on the net asset value reported by external fund managers as described in the investment funds' financial statements, all of which are subject to a third party annual audit.

Alternative investments reported at net asset value are reflected below:

	2017	2016	Unfunded	Redemption	Redemption
	Fair Value	Fair Value	Commitments	Frequency	Notice
			June 30, 2017		Period
Private equity - venture/buyout	\$ 3,685,883	\$ 1,499,745	\$ 5,228,608	N/A	N/A
Private equity - diversified portfolio	512,367	736,890	152,345	N/A	N/A
Private investment partnership	6,733,014	5,805,345	-	Up to 50% of capital each rolling 3-month period	95 days
	<u>\$ 10,931,264</u>	<u>\$ 8,041,980</u>	<u>\$ 5,380,953</u>		

The Chancery may not sell, transfer or pledge their interest in the private equity funds, except with the consent of the general partner. For these investments, periodic distributions are received through liquidation of the underlying investments of the fund. In February 2015, the private equity, real assets fund obtained shares in a newly formed public REIT in exchange for portfolio holdings. Liquidation of the fund was completed in 2016 with the Chancery obtaining shares in the publicly traded REIT. The private equity, real asset investment was transferred from Level 3 to Level 1 in 2016 as the newly formed investment is publicly traded.

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The changes in investment measured at fair value using Level 3 inputs are reflected below:

	<u>2017</u>	<u>2016</u>
Balance, beginning of year	\$ 8,041,980	\$11,161,158
Contributions	2,786,425	1,581,500
Distributions	(204,752)	(193,633)
Change in value - unrealized gain	307,611	346,185
Transfer to Level 1	-	(4,853,230)
Balance, end of year	<u>\$ 10,931,264</u>	<u>\$ 8,041,980</u>

Unrealized gains recorded for Level 3 investments are reported as investment income under other changes in net assets on the statement of activities. Certain distributions from alternative investments are recorded as dividend income when identified by the fund manager as a distribution from earnings and profits from the underlying investments. Distributions from Level 3 investments recorded as dividend income amounts to \$0 and \$166,218 for the years ended June 30, 2017 and 2016, respectively.

The Chancery recognizes transfers into and out of levels at the end of the reporting period.

The estimated fair value of derivative assets and liabilities measured using Level 2 inputs, at June 30 are:

	<u>2017</u>		<u>2016</u>	
	<u>Notional Amount</u>	<u>Fair Value Asset</u>	<u>Notional Amount</u>	<u>Fair Value (Liability)</u>
Interest rate swap agreement	\$ 16,174,192	\$ 43,435	\$ 17,504,896	\$ (675,787)

The Chancery has entered into an interest rate swap agreement in association with a financing arrangement of bonds payable (Note 11). The fair value of the interest rate swap agreement is determined by comparing the difference between the present value of the fixed monthly payments and the estimated present value of the floating monthly payments based on estimated forward rates derived from yield curves. The Chancery has recognized in the statement of activities an increase in fair value of the interest rate swap agreement of \$719,222 for the year ended June 30, 2017 and a decrease of \$769,032 for the year ended June 30, 2016. In the accompanying statement of financial position, assets related to derivatives are reported in prepaid expenses and other assets and liabilities in accounts payable and accrued expenses.

Due to the inherent uncertainty involving assumptions and estimation methods, the fair value of the investments and interest rate swap agreements may differ materially from actual results.

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9. Related-party transactions

The Chancery has transactions with diocesan parishes, schools, and other related entities. Below is a summary of the impact of significant transactions with these related parties on the statements of financial position and statements of activities:

	<u>2017</u>	<u>2016</u>
Assets:		
Accounts receivable, parishes, schools and other related entities, net	\$ 1,060,955	\$ 953,449
Parishes, major gift pledges receivable	462,000	1,117,000
Due from Catholic Charities, split interest annuity	111,844	100,746
Paul VI Catholic High School loan receivable, proceeds used for renovations and additions	3,060,796	3,312,865
Saint John Paul the Great Catholic High School loan receivable, interest waived for 2017 and 2016, no fixed repayment, repayments accepted as cash is available, net of allowance	-	-
200 North Glebe Road, Inc., interest waived for 2017 and 2016, due on demand, repayments accepted as cash is available	2,234,286	2,654,286
	<u>\$ 6,929,881</u>	<u>\$ 8,138,346</u>

	<u>2017</u>	<u>2016</u>
Liabilities:		
Accounts payable, parishes, schools, other related entities	\$ 25,083	\$ 16,911
Due to parishes, split interest annuities	7,933	5,529
Amounts held on behalf of other diocesan entities:		
DIAL Corp, funds held in investment pool	93,890,315	82,348,214
Catholic Charities, endowment funds held in investment pool	13,974,207	12,556,077
The Foundation, endowment funds held in investment pool	7,129,042	4,426,553
Catholic Charities, capital campaign pledges	-	4,128
Parishes, capital campaign and major gift pledges	73,422	317,592
ADEF funds held for schools	2,572,584	2,463,272
	<u>\$ 117,672,586</u>	<u>\$ 102,138,276</u>

