



Report of Independent Auditors and  
Financial Statements with  
Additional Information for

## Episcopal Community Services

June 30, 2014 and 2013

**MOSS-ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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## REPORT OF INDEPENDENT AUDITORS

The Board of Directors  
Episcopal Community Services

### **Report on Financial Statements**

We have audited the accompanying financial statements of Episcopal Community Services, which comprise the statements of financial position as of June 30, 2014 and 2013, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to 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 obtained is sufficient and appropriate to provide a basis for our audit opinion.

MOSS ADAMS<sub>LLP</sub>

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Episcopal Community Services as of June 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Moss Adams LLP*

San Diego, California

October 23, 2014

**EPISCOPAL COMMUNITY SERVICES**  
**STATEMENTS OF FINANCIAL POSITION**  
**JUNE 30, 2014 AND 2013**

|  | June 30,            |                     |
|--|---------------------|---------------------|
|  | 2014                | 2013                |
| <b>ASSETS</b>  |                     |                     |
| <b>Current Assets</b>                                      |                     |                     |
| Cash and cash equivalents                                  | \$ 895,808          | \$ 1,268,554        |
| Investments  | 1,187,675           | -                   |
| Funds held by others                                       | -                   | 879,817             |
| Receivables, net   | 784,914             | 1,192,534           |
| Prepaid expenses and other current assets                  | 372,600             | 280,087             |
| Total current assets                                       | <u>3,240,997</u>    | <u>3,620,992</u>    |
| <b>Deposits and Other Assets</b>                           | 166,662             | 158,530             |
| <b>Unconditional Promises to Give, net</b>                 | 457,207             | 477,849             |
| <b>Property and Equipment, net</b>                         | <u>1,428,795</u>    | <u>1,742,219</u>    |
| Total assets   | <u>\$ 5,293,661</u> | <u>\$ 5,999,590</u> |
| <b>LIABILITIES AND NET ASSETS</b>                          |                     |                     |
| <b>Current Liabilities</b>                                 |                     |                     |
| Accounts payable and accrued expenses                      | \$ 449,887          | \$ 743,450          |
| Accrued payroll  | 1,025,760           | 1,040,078           |
| Deferred revenue   | 7,070               | 30,349              |
| Current portion of long-term debt                          | 30,532              | 31,670              |
| Total current liabilities                                  | <u>1,513,249</u>    | <u>1,845,547</u>    |
| <b>Long-term Debt</b>                                      | 428,704             | 452,452             |
| <b>Conditional Contribution</b>                            | <u>271,200</u>      | <u>295,800</u>      |
| Total liabilities  | <u>2,213,153</u>    | <u>2,593,799</u>    |
| <b>Commitments and Contingencies (Notes 8, 11, and 13)</b> |                     |                     |
| <b>Net Assets</b>  |                     |                     |
| Unrestricted   | 2,622,872           | 2,893,264           |
| Temporarily restricted                                     | 457,636             | 512,527             |
| Total net assets   | <u>3,080,508</u>    | <u>3,405,791</u>    |
| Total liabilities and net assets                           | <u>\$ 5,293,661</u> | <u>\$ 5,999,590</u> |

**EPISCOPAL COMMUNITY SERVICES**  
**STATEMENTS OF ACTIVITIES**  
**YEARS ENDED JUNE 30, 2014 AND 2013**

|  | Years Ended June 30, |                        |                     |                     |                        |                     |
|--|----------------------|------------------------|---------------------|---------------------|------------------------|---------------------|
|  | 2014                 |                        |                     | 2013                |                        |                     |
|  | Unrestricted         | Temporarily Restricted | Total               | Unrestricted        | Temporarily Restricted | Total               |
| <b>REVENUES, GAINS, AND OTHER SUPPORT</b>                              |                      |                        |                     |                     |                        |                     |
| Grants and contracts   | \$ 19,316,434        | \$ -                   | \$ 19,316,434       | \$ 20,325,419       | \$ -                   | \$ 20,325,419       |
| Service fees   | 2,822,570            |                        | 2,822,570           | 2,854,999           | -                      | 2,854,999           |
| Contributions  | 394,321              |                        | 394,321             | 577,378             | 4,179                  | 581,557             |
| Other  | 182,069              | -                      | 182,069             | 159,004             | -                      | 159,004             |
| Change in value of beneficial interests in charitable remainder trusts | -                    | (20,642)               | (20,642)            |                     | (74,277)               | (74,277)            |
| Net assets released from restrictions                                  | 34,249               | (34,249)               | -                   | -                   | -                      | -                   |
| Total revenues, gains, and other support                               | <u>22,749,643</u>    | <u>(54,891)</u>        | <u>22,694,752</u>   | <u>23,916,800</u>   | <u>(70,098)</u>        | <u>23,846,702</u>   |
| <b>EXPENSES</b>  |                      |                        |                     |                     |                        |                     |
| Programs:  |                      |                        |                     |                     |                        |                     |
| Child development  | 14,917,188           | -                      | 14,917,188          | 15,568,624          | -                      | 15,568,624          |
| Clinical services  | 2,935,093            | -                      | 2,935,093           | 2,850,202           | -                      | 2,850,202           |
| Housing and supportive services  | 1,802,327            | -                      | 1,802,327           | 1,704,151           | -                      | 1,704,151           |
| Nutrition services   | 793,847              | -                      | 793,847             | 956,445             | -                      | 956,445             |
| Total program expenses   | <u>20,448,455</u>    | <u>-</u>               | <u>20,448,455</u>   | <u>21,079,422</u>   | <u>-</u>               | <u>21,079,422</u>   |
| Management and general   | 2,374,600            | -                      | 2,374,600           | 2,436,588           | -                      | 2,436,588           |
| Fundraising and communications   | 196,980              | -                      | 196,980             | 268,046             | -                      | 268,046             |
| Total expenses   | <u>23,020,035</u>    | <u>-</u>               | <u>23,020,035</u>   | <u>23,784,056</u>   | <u>-</u>               | <u>23,784,056</u>   |
| <b>CHANGE IN NET ASSETS</b>  | (270,392)            | (54,891)               | (325,283)           | 132,744             | (70,098)               | 62,646              |
| <b>NET ASSETS</b>  |                      |                        |                     |                     |                        |                     |
| Beginning of year  | <u>2,893,264</u>     | <u>512,527</u>         | <u>3,405,791</u>    | <u>2,760,520</u>    | <u>582,625</u>         | <u>3,343,145</u>    |
| End of year  | <u>\$ 2,622,872</u>  | <u>\$ 457,636</u>      | <u>\$ 3,080,508</u> | <u>\$ 2,893,264</u> | <u>\$ 512,527</u>      | <u>\$ 3,405,791</u> |

