

February 18 2008

To: Convention, Episcopal Diocese of Lexington
From: Molly Lovelock, Acting Bishop's Deputy for Financial Affairs
Ann Davis McClain, Acting Treasurer

We thought it might be helpful to point out some key items in the Preliminary 2007 Financial Statements.

First, adjustments are always made to the financial statements in the course of preparing for the annual audit and/or by the auditor. This year, we did not receive the 2006 audit adjustments until late January 2008. These 2006 adjustments are included in these statements, but, in some cases, further work may be needed on these adjustments and their implications on 2007 accounts. In addition, last year, the Diocese employed an outside accounting firm to perform all accounting functions. In 2008, the work was brought back in house, both the financial and the administrative functions. There was a back-log of 2007 work, which normally would have been done through-out the year. This work includes tracking certain payments and reimbursements, cross-checking accounts, and working with programs to ensure accuracy of reporting. We appreciate all the help we are now receiving on this, from programs and churches throughout the diocese. Although the adjustments and corrections still required may be numerous, our belief is that they will not have a major affect on the overall picture presented in these statements.

Mission and Ministry (“The Episcopal Church in the Diocese of Lexington, Inc.”)

- Preliminary figures show that the year 2007 ended with a deficit of \$4,733. The comparable number in 2006, after Audit Adjustments, was a surplus of \$54,524.
- The major shortfall was in assessment income, because of difficulties faced by Grace, Florence. This kind of shortfall is unusual. Although Ascension, Frankfort, did not pay their whole pledge in 2007, they presented a plan, approved by Executive Council, to pay that pledge in full over the next two years. Accordingly, it is included in 2007 income as a pledge and a receivable. (Note: There also appear to be some accounting issues on several church's assessments, perhaps timing of payments, which may need further research and adjusting.)
- Although certain designated contribution income is below budget, the associated expenses also are.
- One outstanding 2007 item is the \$10,000 Support to Our Saviour Madison County, a grant budgeted towards paying down a loan made by the Diocese to purchase their property—further research is needed to ensure proper accounting for this.
- Most items that are under or over budget are fairly self-explanatory. In at least one case, the salary of the bishop, the variation was from a budget miscalculation, not an increase in the actual.
- Two key budget items in 2007 appear as balance sheet items. A total of \$15,039 in principle was paid on the bank loan from BB&T, associated with Mission

House. And the \$10,000 budgeted towards repayment of a loan from the Bishop's Discretionary Fund Endowment was paid; the 2006 budgeted payment was also made in 2007 so that loan balance now stands at \$70,000.

Cathedral Domain

- Preliminary figures, including the budgeted Diocesan income subsidy of \$67,765, show a deficit of \$63,690 in the Cathedral Domain. The comparable number for 2006 was a deficit of \$78,512.
- In December, the Executive Council approved a transfer from the Domain's endowment of \$80,000, recommended by the Finance Committee based on the predicted deficit and money owed to the Diocesan Fund.
- The Executive Council also approved money from the Endowment to be transferred to cover the 2006 deficit. The auditor interpreted this as a loan from the Endowment, so it shows on the balance sheet as "Due to Endowment." The money was actually transferred in 2007.

St. Agnes House

- Preliminary figures show a deficit in 2007 of \$10,882. The comparable number for 2006 was a deficit of \$6,330.
- The budget deficit in 2007 was \$5,738. The increase in accounting fees (Administrative Costs) related to outsourcing in 2007 were particularly challenging for this program.

Reading Camp

- Preliminary figures show a surplus in 2007 of \$30,254. The comparable number for 2006 was a surplus of \$10,540.
- In 2007, the category "Administrative Costs" in the budget included one lump figure for a variety of costs, both program and administrative, which are shared by all camps. These costs are broken down in the 2008 budget.

Small Church Ministry Consortium

- 2007 was only a partial year for this program, which began in the summer.
- The employee pension and health insurance expenses are not yet showing, because of the lag in setting these up for a new employee. They will appear retroactively in 2008, and most likely will be adjusted back to 2007 in the final year-end figures.