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	<u>2017</u>	<u>2016</u>
Revenues and Support:		
Operational assessment, parishes	\$ 7,602,149	\$ 7,525,121
Contributions, diocesan tuition assistance program	2,375,671	2,351,600
Contributions, major gifts (LGI), parishes	-	1,329,400
Contribution, restricted, from GMU Catholic Campus Ministry	1,003,917	-
Program fees	2,809,667	1,795,999
Information technology, accounting and administrative support	370,228	341,210
Rental income, Catholic Charities	316,913	302,324
Rental income, Arlington Catholic Herald	135,569	129,328
Rental income, Saint John Paul the Great Catholic High School	1,434,456	1,434,456
Insurance and risk management premiums billed	19,516,663	18,514,825
	<u>\$35,565,233</u>	<u>\$33,724,263</u>
	<u>2017</u>	<u>2016</u>
Expenses:		
Rent paid to 200 N. Glebe Road, Inc.	\$ 2,226,692	\$ 2,139,675
Contributions, tuition assistance program	2,086,574	2,332,865
Contributions, tuition assistance endowment grants	1,025,000	850,000
Contributions, student financial aid (LGI)	406,075	267,500
Contribution, subsidy to Catholic Charities	1,917,676	1,863,433
Contribution, Catholic Charities endowment fund (LGI)	104,300	660,403
Contribution, restricted for Catholic Charities programs (LGI)	555,764	115,729
Contribution, restricted, diocesan high schools capital needs (LGI)	1,698,368	2,205,649
Contribution, restricted, Foundation for the CDA SEEF (LGI)	-	138,670
Contribution, other program service subsidies	108,993	77,560
Contribution, Cathedral of St. Thomas More renovations	-	500,000
Contributions made to Lay Retirement Plan	1,102,997	1,047,350
Contributions made to Priest Retirement Plan	336,000	300,000
Advertising expense to Arlington Catholic Herald	147,438	153,690
	<u>\$11,715,877</u>	<u>\$ 12,652,524</u>

Affiliates participating in the diocesan sponsored insurance plans are charged premiums to cover estimated claims and program expenses. The net revenue or expense of these programs is reflected under other changes in net assets.

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Certain parishes have chosen to participate in the Arlington Diocese Educational Foundation (ADEF) program. This program was established to support the cause of Catholic education through endowments or quasi-endowment investment accounts. The assets of ADEF are held in trust with the Chancery being steward and guardian of such endowments.

The Chancery administers a master investment pool (Notes 2 and 6). Endowment funds and long term investments of certain affiliates are held in the master pool at their request. Investment income is allocated based on the proportionate market value of investments held by participants.

The Chancery has entered into services agreements with certain affiliates to provide information technology, accounting and administrative support.

Prior to 2017, George Mason University Catholic Campus Ministry (GMU CCM) operated as separate entity distinct from the Chancery, with the Chancery providing some support in personnel and professional services. In 2017, it was agreed that the entire operations of GMU CCM would be incorporated into the Chancery as a department. As part of this transition, it was also agreed that a contribution would be made from GMU CCM to the Chancery of accumulated cash and investment reserves. This initial contribution in the amount of \$1,003,917 will be restricted for program activities of GMU CCM. In addition to this restricted contribution, continued operations of GMU CCM will be supported by GMU CCM collection income and BLA contributions.

Property and equipment includes the original buildings and grounds of four diocesan high schools and a regional elementary school acquired by the Chancery. The Chancery does not charge Bishop O'Connell, Paul VI or Bishop Ireton Catholic High Schools, nor the regional elementary school, Epiphany Catholic School, for use of the facilities. Improvements and repairs necessary to maintain the property are financed by the schools and carried on their financial statements. The Chancery has joined with Catholic Charities in providing transitional housing and counseling services by providing use of a family housing facility at no charge.

The Chancery has advanced funds to Saint John Paul the Great Catholic High School periodically since its opening in August 2008, to supplement tuition in covering operating costs. The collectability of the loan was reviewed in 2017 and 2016 and based on current enrollment and operating financial position a reserve was established on the loan balance, \$12,116,013 at June 30, 2017 and 2016, respectively. It is at least reasonably possible that the estimated loan to be collected may change as school enrollment and fundraising activities increase.

The Chancery obtained financing through issuance of tax-exempt revenue bonds with the Prince William County Industrial Authority, a portion of which was used for building renovations and improvements to Paul VI Catholic High School (PVI) (Note 11). The Chancery established a loan with PVI in the amount of \$4,960,000, the original amount of bond proceeds used to cover these costs. In April 2016, the Chancery entered into a refinancing arrangement, prepaying the portion of the bond outstanding that financed the PVI renovations and improvements. The Chancery continued to extend terms of the loan with PVI based on the effective rate of the refinanced bonds, 2.482%. Monthly principal and interest payments of \$27,563 are expected to be paid by PVI to the Chancery through maturity, December 1, 2027.