**EPISCOPAL COMMUNITY SERVICES**  
**STATEMENTS OF FUNCTIONAL EXPENSES**  
**YEARS ENDED JUNE 30, 2014 AND 2013**

| <b>Year Ended June 30, 2014</b> |                      |                                       |   |                      |
|---------------------------------|----------------------|---------------------------------------|---|----------------------|
|                                 | <b>Programs</b>      | <b>Management<br/>and<br/>General</b> | <b>Fundraising<br/>and<br/>Communications</b> | <b>Total</b>         |
| Personnel                       | \$ 14,423,523        | \$ 1,661,330                          | \$ 92,903                                     | \$ 16,177,756        |
| Other direct costs              | 3,324,063            | 409,865                               | 77,177  | 3,811,105            |
| Occupancy                       | 2,302,550            | 273,495                               | 26,900  | 2,602,945            |
| Depreciation                    | 398,319              | 20,583                                | -   | 418,902              |
| Interest                        | -                    | 9,327                                 | -   | 9,327                |
| <b>Total expenses</b>           | <b>\$ 20,448,455</b> | <b>\$ 2,374,600</b>                   | <b>\$ 196,980</b>                             | <b>\$ 23,020,035</b> |

| <b>Year Ended June 30, 2013</b> |                      |                                       |   |                      |
|---------------------------------|----------------------|---------------------------------------|---|----------------------|
|                                 | <b>Programs</b>      | <b>Management<br/>and<br/>General</b> | <b>Fundraising<br/>and<br/>Communications</b> | <b>Total</b>         |
| Personnel                       | \$ 14,749,628        | \$ 1,736,134                          | \$ 142,324                                    | \$ 16,628,086        |
| Other direct costs              | 3,550,283            | 309,510                               | 102,346                                       | 3,962,139            |
| Occupancy                       | 2,410,288            | 355,552                               | 21,724  | 2,787,564            |
| Depreciation                    | 361,997              | 32,769                                | 1,652   | 396,418              |
| Interest                        | 7,226                | 2,623                                 | -   | 9,849                |
| <b>Total expenses</b>           | <b>\$ 21,079,422</b> | <b>\$ 2,436,588</b>                   | <b>\$ 268,046</b>                             | <b>\$ 23,784,056</b> |

