

**THE CONVENTION OF THE
PROTESTANT EPISCOPAL CHURCH IN
THE DIOCESE OF TENNESSEE**

FINANCIAL STATEMENTS

December 31, 2016 and 2015

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE**

TABLE OF CONTENTS

Independent Auditor’s Report..... 1 – 2

Financial Statements:

Statements of Financial Position 3

Statements of Activities..... 4 – 5

Statements of Cash Flows 6

Notes to Financial Statements..... 7 – 19



INDEPENDENT AUDITOR'S REPORT

To the Bishop and Council of
The Convention of the Protestant Episcopal Church in the Diocese of Tennessee
Nashville, Tennessee

We have audited the accompanying financial statements of The Convention of the Protestant Episcopal Church in the Diocese of Tennessee (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, 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.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to 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 Convention of the Protestant Episcopal Church in the Diocese of Tennessee as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Fraser, Dean & Howard, PLLC

Nashville, Tennessee
May 26, 2017

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
STATEMENTS OF FINANCIAL POSITION
December 31, 2016 and 2015**

	2016	2015
Assets		
Cash and cash equivalents	\$ 1,270,848	\$ 693,564
Accounts receivable	7,758	10,771
Prepaid expenses	2,800	15,574
Investments	8,298,419	7,798,120
Notes receivable, net	115,288	239,685
Beneficial interest in trust	54,780	61,874
Property and equipment, net	1,831,438	1,893,376
Total assets	\$ 11,581,331	\$ 10,712,964
Liabilities and Net Assets		
Accounts payable	\$ 47,448	\$ 15,418
Accrued expenses	13,872	22,335
Note payable	251,100	278,100
Total liabilities	312,420	315,853
Net assets:		
Unrestricted:		
Designated:		
Dandridge Trust	2,016,108	1,916,866
Endowment and similar funds	693,301	654,384
Mid-Cumberland Mountain Ministries	399,819	464,514
Total designated	3,109,228	3,035,764
Undesignated	2,863,335	2,351,994
Total unrestricted	5,972,563	5,387,758
Temporarily restricted:		
Endowment and similar funds	3,344,610	3,064,838
Other temporarily restricted	34,303	30,644
Total temporarily restricted	3,378,913	3,095,482
Permanently restricted endowment and similar funds	1,917,435	1,913,871
Total net assets	11,268,911	10,397,111
Total liabilities and net assets	\$ 11,581,331	\$ 10,712,964

See accompanying notes.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
STATEMENT OF ACTIVITIES
For the Year Ended December 31, 2016**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenue and support:				
Contributions	\$ 2,019,591	\$ 119,359	\$ -	\$ 2,138,950
Net unrealized and realized gain on investments	210,149	315,082	-	525,231
Investment income	39,881	77,335	-	117,216
Other income	50,853	-	-	50,853
Interest income	4,139	-	-	4,139
Change in value of charitable lead trust	-	-	3,564	3,564
Net assets released from restrictions	228,345	(228,345)	-	-
Total revenue and support	<u>2,552,958</u>	<u>283,431</u>	<u>3,564</u>	<u>2,839,953</u>
Expenses:				
Compensation and benefits	899,344	-	-	899,344
Administration	425,364	-	-	425,364
Outreach Beyond Diocese	246,827	-	-	246,827
Missions Council	103,939	-	-	103,939
Educational Council	84,424	-	-	84,424
Ministry/Service Council	83,628	-	-	83,628
Depreciation	71,461	-	-	71,461
Church Government	34,839	-	-	34,839
Special Programs	18,327	-	-	18,327
Total expenses	<u>1,968,153</u>	<u>-</u>	<u>-</u>	<u>1,968,153</u>
Change in net assets	584,805	283,431	3,564	871,800
Net assets at beginning of year	<u>5,387,758</u>	<u>3,095,482</u>	<u>1,913,871</u>	<u>10,397,111</u>
Net assets at end of year	<u>\$ 5,972,563</u>	<u>\$ 3,378,913</u>	<u>\$ 1,917,435</u>	<u>\$ 11,268,911</u>