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Loans have been made to 200 N. Glebe Road, Inc., a related entity and lessor of office space to the Chancery. The loan to 200 N. Glebe Road, Inc. is due on demand, with repayments accepted as cash is available. Amounts repaid by 200 N. Glebe Road, Inc. were \$420,000 and \$800,000 for the years ended June 30, 2017 and 2016, respectively.

Annually, management assesses the adequacy of the allowance for credit losses evaluating required and expected repayment on loans. Changes in the allowance for related party loans receivable as of June 30 are as follows:

	<u>2017</u>	<u>2016</u>
Balance, beginning of year	\$ 12,116,013	\$12,116,013
Provision for credit losses	-	-
Balance, end of year	<u>\$ 12,116,013</u>	<u>\$12,116,013</u>

The Chancery granted three diocesan high schools \$1,698,368 and \$2,205,649 for the years ended June 30, 2017 and 2016, respectively. These funds were raised through the Leadership Gift Initiative campaign and restricted for the capital needs of the schools. The grants may only be used for capital improvements approved by the Chancery.

10. Property, equipment and land, net

Property, equipment and land, net, consist of the following at June 30:

	<u>2017</u>	<u>2016</u>
Operating properties-buildings	\$ 85,463,929	\$ 85,463,929
Operating properties-land and land development	25,834,566	25,834,566
Operating properties-improvements	9,054,186	8,813,256
Operating properties-furniture and equipment	3,912,856	3,915,755
Land held for future projects and parishes	12,824,939	12,481,688
Office furniture and equipment	801,160	770,113
Computer hardware	572,189	467,093
Computer software	1,415,485	1,047,836
Vehicles	791,236	645,968
Leasehold improvements	1,042,610	1,042,610
Total property, equipment and land	<u>141,713,156</u>	<u>140,482,814</u>
Less: accumulated depreciation	<u>(37,642,008)</u>	<u>(34,859,475)</u>
Property, equipment and land, net	<u>\$ 104,071,148</u>	<u>\$ 105,623,339</u>

Depreciation expense was \$2,872,107 and \$2,804,265 during the years ended June 30, 2017 and 2016, respectively. Of the total assets listed above, \$14,169,257 and \$13,593,109 were fully depreciated at June 30, 2017 and 2016, respectively.

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Construction in progress and assets not yet placed in service includes costs related to the building of the second phase of the diocesan priests' retirement home residence and planning and design of the new facility for Paul VI Catholic High School to be located in Loudoun County.

In 1998, a conditional gift of approximately forty acres of land in Prince William County was donated to the Chancery. In August 2006, the conditions of this gift were satisfied and the donation was recorded at the appraised value of \$14,500,000. The land must be used for educational purposes for a period of thirty years and therefore the donation will remain in temporarily restricted net assets until such time this restriction expires.

Construction of Saint John Paul the Great Catholic High School was funded, in part, from tax-exempt bonds (Note 11). Interest costs, net of interest earned from the temporary investment of the bonds were capitalized. Upon completion of the high school, bond interest cost was charged to expense.

Capitalized interest is included in operating properties. Amortization of capitalized interest is included in depreciation expense. Capitalized interest at June 30 was:

	<u>2017</u>	<u>2016</u>
Net amount capitalized, beginning of year	\$ 827,010	\$ 846,642
Less: amortization expense	<u>19,632</u>	<u>19,632</u>
Net amount capitalized, end of year	<u>\$ 807,378</u>	<u>\$ 827,010</u>

Cumulative investment earnings do not exceed cumulative investment expenses, and therefore the Diocese does not have an arbitrage recapture obligation.

Interest incurred on the Loudoun County bond to be used in construction of a new facility for Paul VI Catholic High School (Note 11) is included in construction in progress and will included in operating properties when placed in service.

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11. Bonds payable

The Chancery has obtained two separate bank qualified tax-exempt financing arrangements for the construction of two high school facilities. The following bonds were outstanding at June 30:

	Year of Final Maturity	Current Rate 2017	2017	2016
Prince William County, Educational Facilities Revenue Refunding Bond, Series 2016	12/1/2027	1.36%	\$ 14,430,396	\$ 15,354,138
Loudoun County, Educational Facilities Revenue Bond, Series 2016	2/1/2041	1.46%	<u>70,000,000</u>	<u>70,000,000</u>
			84,430,396	85,354,138
Less unamortized bond issuance costs			<u>212,119</u>	<u>224,166</u>
			<u>\$ 84,218,277</u>	<u>\$ 85,129,972</u>