**EPISCOPAL COMMUNITY SERVICES**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2014 AND 2013**

|  | Years Ended June 30, |                     |
|--|----------------------|---------------------|
|  | 2014                 | 2013                |
| <b>OPERATING ACTIVITIES</b>  |                      |                     |
| Change in net assets   | \$ (325,283)         | \$ 62,646           |
| Adjustments to reconcile change in net assets to net cash and cash equivalents (used in) provided by operating activities: |                      |                     |
| Depreciation   | 418,902              | 396,418             |
| Allowance for uncollectible receivables  | -                    | (20,060)            |
| Change in value of charitable remainder trusts   | 20,642               | 74,277              |
| Net realized and unrealized gains net of fees on funds held by others  | (65,023)             | (76,524)            |
| Net realized and unrealized (gains) net of fees on investments   | (55,646)             | -                   |
| Loss on disposal of property and equipment   | -                    | 11,193              |
| Accrued interest added to note payable   | 6,784                | 6,785               |
| Conditional contribution forgiveness   | (24,600)             | (24,600)            |
| Deferred revenue   | (23,279)             | (97,362)            |
| (Increase) decrease in operating assets:   |                      |                     |
| Receivables  | 407,620              | (36,196)            |
| Prepaid expenses and other current assets  | (92,513)             | (38,720)            |
| Deposits and other assets  | (8,132)              | (40,217)            |
| Increase (decrease) in operating liabilities:  |                      |                     |
| Accounts payable and accrued expenses  | (293,563)            | (148,654)           |
| Accrued payroll  | (14,318)             | 63,199              |
| Net cash (used in) provided by operating activities  | <u>(48,409)</u>      | <u>132,185</u>      |
| <b>INVESTING ACTIVITIES</b>  |                      |                     |
| Purchases of property and equipment  | (105,478)            | (86,164)            |
| Purchases of investments   | (1,132,029)          | -                   |
| Proceeds from sales of funds held by others  | 944,840              | -                   |
| Increase in funds held by others   | -                    | (214,373)           |
| Net cash (used in) investing activities  | <u>(292,667)</u>     | <u>(300,537)</u>    |
| <b>FINANCING ACTIVITIES</b>  |                      |                     |
| Repayment of conditional contribution  | -                    | (97,094)            |
| Repayment of long-term debt  | (31,670)             | (42,550)            |
| Net cash (used in) financing activities  | <u>(31,670)</u>      | <u>(139,644)</u>    |
| <b>(DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | (372,746)            | (307,996)           |
| <b>CASH AND CASH EQUIVALENTS</b>   |                      |                     |
| Beginning of year  | <u>1,268,554</u>     | <u>1,576,550</u>    |
| End of year  | <u>\$ 895,808</u>    | <u>\$ 1,268,554</u> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>  |                      |                     |
| Cash payments for interest   | <u>\$ 2,543</u>      | <u>\$ 3,063</u>     |



## EPISCOPAL COMMUNITY SERVICES NOTES TO FINANCIAL STATEMENTS

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### **Note 1 – Nature of Organization**

Episcopal Community Services (“ECS”), a California not-for-profit public benefit corporation which provides services to the community through programs that address specific social needs, is affiliated with the Episcopal Diocese of San Diego.

Programs offered by ECS are:

**Child development programs** – Head Start and Early Head Start are federally-funded comprehensive child development programs serving pregnant women, children from birth to age five, and their families. The programs were designed to help break the cycle of poverty by providing preschool children of low-income families with a comprehensive program to meet their emotional, social, health, nutritional, and psychological needs.

**Other programs** – ECS also offers programs that assist individuals and families through the often difficult transition from an existence which is dependent on social services, unhealthy relationships, or substance abuse to one of self-sufficiency. ECS offers a full spectrum of services to Southern Californians in transition, including emergency assistance and crisis intervention, drug and alcohol education and support services, domestic violence programs, employment assistance, food, counseling services for the chronically mentally ill, and short-term and long-term housing for the special-needs homeless population.

**Income taxes** – As a California not-for-profit public benefit corporation, ECS is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code. ECS may be subject to federal or state income taxes on unrelated business income. For each of the years ended June 30, 2014 and 2013, no provision for such taxes is required. ECS had no unrecognized tax benefits or liabilities as of June 30, 2014 and 2013. ECS files an exempt organization return in the United States federal jurisdiction and with the Franchise Tax Board in the state of California. ECS is no longer subject to income tax examinations by taxing authorities for years before 2011 for its federal filings and for years before 2010 for its state filings.

### **Note 2 – Summary of Significant Accounting Policies**

**Method of accounting** – The financial statements have been prepared on the accrual basis of accounting.

**Financial statement presentation** – Net assets are classified as unrestricted, temporarily restricted, and permanently restricted based upon the following criteria:

- Unrestricted net assets represent expendable funds available for operations that are not otherwise limited by donor restrictions.

## **EPISCOPAL COMMUNITY SERVICES**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 2 – Summary of Significant Accounting Policies (continued)**

- Temporarily restricted net assets consist of contributed funds subject to specific donor-imposed restrictions which are contingent upon a specific performance of a future event or a specific passage of time before ECS may spend the funds.
- Permanently restricted net assets are subject to irrevocable donor restrictions requiring that the assets be maintained in perpetuity, primarily for generating investment income to fund current operations. ECS has no permanently restricted net assets at June 30, 2014 and 2013.

#### **Revenue Recognition**

**Grants and contracts** – Revenue is recognized from grants and contracts to the extent that eligible costs are incurred and as services are provided.

**Service fees** – Revenue from service fees is recognized when services are provided.

**Support** – Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. Contributions subject to donor-imposed restrictions for use in a future period or for a specific purpose are either reported as temporarily or permanently restricted, depending on the nature of the donor's restriction. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Contributions with donor restrictions which are met in the same reporting period are reported as unrestricted revenue.

**Deferred revenue** – Fees received prior to performing services under contractual agreements are recorded as deferred revenue.

**Cash and cash equivalents** – ECS considers all highly-liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

**Cash** – In accordance with the terms of a contract with a funding agency, funds received for the Head Start program are required to be maintained in a separate bank account. As of June 30, 2014 and 2013, approximately \$ 350,000 and \$313,000, respectively, of the Head Start program funds were held in a separate bank account. These funds are included in cash in the accompanying statements of financial position.