Designated Funds

- Designated Funds represent funds set aside by the Convention Budget or by Executive Council, in order to plan forward for spending. The classic designated fund is General Convention, where the Diocese budgets \$12,000 a year for three years, rather than having to budget \$36,000 in the year Convention occurs.
- The Equity lines on the balance sheet present the amount that was available at the end of 2007 for each of the purposes.
- A designated transfer for St. Paul's Newport from the sale of real estate was interpreted by the auditor as a loan from the Real Estate Fund, and shows this way

on the balance sheet. This does not seem to be the intention of Executive Council, so further research and a potential 2007 adjustment may be needed.

Restricted Funds

- Restricted Funds includes a variety of small programs with funding restricted by donors.
- The Equity lines on the balance sheet present the amount that was available at the end of 2007 for each of the purposes.
- Each of the Commissions or other bodies in charge of these programs can request disbursements or payment of expenses.
- There may be some backlog of disbursements needed. There also needs to be some further analysis, because payments may have been made in 2007 from other funds that could or should have been made from Restricted.

St. Augustine's Chapel

- The Diocese subsidizes all building-related costs at St. Augustine's Chapel, and the Lutherans, in a joint programming agreement, provide a pastor.
- The Diocese is also paying back a loan from the Diocesan Loan Fund for a boiler repair at St. Augustine's, at the rate of \$5,000 a year. Because this is a balance sheet item, not an expense per se, this amount appears as a surplus in 2007.

The Close

- The Close Retreat Center is managed by a body separate from the Diocese.
- The Close has its own endowment, which can also be used to cover any operating deficits.

ECW

- The Diocese compiles statements quarterly for ECW, based on information provided by the ECW Treasurer and the United Thank Offering Treasurer.

Diocesan Loan Fund

- Payments were received in 2007 from all churches with loans from the Loan Fund, except Our Saviour, where the agreement was for deferred payments.
- Any accrued interest for 2007 is not included in these statements—this entry is done year-end as part of the audit process.
- Although the assets appear to be lower in 2007 than 2006, that is balanced by a decrease in a liability to National City. In early 2007, St. Raphael's paid off a note to National City, where the Diocese was a co-signer, which reduced both an asset and a liability on the Loan Fund books.
- The total Equity in the Loan Fund of \$938,542 is slightly above the 2006 level.

Episcopal Seminary Fund

- The Seminary Fund consists of assets held in trust from the closing of the Episcopal Seminary of Kentucky in 1990.

- The primary asset of the Fund is the loan on Mission House. Interest payments on this loan from Mission and Ministry support the programs of the Seminary Fund. There are also some restricted trusts, which also provide income to this fund.
- The Seminary Fund provides funding to the Diocese for education-related ministries, such as continuing education, the Commission on Ministry, Seminarians, and College Ministry. Transfers appear as designated contribution income in the Mission and Ministry budget.
- A surplus of \$30,465 in 2006 enabled the Seminary Fund to have a deficit of \$10,281 in 2007.

Real Estate Fund

- The Real Estate Fund consists of the real estate assets of the Diocese, including land and building used by Diocesan programs (Domain, Mission House) and those churches for which the Diocese holds the deed.
- In 2007, property of St. Stephen's was sold.
- Most adjustments to the Real Estate Fund are done year-end as part of the audit process, including changes in valuation. None of these have been done at this point.

Endowment Fund

- The Diocese follows a practice of distributing 5% of a three-year moving average of investment value to the programs associated with the various endowments.
- Some of endowments are not restricted to income-only, including the Domain, St. Agnes, and the Close. Domain 2007 distributions from Endowment are discussed under the Domain.
- In 2007, the Executive Council determined that a Trust formerly belonging to St. Stephen's was for missions and should, therefore, be set aside for the Small Church Ministry Consortium. The Trust had been temporarily placed in one of the Domain's endowment accounts. Certain Domain-related expenditures were authorized by Executive Council from the Trust, but not yet paid. Although the funds are still physically in the Domain's Vanguard account, they have been separated out on this statement, pending further research on authorized expenditures.
- Most of the Endowment Funds had Unrealized Losses in 2007, particularly in the fourth quarter, as a result of drops in market value of the investments.