In April 2016, the Chancery entered into a refinancing arrangement related to the Prince William County Series 2012 bonds, prepaying \$3,347,382, the portion of the bond outstanding that financed additions and renovations to Paul VI Catholic High School. The outstanding principal balance of the bond after this repayment was refinanced with proceeds from Industrial Development Authority of the County of Prince William Educational Facilities Revenue Refunding Bond, Series 2016. This indebtedness relates only to the construction of the Saint John Paul the Great High School located in Prince William County, Virginia. The Prince William County, Series 2012 bonds payable bear interest at a floating rate, 78% of the 1-month London Interbank Offered Rate (LIBOR) plus 1.002%. The Prince William County, Series 2016 bonds payable bear interest at a floating rate, 68% of the 1-month London Interbank Offered Rate (LIBOR) plus .65%. Principal and interest are payable monthly based on a 20 year amortization with a balloon payment due December 2027. The Chancery kept in place an interest rate swap agreement related to Prince William County bonds, securing an effective fixed rate of 2.13% for an original notional amount of \$21,405,966, decreasing based on a 15 year amortization, terminating December 1, 2017. The notional amount at June 30, 2017 and 2016 is \$16,174,192 and \$17,504,896, respectively.

In February 2016, the Chancery secured bank qualified tax-exempt financing, Loudoun County, Education Facilities Revenue Bond, Series 2016 in the amount of \$70,000,000 to be used in construction of a new facility for Paul VI Catholic High School. The Loudoun County, Series 2016 bonds payable bear interest at a floating rate, 68% of the 1-month London Interbank Offered Rate (LIBOR) plus .7475%. As of June 30, 2017, \$70,000,000 in proceeds have been advanced on the loan, \$69,823,221 held separately in an interest-bearing checking account to be used exclusively for payment of project expenditures. The Chancery is required to maintain a debt service reserve fund with the bank for a percentage of the outstanding balance on the bond, \$500,296 and \$500,092 as of June 30, 2017 and 2016, respectively. Following a four year interest only period, the Chancery will be required to make minimum principal reductions through 2025 totaling \$50,000,000. The remaining balance of \$20,000,000 is to be amortized over 16 years, with a final payment due February 1, 2041.

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The bonds contain no pre-payment penalties but require compliance with certain covenants such as operating liquidity, additional indebtedness, maintenance of insurance on the project, use of the bond proceeds, maintenance of tax-exempt status of the Diocese and financial reporting.

Bond interest expense is \$328,566 and \$375,769, reflective of the swap agreement, for the years ended June 30, 2017 and 2016, respectively. Bond related costs for the year ended June 30, 2016 include the write off of unamortized bond costs in connection with the redemption of 2012 bonds payable. Amortization of bond issuance costs is reported as bond interest and related expenses in the statement of activities.

Maturities on the bonds payable annually for the years through 2022 and thereafter are as follows:

2018	\$ 948,515
2019	973,249
2020	998,078
2021	21,051,362
2022	16,024,105
Thereafter	44,222,968
	<u>\$ 84,218,277</u>

12. Pension expense

Pension plan - employees

The Diocese has a noncontributory defined benefit pension plan which covers substantially all lay employees within the Diocese. The plan provides benefits based on a formula which takes into account the lay employees' annual compensation, period of service, and age.

The lay employees' plan is administered by the Chancery, but is a multi-employer plan. The plan covers employees from other diocesan organizations, such as parishes and schools, the Arlington Catholic Herald, and diocesan high schools, which, as noted in Note 2, are not combined with the Chancery for financial reporting purposes. Premiums are calculated based on 10% of eligible participant salaries, and are used toward the quarterly funding of the plan. The cost of the plan for the Chancery and charged to expense was \$1,102,997 and \$1,047,350 for the years ended June 30, 2017 and 2016, respectively. The plan is not subject to ERISA funding requirements.

Pension plan - priests

The Diocese also has a noncontributory defined benefit plan which covers diocesan priests incardinated in the Diocese and provides benefits based on age and compensation at retirement. As required by generally accepted accounting standards in the United States of America, the full funding status of the defined benefit pension plans, as of the statement of financial position date, has been recognized as an asset (overfunded plan) or as a liability (underfunded plan). The pension benefit obligation for retired priests has been actuarially determined.

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The following amounts relate to the diocesan priests' defined benefit pension plan:

	<u>2017</u>	<u>2016</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$26,046,524	\$22,768,335
Service cost	927,837	765,013
Interest cost	999,925	1,027,550
Actuarial (gain) loss	(357,995)	2,359,573
Benefits paid	<u>(950,939)</u>	<u>(873,947)</u>
Benefit obligation at end of year	<u>26,665,352</u>	<u>26,046,524</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	16,452,415	14,087,977
Return on plan assets	2,066,290	(202,777)
Employer contributions	2,394,988	3,441,162
Benefits paid	<u>(950,939)</u>	<u>(873,947)</u>
Fair value of plan assets at end of year	<u>19,962,754</u>	<u>16,452,415</u>
Accrued pension liability, priests	<u>\$ 6,702,598</u>	<u>\$ 9,594,109</u>

Additional employer contributions of \$452,988 in 2017 and \$1,830,162 in 2016 were made available through restricted contributions.