**Funds held by others** – Funds held by others were funds invested at the Rancho Santa Fe Foundation (“RSFF”). Under a custodial agreement, RSFF managed the investment of the funds, which were primarily invested in publicly-traded fixed income and equity funds. RSFF reported the fair value of the amounts due to ECS on a regular basis. ECS did not grant variance power over the investments to RSFF. Distributions could be made from the funds only with written authorization from ECS. RSFF determined the fair value of investments held at RSFF based on the unit value of ECS' interest in the pools in which it had invested. The unit value was based on the fair value of the underlying assets in the pools.

## EPISCOPAL COMMUNITY SERVICES NOTES TO FINANCIAL STATEMENTS

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### **Note 2 – Summary of Significant Accounting Policies (continued)**

In November 2013, a resolution was passed by the Board of Directors that selected the investment firm Dowling & Yahnke, LLC (“D&Y”) to provide investment management services for ECS. The decision was based on the Investment Policy approved by the Board in May 2013 which requires a greater degree of tailored management and reporting. Based on the Board’s decision the funds held at the RSFF were liquidated and transferred to a custodian account with Charles Schwab. D&Y manages the investment of the funds. D&Y reports the fair value of the amounts due to ECS on a regular basis.

The Controller, as monitored by the Chief Financial Officer, reviewed and evaluated the values provided by RSFF and agreed with the valuation methods used. At June 30, 2013, there were no funds held at RSFF.

**Investments** – Investments are reported at fair value. Realized and unrealized gains and losses are reflected in the accompanying statement of activities as investment income (loss). Mutual funds invested in domestic and international bonds, stocks, and real estate are based on quoted prices in active markets. The Controller, as monitored by the Chief Financial Officer, reviews and evaluates the values provided by D&Y annually and agrees with the valuation methods used. Investment income or loss (including interest and realized gains and losses) is included in unrestricted revenues unless restricted by donor or law.

**Receivables** – Receivables consist of amounts due to ECS for services provided through June 30 that have not yet been collected. Amounts are generally considered past due if not collected within 30 days of billings. Interest is not charged on outstanding balances.

**Unconditional promises to give** – Unconditional promises to give expected to be collected in future years are recorded at fair value when the promise is made based on a discounted cash flow model. In future years, the discounts to present value are computed using discount rates established in the years in which those promises are received. Amortization of the discounts is included in contributions.

Included in unconditional promises to give are beneficial interests ECS has received in irrevocable charitable remainder trusts. The trust agreements require the trusts to make periodic payments, as defined, to the grantors or other designated beneficiaries of the trust over the beneficiary’s lifetime and, in some cases, after the beneficiary’s death. The trusts terminate upon the death of the grantors or completion of the specified benefit periods after their death. Upon termination of the trusts, ECS will receive its share of the remaining trust assets as designated in the trust agreements. The portion of a trust attributable to the fair value of the future benefits to be received by ECS is recorded in the statement of activities as temporarily restricted contributions in the year the trust is established. The fair value of the remainder interests at June 30, 2014 and 2013 is calculated based on a discounted cash flow model using the fair value of the assets in the trusts as provided by the trustees, interest rates of approximately 3 percent and life expectancies (based on applicable mortality tables) and other terms, as applicable, for payments to beneficiaries beyond the life expectancies ranging from 7 to 27 years. The unobservable inputs used in the calculations are evaluated and adjusted, as necessary, annually by the Controller, as monitored by the Chief Financial Officer.

## **EPISCOPAL COMMUNITY SERVICES**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **Note 2 – Summary of Significant Accounting Policies (continued)**

**Allowance for estimated uncollectible accounts** – The allowance for estimated uncollectible accounts is based on past experience and on an analysis of current receivable balances. ECS does not obtain collateral. Accounts deemed uncollectible are written-off against the allowance in the year deemed uncollectible. As of June 30, 2014 and 2013, management does not consider an allowance for uncollectible accounts necessary.

**Property and equipment** – Property and equipment are recorded at cost for purchased assets and fair value at the date of donation for donated assets. Certain property and equipment acquired with grant funds are capitalized and are considered to be owned by the granting agency. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from 5 to 25 years. It is ECS' policy to capitalize purchases with a cost greater than \$5,000.

**Impairment of long-lived assets** – ECS evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset are less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value. To date, no such write-downs have occurred.

**Functional allocation of expenses** – The costs of providing the various programs and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

**Use of estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions related to the reported amounts of assets and liabilities, 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 may materially differ from those estimates.

**Subsequent events** – Subsequent events are events or transactions that occur after the statement of financial position date, but before the financial statements are issued. ECS recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. ECS' financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position, but arose after the statement of financial position date and before the financial statements are available to be issued. ECS has evaluated subsequent events through October 23, 2014, which is the date the financial statements were available to be issued.

#### **Note 3 – Concentrations**

**Investments** – ECS maintains investments in accounts which at times exceed the Securities Investors Protection Corporation ("SIPC") limits.