See accompanying notes.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
STATEMENT OF ACTIVITIES
For the Year Ended December 31, 2015**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenue and support:				
Contributions	\$ 1,536,241	\$ 44,604	\$ -	\$ 1,580,845
Investment income	64,412	84,648	-	149,060
Other income	43,923	-	-	43,923
Interest income	10,296	1	-	10,297
Change in value of charitable lead trust	-	-	(2,224)	(2,224)
Net unrealized and realized loss on investments	(99,402)	(219,180)	-	(318,582)
Net assets released from restrictions	256,705	(256,705)	-	-
Total revenue and support	<u>1,812,175</u>	<u>(346,632)</u>	<u>(2,224)</u>	<u>1,463,319</u>
Expenses:				
Compensation and benefits	917,165	-	-	917,165
Administration	296,764	-	-	296,764
Outreach Beyond Diocese	241,332	-	-	241,332
Missions Council	137,394	-	-	137,394
Educational Council	83,783	-	-	83,783
Depreciation	69,874	-	-	69,874
Church Government	62,352	-	-	62,352
Ministry/Service Council	49,578	-	-	49,578
Special Programs	29,930	-	-	29,930
Total expenses	<u>1,888,172</u>	<u>-</u>	<u>-</u>	<u>1,888,172</u>
Change in net assets	(75,997)	(346,632)	(2,224)	(424,853)
Net assets at beginning of year	<u>5,463,755</u>	<u>3,442,114</u>	<u>1,916,095</u>	<u>10,821,964</u>
Net assets at end of year	<u>\$ 5,387,758</u>	<u>\$ 3,095,482</u>	<u>\$ 1,913,871</u>	<u>\$ 10,397,111</u>

See accompanying notes.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Change in net assets	\$ 871,800	\$ (424,853)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Forgiveness of note receivable	67,983	-
Depreciation	71,461	69,874
Change in value of charitable lead trust	(3,564)	2,224
Net unrealized and realized (gain) loss on investments	(525,231)	318,582
Loss on disposal of property and equipment	3,612	-
Changes in operating assets and liabilities:		
Accounts receivable	3,013	6,190
Prepaid expenses	12,774	(15,574)
Accounts payable	32,030	(673)
Accrued expenses	(8,463)	241
Net cash provided by (used in) operating activities	<u>525,415</u>	<u>(43,989)</u>
Cash flows from investing activities:		
Issuance of notes receivable	-	(15,711)
Principal payments received on loans	63,414	108,281
Purchases of investments	(541,009)	(202,668)
Proceeds from sale of investments	576,599	311,736
Purchases of property and equipment	(25,135)	(13,793)
Proceeds from sale of property and equipment	5,000	-
Net cash provided by investing activities	<u>78,869</u>	<u>187,845</u>
Cash flows from financing activities:		
Proceeds from gifts restricted for permanent endowment	-	11,713
Principal payments on note payable	(27,000)	(27,374)
Net cash used in financing activities	<u>(27,000)</u>	<u>(15,661)</u>
Increase in cash and cash equivalents	577,284	128,195
Cash and cash equivalents at beginning of year	<u>693,564</u>	<u>565,369</u>
Cash and cash equivalents at end of year	<u>\$ 1,270,848</u>	<u>\$ 693,564</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	<u>\$ 3,265</u>	<u>\$ 3,603</u>
Noncash investing activity:		
Note receivable forgiven	<u>\$ 67,983</u>	<u>\$ -</u>
Note receivable issued in sale of property and equipment	<u>\$ 7,000</u>	<u>\$ -</u>

See accompanying notes.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS
December 31, 2016 and 2015**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The financial statements of The Convention of the Protestant Episcopal Church in the Diocese of Tennessee (the “Diocese”) have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation

The financial statement presentation of the Diocese follows the recommendations of accounting and financial reporting standards prescribed for not-for-profit organizations. Accordingly, net assets of the Diocese and changes therein are classified and reported as follows:

Unrestricted net assets:

Undesignated – Net assets that are not subject to donor-imposed stipulations or designated by the Diocese board.

Designated – Net assets designated by the Diocese for particular purposes.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Diocese and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that are to be maintained permanently by the Diocese.

The Diocese is comprised of 45 parishes and missions in the Middle Tennessee area. The Bishop and Council of the Diocese have fiduciary responsibility for the Diocese. Those responsibilities include oversight of the regular operating activities in the operating budget, and for the Dandridge Trust and Mid-Cumberland Mountain Ministries (“MCMM”). The Dandridge Trust, a grant making body of the Diocese, gives grants for outreach projects primarily inside of the Diocese. MCMM provides zero to low percent interest bearing housing loans and rehabilitation loans to qualifying participants in the Grundy County area. The accounts of the Dandridge Trust and MCMM are included in the accompanying financial statements.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation (Continued)

When deemed appropriate, parishes and missions may deposit funds into the Episcopal Endowment Corporation, a common trust fund held at a financial institution. The common trust funds owned by the Diocese are included in these financial statements. Other funds owned at the congregational level are not a part of these financial statements.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Diocese considers its cash and cash equivalents to include cash in checking and savings accounts, certificates of deposit and money market accounts which are readily available for current operations. Cash and cash equivalents during the year may exceed Federal Deposit Insurance Corporation (“FDIC”) limits.