The accumulated benefit obligation at June 30, 2017 and 2016 was \$24,617,171 and \$23,998,232, respectively. The net periodic pension cost for the years ended June 30, 2017 and 2016 were \$1,171,049 and \$1,082,565, respectively. Amounts previously recognized in unrestricted net assets not yet recognized as periodic pension cost at June 30:

	<u>2017</u>	<u>2016</u>
Net (loss)	\$ (11,005,175)	\$ (12,655,870)
Net prior service cost	<u>(268,063)</u>	<u>(284,940)</u>
Amounts previously recognized in unrestricted net assets, not yet recognized as periodic benefit cost	<u>\$ (11,273,238)</u>	<u>\$ (12,940,810)</u>

The estimated net loss that will be amortized from changes in unrestricted net assets into net periodic benefit cost in 2018 is \$445,401.

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Assumptions used to determine the year-end benefit obligation:

	<u>2017</u>	<u>2016</u>
Discount rate on the benefit obligation	4.00%	3.90%
Rate of expected return on plan assets	7.50%	7.50%
Rate of priests' compensation increase	2.00%	2.00%

The expected return assumption was developed as the weighted average of expected returns determined under a forward looking approach and a historical approach using the plan's target asset assumption. The forward looking assumption was developed based on a market analysis applied to the plan's investment mix. The historical return assumption was developed from a proprietary database of prior investment returns.

The Diocese measures fair value of the plan's assets using a three-level hierarchy based upon observable inputs (Note 8).

Fair values of the plan's assets measured on a recurring basis by level at June 30, 2017 are as follows:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Short-term investments	\$ 1,549,722	\$ 1,549,722	\$ -	\$ -
U.S. Government and sponsored enterprises securities	2,657,430	1,630,604	1,026,826	-
Corporate and foreign bonds	3,172,957	-	3,172,957	-
Equities	12,582,645	12,582,645	-	-
Total	<u>\$ 19,962,754</u>	<u>\$ 15,762,971</u>	<u>\$ 4,199,783</u>	<u>\$ -</u>

Fair values of the plan's assets measured on a recurring basis by level at June 30, 2016 are as follows:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Short-term investments	\$ 1,103,739	\$ 1,103,739	\$ -	\$ -
U.S. Government and sponsored enterprises securities	2,219,491	1,564,350	655,141	-
Corporate and foreign bonds	2,498,369	-	2,498,369	-
Equities	10,630,816	10,630,816	-	-
Total	<u>\$ 16,452,415</u>	<u>\$ 13,298,905</u>	<u>\$ 3,153,510</u>	<u>\$ -</u>

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The Diocese’s overall strategy is to invest in high-grade securities and other assets with a minimum risk of market value fluctuation. In general, the Diocese’s goal is to maintain the following allocation ranges:

Equity securities	60% - 70%
Fixed income securities	25% - 35%
Short term cash/money market	0% - 10%

The Diocese expects to contribute approximately \$1,932,000 to the plan in 2018. Projected benefit payments to be made from the plan for the next ten years are as follows:

2018	\$ 1,015,386
2019	1,034,652
2020	1,160,482
2021	1,041,114
2022	1,072,377
2023-2027	6,057,850

Tax-deferred retirement savings plan

The Diocese also sponsors and maintains a tax-deferred 403(b) retirement savings plan for eligible employees and diocesan priests. All contributions are from employee elective salary reduction agreements. Since there is no employer match, there is no expense to the Chancery related to this plan.

13. Postretirement benefits

The Chancery sponsors a post-retirement Medicare supplemental plan for retired priests. The plan pays medical and prescription costs not covered by parts A and B of Medicare. The plan is noncontributory for diocesan priests. The Chancery also sponsors a lay-retiree postretirement plan which provides health benefits to retired lay employees meeting service and other participation requirements. The plan provides benefits to employees of the Chancery and other diocesan organizations, such as parishes, schools, the Arlington Catholic Herald, and diocesan high schools. The lay retirees pay 100% of the stated premium which is a blended rate for both active employees and retirees. Because the true medical costs are higher for retirees than for active employees, the plan is providing an “implicit subsidy” to the retirees. The postretirement obligation for both priests and lay retirees has been actuarially determined.

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The following amounts relate to the postretirement health obligation:

	<u>2017</u>	<u>2016</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 14,608,267	\$ 11,724,650
Service cost	498,810	386,505
Interest cost	565,211	534,497
Employee contributions	110,028	126,480
Actuarial (gain) loss	(497,458)	2,078,153
Benefits paid	<u>(201,872)</u>	<u>(242,018)</u>
Benefit obligation at end of year	15,082,986	14,608,267
Change in plan assets:		
Fair value of plan assets at beginning of year	-	-
Employer contributions	91,844	115,538
Employee contributions	110,028	126,480
Benefits paid	<u>(201,872)</u>	<u>(242,018)</u>
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>
Post retirement health benefit obligation	<u>\$ 15,082,986</u>	<u>\$ 14,608,267</u>

The net periodic benefit cost for the years ended June 30, 2017 and 2016 were \$1,213,716 and \$967,235, respectively. Amounts previously recognized in unrestricted net assets not yet recognized as periodic benefit cost at June 30:

	<u>2017</u>	<u>2016</u>
Net (loss)	\$ (3,908,167)	\$ (4,555,320)
Net prior service credit	<u>-</u>	<u>-</u>
Amounts previously recognized in unrestricted net assets, not yet recognized as periodic benefit cost	<u>\$ (3,908,167)</u>	<u>\$ (4,555,320)</u>

The estimated net loss that will be amortized from changes in unrestricted net assets into net periodic benefit cost in 2018 is \$121,770.