**EPISCOPAL COMMUNITY SERVICES**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 3 - Concentrations (continued)**

**Cash and cash equivalents** – ECS maintains cash in bank deposit accounts which at times exceed the federally-insured deposit limits. ECS has not experienced any losses in such accounts.

**Unconditional promises to give** – Unconditional promises to give include beneficial interests in charitable remainder trusts which are exposed to various risks such as interest rates, change in value of underlying assets in the trusts, and donor life expectancies. Changes in the near-term are not expected to materially affect the amounts reported in the financial statements. As of June 30, 2014 and 2013, approximately 95 and 96 percent of unconditional promises to give is due from two trusts, respectively.

**Grants and contracts** – Included in revenue from grants and contracts is approximately \$16,348,000 and 17,200,000 during the years ended June 30, 2014 and 2013, respectively. The revenue was earned from one funding source, which represents approximately 72 percent of total revenues, gains, and other support for each of the years ended June 30, 2014 and 2013. Included in receivables from grants and contracts is approximately \$438,000 and \$553,000 due from four and one funding source(s) for the years ended June 30, 2014 and 2013, respectively.

**Note 4 - Receivables**

As of June 30, receivables consist of:

|                                      | <u>2014</u>       | <u>2013</u>         |
|--------------------------------------|-------------------|---------------------|
| Grants and contracts                 | \$ 610,054        | \$ 1,025,190        |
| Service fees                         | 165,060           | 136,182             |
| Other                                | 9,800             | 31,162              |
|                                      | <u>784,914</u>    | <u>1,192,534</u>    |
| Less allowance for doubtful accounts | -                 | -                   |
|                                      | <u>\$ 784,914</u> | <u>\$ 1,192,534</u> |

**Note 5 - Unconditional Promises to Give**

As of June 30, unconditional promises to give consist of:

|  |                   |                   |
|--|-------------------|-------------------|
| Due in more than five years:                                   |                   |                   |
| Beneficial interest in charitable remainder trusts             | \$ 872,158        | \$ 952,397        |
| Less discount to fair value                                    | <u>(414,951)</u>  | <u>(474,548)</u>  |
|  | <u>\$ 457,207</u> | <u>\$ 477,849</u> |
| Net unconditional promises to give due in more than five years | <u>\$ 457,207</u> | <u>\$ 477,849</u> |

# EPISCOPAL COMMUNITY SERVICES

## NOTES TO FINANCIAL STATEMENTS

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### Note 6 – Fair Value Measurements

Fair value is defined as 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. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

**Level 1** – Quoted prices in active markets for identical assets or liabilities;

**Level 2** – Observable inputs other than Level 1 prices, 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 full term of the assets or liabilities; and

**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.

Investments are exposed to various risks such as interest rates, market, and credit risk. Risk is managed through rigorous evaluation before an investment is made, quarterly monitoring of valuations and regular communication with investment managers. It is at least reasonably possible, given the level of risk associated with investments, that changes in the near term could materially affect the amounts reported in the financial statements.

Investments at fair value consist of the following at June 30, 2014:

|                           |                            |
|---------------------------|----------------------------|
| Stock funds               | \$ 695,725                 |
| Bond funds                | 404,572                    |
| Real estate funds         | 73,718                     |
| Cash and cash equivalents | <u>13,660</u>              |
| Total investments         | <u><u>\$ 1,187,675</u></u> |

There were no investments held at June 30, 2013.

Investment income consists of the following for the year ended June 30:

|                                   |                         |
|-----------------------------------|-------------------------|
| Net realized and unrealized gains | \$ 45,773               |
| Interest and dividends            | <u>9,874</u>            |
| Total investment income           | <u><u>\$ 55,647</u></u> |

See Note 2 for the valuation methodologies used for funds held by others, investments, and beneficial interests in irrevocable charitable remainder trusts (unconditional promises to give) that are measured at fair value on a recurring basis and recognized in the accompanying statements of financial position. The funds held by others and the beneficial interests in charitable remainder trusts are classified as Level 3 in the fair value hierarchy.

**EPISCOPAL COMMUNITY SERVICES**  
**NOTES TO FINANCIAL STATEMENTS**

**Note 6 – Fair Value Measurements (continued)**

The following tables present the investments carried at fair value on the statement of financial position as of June 30, 2014:

|  | June 30, 2014       |             |                   | Total               |
|--|---------------------|-------------|-------------------|---------------------|
|  | Level 1             | Level 2     | Level 3           |                     |
| <b>Cash and cash equivalents</b>   | \$ 13,660           | \$ -        | \$ -              | \$ 13,660           |
| <b>Bond funds</b>  |                     |             |                   |                     |
| Domestic   | 301,911             | -           | -                 | 301,911             |
| Foreign  | 102,661             | -           | -                 | 102,661             |
| <b>Stock funds</b>   |                     |             |                   |                     |
| US Large   | 344,137             | -           | -                 | 344,137             |
| US Small-Medium  | 137,947             | -           | -                 | 137,947             |
| Foreign  | 213,641             | -           | -                 | 213,641             |
| <b>Real estate funds</b>   |                     |             |                   |                     |
| Domestic   | 43,942              | -           | -                 | 43,942              |
| Foreign  | 29,776              | -           | -                 | 29,776              |
| Subtotal investments   | 1,187,675           | -           | -                 | 1,187,675           |
| <b>Beneficial interests in irrevocable charitable remainder interest</b> | -                   | -           | 457,207           | 457,207             |
| Total assets measured at fair value                                      | <u>\$ 1,187,675</u> | <u>\$ -</u> | <u>\$ 457,207</u> | <u>\$ 1,644,882</u> |