Assumptions used to determine the year-end benefit obligation:

	<u>2017</u>	<u>2016</u>
Discount rate on the benefit obligation	4.00%	3.90%

For measurement purposes, a 6.54% increase in the cost of health care benefits was assumed for 2017. This rate was assumed to decrease over a 15 year period to an ultimate rate of 4.5% by 2032.

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For 2016, a 6.79% increase in the cost of health care benefits was assumed. This rate was assumed to decrease over a 16 year period to an ultimate rate of 4.5% by 2032.

The Diocese expects to contribute approximately \$242,000 to the plan in 2018. Projected benefit payments to be made from the plan for the next ten years are as follows:

2018	\$	242,000
2019		262,000
2020		319,000
2021		383,000
2022		427,000
2023-2027		2,676,000

14. Temporarily restricted net assets

Expenses incurred for program activities such as seminarian education, educational programs, youth ministry, outreach, communications, and operations of the priests' retirement home resulted in a release of restricted net assets which is included in operations. Net assets were also released from restrictions with grants made to related parties for diocesan high school capital needs and charitable programs (Note 9). Affiliates are required to record these contributions as temporarily restricted and release from restrictions as funds are expended for the donor-specified purposes. Restricted contributions received for the benefit of retired priests' needs were used, in part, to reduce the unfunded priests' pension liability (Note 12).

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

	<u>2017</u>	<u>2016</u>
Catholic education, endowment income	\$ 16,682,481	\$ 12,692,196
Donated land restricted for high school	14,500,000	14,500,000
Bishop's targeted initiatives	5,699,825	7,472,156
Retired priests' needs	4,575,693	4,428,939
Student financial aid	1,862,162	1,816,795
New evangelization	1,483,257	1,443,564
Diocesan operations, endowment income	1,209,172	174,564
Campus Ministry	1,094,938	-
ADEF education scholarships, endowment income	815,591	720,115
Charitable programs	684,859	1,027,106
ADEF seminarian education	593,977	543,617
Continuing formation funds	517,249	490,283
Respect Life	515,812	453,730
Youth ministry, endowment income	490,851	400,323
High school capital	389,324	164,614
Catholic education	376,082	81,097
Project Rachel and Gabriel	339,912	375,134
Spirituality Center	268,734	261,581
Seminarian support	109,365	97,006
Campaign for human development	102,354	92,839
Permanent diaconate	96,777	84,992
Charitable annuities	96,628	77,226
Black and Indian mission	70,095	75,057
Communications	64,193	77,617
Diocesan work camp	8,984	59,046
Seminarian education	-	84,533
Others	109,856	44,302
Total	<u>\$ 52,758,171</u>	<u>\$ 47,738,432</u>

Included in Bishop's targeted initiatives are amounts raised through the LGI campaign, where the donors have expressed support for all the stated campaign goals (Note 1). The actual allocation of these funds among the stated goals will be determined based on need.

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15. Permanently restricted endowments

As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Diocesan Bishop to function as endowment funds, are classified and reported based on the existence of donor-imposed restrictions.

Permanently restricted endowments are for the following purposes at June 30:

	<u>2017</u>	<u>2016</u>
Catholic education	\$ 23,340,729	\$ 23,299,541
Diocesan operations	10,610,000	6,650,000
Catechetics	2,045,653	2,045,653
Youth ministry	510,988	510,988
ADEF education scholarships	310,500	310,500
Original endowment corpus	36,817,870	32,816,682
Endowment major gifts/bequests receivable	3,660,612	7,561,800
Total	<u>\$ 40,478,482</u>	<u>\$ 40,378,482</u>

Interpretation of relevant law

The Uniform Prudent Management of Institutional Funds Act (UPMIFA), effective July 1, 2008, in the Commonwealth of Virginia, has been interpreted as requiring the preservation of fair value of the original gift as of the date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Chancery classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Chancery in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Chancery considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the funds
2. The purposes of the Chancery and the donor-restricted endowment funds
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Chancery
7. The investment policies of the Chancery

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Funds with deficiencies

From time to time, the fair value of assets associated with individual donor-restricted funds may fall below the level that the donor or UPMIFA requires the Chancery to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2017 and 2016.

Investment return objectives, risk parameters and strategies

The Chancery has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income as well as capital appreciation, which exceeds the annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes equity and debt securities, which is intended to result in a consistent inflation-protected rate of return that has sufficient liquidity to make an annual distribution ranging from 4% to 5%, while growing the funds if possible. Therefore, the Chancery expects its endowment assets, over time, to produce an average rate of return of between 7% and 10% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending policy

The Chancery has a policy of appropriating for distribution each year 4% of its endowment fund average fair value of the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned except for ADEF education scholarships which is 5% of the average fair value of the three previous calendar years. In establishing these policies, the Chancery considered the long-term expected return on its investment assets. The Chancery expects the current spending policy to allow its endowment funds to grow at a nominal average rate of between 3% and 4% annually over the spending rate. This is consistent with the Chancery's objective to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts and investment return.

Endowment net asset composition by type of fund as of June 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor-restricted endowment funds	\$ -	\$ 19,198,095	\$ 36,817,870	\$ 56,015,965
Endowment major gifts/bequest receivable	-	-	3,660,612	3,660,612
Board-designated endowment funds	13,391,235	-	-	13,391,235
Total funds	<u>\$ 13,391,235</u>	<u>\$ 19,198,095</u>	<u>\$ 40,478,482</u>	<u>\$ 73,067,812</u>

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Endowment net asset composition by type of fund as of June 30, 2016 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor-restricted endowment funds	\$ -	\$ 13,987,198	\$ 32,816,682	\$ 46,803,880
Endowment major gifts receivable	-	-	7,561,800	7,561,800
Board-designated endowment funds	11,745,027	-	-	11,745,027
Total funds	<u>\$ 11,745,027</u>	<u>\$ 13,987,198</u>	<u>\$ 40,378,482</u>	<u>\$ 66,110,707</u>

Donor-restricted endowments

Changes in donor-restricted endowment net assets as of June 30, 2017 are as follows:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets, beginning of year	\$ 13,987,198	\$ 32,816,682	\$ 46,803,880
Contributions	-	4,001,188	4,001,188
Investment income	703,357	-	703,357
Net appreciation	6,019,076	-	6,019,076
Amounts appropriated for expenditure and satisfying purpose restrictions	(1,511,536)	-	(1,511,536)
Endowment net assets, end of year	<u>\$ 19,198,095</u>	<u>\$ 36,817,870</u>	<u>\$ 56,015,965</u>

Changes in donor-restricted endowment net assets as of June 30, 2016 are as follows:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets, beginning of year	\$ 16,117,067	\$ 24,655,482	\$ 40,772,549
Contributions	-	8,161,200	8,161,200
Investment income	988,609	-	988,609
Net appreciation	(2,009,821)	-	(2,009,821)
Amounts appropriated for expenditure and satisfying purpose restrictions	(1,108,657)	-	(1,108,657)
Endowment net assets, end of year	<u>\$ 13,987,198</u>	<u>\$ 32,816,682</u>	<u>\$ 46,803,880</u>

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Included in contributions and reclassifications is \$1,250,000 at June 30, 2016, transferred from temporarily restricted net assets to the permanently restricted endowment for Catholic education, in accordance with LGI purposes.

Board-designated endowment (functioning as endowment)

Certain amounts of unrestricted net assets, which include the original patrimony of the Diocese, have been designated by the Diocesan Bishop as functioning as endowment. Since these amounts resulted from an internal designation and are not donor-restricted, they are classified and reported as unrestricted net assets (functioning as endowment). This endowment’s investment policy, strategy and objectives are similar to the donor-invested policies, except as it relates to investment spending. All investment returns are added to the endowment.

Composition of and changes in board-designated endowment net assets for the year ended June 30, are as follows:

	<u>Unrestricted</u>	
	<u>2017</u>	<u>2016</u>
Board-designated endowment net assets, beginning of year	\$ 11,745,027	\$ 12,112,628
Investment income	165,917	159,341
Net appreciation (depreciation)	1,480,291	(526,942)
Board-designated endowment net assets, end of year	<u>\$ 13,391,235</u>	<u>\$ 11,745,027</u>

16. Insurance programs

The Diocese maintains health, property, general liability and workers compensation insurance plans for the Chancery and participating affiliates. Each entity participating in the plans is charged premiums to cover estimated losses, administrative costs, and excess insurance policy premiums.

Under the medical plan, the self-insured retention layer includes an individual loss limit, \$275,000 in plan year 2017 and \$250,000 in plan year 2016, as well as an aggregate loss limit of up to 125% of expected claims, or about \$18,333,000, in plan year March 2017-February 2018. Losses exceeding these amounts are covered by the stop-loss insurance policy with no annual limit on aggregate losses. Incurred but not reported health claims are estimated to be \$1,606,000 and \$1,715,000 at June 30, 2017 and 2016, respectively.

The Diocese continues to maintain a multi-tiered approach to its risk financing program which includes both risk retention and risk transferring strategies. With regard to workers’ compensation, coverage is 100% insured and the Diocese does not retain any exposure for this coverage.