The following table discloses the summary of changes in the fair value of ECS' Level 3 assets for the years ended June 30:

|   | 2014                 |                      |                     |
|---|----------------------|----------------------|---------------------|
|   | Beneficial Interests | Funds Held by Others | Total               |
| Balance, beginning of year                | \$ 477,849           | \$ 879,817           | \$ 1,357,666        |
| Sales                                     | -                    | (944,840)            | (944,840)           |
| Change in value of beneficial interests   | (20,642)             | -                    | (20,642)            |
| Realized and unrealized gains net of fees | -                    | 65,023               | 65,023              |
| Balance, end of year                      | <u>\$ 457,207</u>    | <u>\$ -</u>          | <u>\$ 457,207</u>   |
|   | 2013                 |                      |                     |
|   | Beneficial Interests | Funds Held by Others | Total               |
| Balance, beginning of year                | \$ 552,126           | \$ 588,920           | \$ 1,141,046        |
| Additions                                 | -                    | 214,373              | 214,373             |
| Change in value of beneficial interests   | (74,277)             | -                    | (74,277)            |
| Realized and unrealized gains net of fees | -                    | 76,524               | 76,524              |
| Balance, end of year                      | <u>\$ 477,849</u>    | <u>\$ 879,817</u>    | <u>\$ 1,357,666</u> |

Realized and unrealized gains net of fees are reported in the statements of activities as a component of other income. The change in value of the beneficial interests is a separate line in the statements of activities. Unrealized gains of approximately \$65,023 for the year ended June 30, 2014 relate to funds held by others at June 30, 2013.

## EPISCOPAL COMMUNITY SERVICES

### NOTES TO FINANCIAL STATEMENTS

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#### Note 7 – Property and Equipment

As of June 30, property and equipment consists of:

|  | <u>2014</u>         | <u>2013</u>         |
|--|---------------------|---------------------|
| Leasehold improvements                         | \$ 1,918,490        | \$ 1,892,224        |
| Equipment                                      | 930,764             | 886,652             |
| Buildings and improvements                     | 650,655             | 615,555             |
| Vehicles                                       | 182,677             | 182,677             |
|  | <u>3,682,586</u>    | <u>3,577,108</u>    |
| Less accumulated depreciation and amortization | <u>(2,377,491)</u>  | <u>(1,958,589)</u>  |
|  | 1,305,095           | 1,618,519           |
| Land   | <u>123,700</u>      | <u>123,700</u>      |
|  | <u>\$ 1,428,795</u> | <u>\$ 1,742,219</u> |

#### Note 8 – Debt

As of June 30, long-term debt consists of:

|   |                   |                   |
|---|-------------------|-------------------|
| Note payable of \$226,150, San Diego Housing Commission ("SDHC"), secured by deed of trust on land and building. Bears simple interest of 3 percent per annum. Principal and interest are due the earlier of November 2051, upon the generation of residual receipts, or upon acceleration of the loan as defined in the agreement. | \$ 337,588        | \$ 330,804        |
| Note payable, Diocese of Los Angeles, unsecured. Annual payments of \$25,000; due December 2018; non-interest bearing   | 100,000           | 125,000           |
| Note payable, Diocese of San Diego, unsecured. Monthly principal and interest payments of \$538; interest of 4.8 percent; due March 2018  | 21,648            | 26,921            |
| Note payable, finance company, paid in full September 2013  | <u>-</u>          | <u>1,397</u>      |
|   | 459,236           | 484,122           |
| Less current portion  | <u>30,532</u>     | <u>31,670</u>     |
|   | <u>\$ 428,704</u> | <u>\$ 452,452</u> |



**EPISCOPAL COMMUNITY SERVICES**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 8 - Debt (continued)**

Future minimum debt service payments are as follows:

|                       |                   |
|-----------------------|-------------------|
| Years ending June 30, |                   |
| 2015                  | \$ 30,532         |
| 2016                  | 30,804            |
| 2017                  | 31,088            |
| 2018                  | 29,224            |
| 2019                  | -                 |
| Thereafter            | <u>337,588</u>    |
|                       | <u>\$ 459,236</u> |

**Line of credit** – ECS has a revolving bank line of credit in the amount of \$250,000 secured by assets of ECS. No balance was outstanding on the line of credit as of June 30, 2014 and 2013. The interest rate on the line is the bank's prime rate plus 1.5 percent (4.75 percent at June 30, 2013).

Total interest expense on debt was approximately \$ 9,300 and \$8,200 for the years ended June 30, 2014 and 2013, respectively.

**Note 9 - Conditional Contributions**

During 1999, ECS was awarded a conditional contribution of \$394,200 from the San Diego Housing Commission ("SDHC"). The contribution was used to purchase or rehabilitate facilities that were placed into service during November 1999, and are utilized by ECS to provide supportive housing to the homeless. The SDHC funds were used for the San Diego Downtown Safe Haven facility.

Of the total SDHC conditional contribution, \$246,000 was considered fully revocable until ten years from the date the facilities were placed into supportive housing program operations. Ten percent of these contributions become unconditional each year subsequent to the tenth year of operation. The ten-year period of operation for the SDHC facilities was completed in November 2009. During each of the years ended June 30, 2014 and 2013, ECS recognized 10 percent of the SDHC conditional contribution totaling \$24,600. The remaining \$148,200 of the conditional contribution from SDHC is considered fully revocable until 55 years from the date of contribution. This contribution will become unconditional in February 2054 provided ECS has used the facility to provide supportive housing to the homeless until that time. The remaining SDHC conditional contribution at June 30, 2014 and 2013 is \$271,200 and \$295,800, respectively.

The SDHC conditional contribution and a note payable to SDHC (Note 8) are secured by a first trust deed on a building and land with a net book value of approximately \$400,000 at June 30, 2014 and 2013.

## EPISCOPAL COMMUNITY SERVICES

### NOTES TO FINANCIAL STATEMENTS

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#### Note 10 – Temporarily Restricted Net Assets

As of June 30, temporarily restricted net assets consist of:

|                                 | <u>2014</u>       | <u>2013</u>       |
|---------------------------------|-------------------|-------------------|
| Time restrictions:              |                   |                   |
| Charitable remainder trusts     | \$ 457,207        | \$ 477,849        |
| Purpose restrictions - programs | <u>429</u>        | <u>34,678</u>     |
|                                 | <u>\$ 457,636</u> | <u>\$ 512,527</u> |

For the year ended June 30, 2014, a total of approximately \$34,400 was released from temporarily restricted net assets and was comprised of: approximately \$30,500 released for the Emergency Assistance Program, \$3,500 released for housing and supportive services, \$65 released for Head Start, and \$300 released for program administration.

#### Note 11 – Employee Benefit Plan

ECS has a 401(k) retirement plan (the “Plan”) covering all employees who have completed one year of service and are at least 18 years of age. ECS’ contributions to the Plan are determined annually by the Board of Directors. ECS has expensed and accrued matching and profit-sharing contributions to the Plan totaling approximately \$309,000 and \$345,000 for the years ended June 30, 2014 and 2013, respectively.

#### Note 12 – Union Contract

A substantial portion of ECS’ labor force is subject to a collective bargaining agreement. The agreement expires on June 30, 2015.

#### Note 13 – Commitments and Contingencies

ECS occupies facilities in various locations under month-to-month and long-term operating leases with terms extending through December 2023. Rental expense under operating leases was approximately \$1,601,000 and \$1,705,000 for the years ended June 30, 2014 and 2013, respectively.

Future minimum annual rentals under long-term operating leases at June 30, 2014 are as follows:

|                       |                     |
|-----------------------|---------------------|
| Years ending June 30, |                     |
| 2015                  | \$ 1,636,528        |
| 2016                  | 1,125,511           |
| 2017                  | 808,870             |
| 2018                  | 570,379             |
| 2019                  | 579,080             |
| Thereafter            | <u>2,325,522</u>    |
|                       | <u>\$ 7,045,890</u> |

## EPISCOPAL COMMUNITY SERVICES NOTES TO FINANCIAL STATEMENTS

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### Note 13 - Commitments and Contingencies (continued)

**Grants and contracts** – ECS has contracts with government agencies which are subject to audit. No provision has been made for any additional liabilities that may arise from such audits, since the amounts, if any, cannot be determined. Management believes that any additional liability that may result from any such audits would not be material. Certain of these contracts may be terminated or reduced with 30-days written notice to ECS in the event that federal, state, or county funding for the agreement ceases or is reduced prior to the expiration dates of the contracts.

**Risks and uncertainties** – The operations of ECS are subject to the administrative directives, rules, and regulations of federal, state, and local regulatory agencies. Such administrative directives, rules, and regulations are subject to change by an act of Congress or other government agency or an administrative change. Such changes may occur with little notice or inadequate funding to pay for the related cost, including the additional administrative burden, if any, to comply with a change.

**Legal** – ECS is a party to certain legal actions and investigations arising in the ordinary course of business. Management and ECS' legal counsel are unable to determine the likelihood of unfavorable outcomes, if any.

### Note 14 - Related-party Transactions

Related-party transactions as of and for the years ended June 30 are as follow:

|  | <u>2014</u> | <u>2013</u> |
|--|-------------|-------------|
| Note payable to Episcopal Diocese of Los Angeles | \$ 100,000  | \$ 125,000  |
| Note payable to Episcopal Diocese of San Diego   | 21,648      | 26,921      |
| Contribution from Episcopal Diocese of San Diego | 20,000      | 20,000      |

ECS also has a beneficial interest in a charitable remainder trust for which a member of the Board of Directors is a trustee. ECS' beneficial interest is valued at approximately \$ 238,000 and \$233,000 as of June 30, 2014 and 2013, respectively.