The Diocese retains the first layer of coverage for all other property and casualty exposures with the exception of workers’ compensation which is fully insured. The self-insured retention layer is \$500,000 per occurrence with an annual aggregate of \$1,500,000. The retention amount applies cumulatively to property and liability exposures. The Chancery’s estimated exposure for future

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payments of this layer is \$910,000 and \$1,230,000 at June 30, 2017 and 2016, respectively. Several layers of excess coverage from various carriers beyond the self-insured retention layer and primary insurance layer exist. The amount of excess coverage differs based on the given line of coverage, and at a minimum provides \$1,000,000 of additional insurance.

Prior to July 2007, the second layer of coverage was retained by the Catholic Umbrella Pool II (CUP II) which is a risk retention pool consisting of member Dioceses of which Arlington is included. This coverage provided \$5,500,000 in excess of the primary layer of \$1,500,000 of insurance coverage. Currently there are 59 participants each with equal voting rights. Participation percentages vary annually based on the exposures of the Diocese and the number of participating entities. The Diocese participation interest has averaged 2% of the total contributions to the Pool.

The Diocese does retain an exposure equal to its participation level in any year should the claims in that year exceed contributions collected. The Chancery estimates no material loss with regard to this participation.

Included in accounts payable and accrued expenses are the following:

	<u>2017</u>	<u>2016</u>
Incurred but not reported estimated health claims	\$ 1,606,000	\$ 1,715,000
Estimated property and general liability claims	\$ 910,000	\$ 1,230,000

17. Commitments and contingencies

Leases

The Chancery leases office space under a non-cancelable lease agreement with 200 North Glebe Road, Inc., a related entity, which expires July 31, 2017. The lease provides for an automatic adjustment of 3% annually. The financial statements reflect rent expense on a straight-line basis with the excess expense over cash paid reflected in accrued expenses. In addition to lease payments, the office lease generally requires the Chancery to pay any incremental increases in taxes, insurance and utilities. The Chancery also leases office equipment under operating leases expiring through February 2020. Total rent expense, net of sublease rentals for years ended June 30, 2017 and 2016, is as follows:

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	<u>2017</u>	<u>2016</u>
Office space	\$ 2,226,692	\$ 2,139,675
Office equipment	94,253	67,824
Sublease office rental (related entities)	(452,482)	(431,652)
Net expense	<u>\$ 1,868,463</u>	<u>\$ 1,775,847</u>

At June 30, 2017, future minimum lease payments are as follows:

	<u>Total Lease</u>	<u>Sublease</u>	<u>Net Lease</u>
2018	\$ 266,841	\$ 32,976	\$ 233,865
2019	80,170	-	80,170
2020	46,578	-	46,578
2021	9,900	-	9,900
Total future minimum lease payments	<u>\$ 403,489</u>	<u>\$ 32,976</u>	<u>\$ 370,513</u>

Lines of credit and letters of credit

The Chancery has obtained lines of credit as follows:

	<u>June 30, 2017</u>		<u>June 30, 2016</u>	
	<u>Total Available</u>	<u>Outstanding</u>	<u>Total Available</u>	<u>Outstanding</u>
Operating needs	\$ 5,000,000	\$ -	\$ 5,000,000	\$ -
Standby letters of credit for various construction projects	\$ 7,500,000	\$ 4,526,110	\$ 7,500,000	\$ 1,361,487

In connection with the bond refinancing and issuance of bank qualified debt, the Chancery renewed its line of credit and letter of credit facility (Note 11). Under the new agreements, the Chancery is subject to certain covenants such as operating liquidity, additional indebtedness, and financial reporting. The line of credit for operating needs had a stated rate of interest based on the 30-day LIBOR plus 195 basis points for the years ended June 30, 2017 and 2016. The issuance fee for standby letters of credit for various parish and Chancery construction projects was 1.5% per annum with a minimum of \$200 per letter for the years ended June 30, 2017 and 2016. These facilities are subject to annual renewals by our financial institutions.

Litigation

The Diocese has been named as a defendant in various lawsuits. Coverage for each of the lawsuits is provided by either a self-insurance fund or excess insurance coverage. When applicable, reserves have been established for those cases where the potential liability is estimable and probable. In instances where a loss is reasonably possible, but the amount is not estimable no reserve is established. There was no reserve for 2017 and 2016.

Central Administrative Office of the Catholic Diocese of Arlington
Notes to Financial Statements
For the years ended June 30, 2017 and 2016

Construction and development agreements

In connection with the construction of the PVI Catholic High School Loudoun County campus and various other construction projects, the Chancery is committed under contracts with remaining amounts of \$11,587,613.

The Chancery has entered into a redevelopment agreement to provide for the rezoning, entitlement, development and sale of property which is the current site of Paul VI Catholic High School in the city of Fairfax. The agreement is conditional upon obtaining zoning and entitlement which provides for minimum target project yields. The Chancery does retain risk in a limited amount of developer preconstruction projects costs incurred should the agreement be terminated.