**ADDITIONAL INFORMATION**

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## REPORT OF INDEPENDENT AUDITORS ON THE ADDITIONAL INFORMATION

Board of Directors  
Episcopal Community Services

We have audited the financial statements of Episcopal Community Services as of and for the year ended June 30, 2014, and have issued our report thereon dated October 23, 2014, which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The schedule of revenue and expenses by activity is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Moss Adams LLP*

San Diego, California  
October 23, 2014

**EPISCOPAL COMMUNITY SERVICES  
ADDITIONAL INFORMATION  
SCHEDULE OF REVENUE AND EXPENSES BY ACTIVITY  
YEAR ENDED JUNE 30, 2014**

|  | <b>Child<br/>Development<br/>Programs</b> <sup>(1)</sup> | <b>Housing<br/>and Supportive<br/>Services<br/>Programs</b> <sup>(2)</sup> | <b>Clinical<br/>Services<br/>Programs</b> <sup>(3)</sup> | <b>Nutrition<br/>Services</b> | <b>Fundraising<br/>and<br/>Communications</b> | <b>Management<br/>and<br/>General</b> | <b>Capital Fund<br/>Activity</b> | <b>Eliminations</b> | <b>Total</b>        |
|--|--|--|--|-------------------------------|---|---------------------------------------|----------------------------------|---------------------|---------------------|
| <b>Revenue, Gains, and Other Support</b>                             |  |  |  |                               |   |                                       |                                  |                     |                     |
| Grants and contracts   | \$ 17,199,914  | \$ 1,533,158   | \$ 655,297   | \$ -                          | \$ -  | \$ -                                  | \$ -                             | \$ (71,935)         | \$ 19,316,434       |
| Service fees   | 1,107  | -  | 2,813,516  | 908,501                       | -   | (100)                                 | -                                | (900,454)           | 2,822,570           |
| Contributions and change in value<br>of beneficial interests in CRTs | 148  | 55,169   | -  | -                             | 318,362                                       | -                                     | -                                | -                   | 373,679             |
| Other  | 262  | 53,120   | 2,889  | -                             | -   | 125,798                               | -                                | -                   | 182,069             |
| Total revenue, gains, and<br>other support                           | <u>17,201,431</u>  | <u>1,641,447</u>   | <u>3,471,702</u>   | <u>908,501</u>                | <u>318,362</u>                                | <u>125,698</u>                        | <u>-</u>                         | <u>(972,389)</u>    | <u>22,694,752</u>   |
| <b>Expenses</b>  |  |  |  |                               |   |                                       |                                  |                     |                     |
| Personnel  | 10,875,013   | 1,216,483  | 2,107,965  | 295,997                       | 92,903  | 1,661,330                             | -                                | (71,935)            | 16,177,756          |
| Other direct costs   | 3,158,851  | 265,818  | 361,811  | 450,553                       | 77,177  | 409,709                               | (12,360)                         | (900,454)           | 3,811,105           |
| Occupancy  | 1,669,870  | 295,370  | 396,216  | 34,210                        | 26,900  | 273,496                               | (93,117)                         | -                   | 2,602,945           |
| Depreciation   | -  | -  | -  | -                             | -   | -                                     | 418,902                          | -                   | 418,902             |
| Interest   | -  | -  | -  | -                             | -   | 9,327                                 | -                                | -                   | 9,327               |
| Management and general   | 1,632,586  | 250,555  | 420,160  | 45,839                        | 13,366  | (2,362,506)                           | -                                | -                   | -                   |
| Total expenses   | <u>17,336,320</u>  | <u>2,028,226</u>   | <u>3,286,152</u>   | <u>826,599</u>                | <u>210,346</u>                                | <u>(8,644)</u>                        | <u>313,425</u>                   | <u>(972,389)</u>    | <u>23,020,035</u>   |
| <b>Net Activity</b>  | <u>\$ (134,889)</u>                                      | <u>\$ (386,779)</u>  | <u>\$ 185,550</u>  | <u>\$ 81,902</u>              | <u>\$ 108,016</u>                             | <u>\$ 134,342</u>                     | <u>\$ (313,425)</u>              | <u>\$ -</u>         | <u>\$ (325,283)</u> |

<sup>(1)</sup> **Child Development Programs:** Head Start, Early Head Start, T&TA, and Quality Preschool Initiative

<sup>(2)</sup> **Housing and Supportive Services Programs:** Friend to Friend and San Diego Safe Havens

<sup>(3)</sup> **Clinical Services Programs:** ACCORD and Para Las Familias

*Eliminations represent the reversal of revenue and expenses generated from Nutrition Services provided to Child Development and Housing and Supportive Services programs and*

*Revenue and Expenses shown are based on the accounting methods prescribed by the program grants and contracts.*