Notes Receivable

Notes receivable are stated at unpaid principal balance, less an allowance for loan losses. Interest on loans is recognized over the term of the loan and is calculated using the simple interest method on principal amounts outstanding. The accrual of interest on loans is discontinued at the time a loan becomes delinquent. Notes are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. There are no significant past due notes receivable at December 31, 2016 and 2015. Past due status is based on contractual terms. In all cases, loans are placed on nonaccrual status or charged off at an earlier date if management believes that collection of principal or interest is doubtful.

The Diocese maintains an allowance for uncollectible notes receivable carried at an amount which bad debts are reasonably expected not to exceed. The allowance for uncollectible notes receivable is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the notes receivable in light of historical experience, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Notes receivable are charged off against the allowance for uncollectible notes receivable when management of the Diocese determines collection efforts will not be successful. Bad debt expense was not significant in 2016 and 2015.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

The Diocese carries investments in marketable securities with readily determinable fair values and all investments in debt securities at their fair value in the statements of financial position. Unrealized gains and losses are included in the change in net assets in the statements of activities.

Property and Equipment

Property and equipment is recorded at cost or, if donated, at fair value at the date of donation. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, donations of property and equipment are recorded as unrestricted support. Depreciation is computed using the straight-line method over the life of the asset, which ranges from 3 to 40 years.

Land, buildings and equipment of the Diocese parish and mission churches are reported on each congregation's financial statements as they maintain the beneficial use of the property and are not included in the accompanying financial statements. In accordance with the Canons of the Diocese, the title to all properties are held in trust of the Diocese and would revert to the Diocese in the event a congregation ceases operations or ceases operating in accordance with the Charter, Constitution or Canons of the Diocese and the Episcopal Church.

Endowment

The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") was enacted in Tennessee effective July 1, 2007. Accounting principles generally accepted in the United States of America provide guidance on the net asset classification of donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of UPMIFA. It also requires disclosure of a description of the governing board's interpretation of the law that underlies the organization's policies for the appropriation of endowment assets for expenditures (its endowment spending policies), a description of the organization's endowment investment policies, and additional disclosures not previously required.

The endowment includes both donor-restricted funds and funds designated by the Bishop and Council to function as endowments. The net assets associated with endowment funds including funds designated by the Bishop and Council to function as endowments, are classified and reported based on existence or absence of donor imposed restrictions.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Endowment (Continued)

The Diocese has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. To achieve its long-term rate of return objectives, the Diocese relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The Diocese expects its endowment funds over time to provide an average rate of return of approximately 4% to 5% annually.

The Diocese's endowment spending policy uses a percentage of a three year moving average of the endowment fund's market value which is distributed to the appropriate funds. These distributions consist of interest, dividends and, if necessary, a portion of accumulated investment gains.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment fund deficits exist, they are classified as a reduction of unrestricted net assets.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Beneficial Interest in Trust

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") guidelines require that the beneficial interest in trust be recorded as an asset at the estimated net present value. A donor established and funded a charitable lead trust under which an annual 3% distribution is to be made to the Diocese over the trust's term of 10 years. The assets in the trust are assumed to earn a rate of 3% over the life of the trust and the annual payments are discounted at a rate of 2.45%.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Donated Services

No amounts have been reflected in the financial statements with respect to donated services as no objective basis is available to place a value on such services; however, volunteers have donated their time to help in the administration of the Diocese office.

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 that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates and assumptions also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Income Taxes

The Diocese is generally exempt from federal income taxes on related income under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no income tax was paid or recorded in the financial statements for the years ended December 31, 2016 and 2015.

The Diocese follows FASB ASC guidance that clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. This guidance prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. The Diocese has no tax penalties or interest reported in the accompanying financial statements. The Diocese had no uncertain tax positions at December 31, 2016 or 2015.

Subsequent Events

The Diocese evaluated subsequent events through May 26, 2017, when these financial statements were available to be issued. Management is not aware of any significant events that occurred subsequent to the statement of financial position date but prior to the filing of this report that would have a material impact on the accompanying financial statements.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 2 – FAIR VALUE MEASUREMENTS

The Diocese uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the *Fair Value Measurement* topic of FASB ASC, the fair value of a financial instrument is 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. In accordance with this guidance, the Diocese groups its financial assets and liabilities generally measured at fair value in a three level valuation hierarchy for disclosure of fair value measurements defined in Level 1 – inputs for quoted market prices for identical assets or liabilities in active markets; Level 2 – inputs include quoted market prices for similar assets and liabilities in active markets and inputs that are observable either directly or indirectly and; Level 3 – inputs that are unobservable and significant to the fair value measurements.

Fair value of assets and liabilities measured on a recurring basis at December 31, 2016 are as follows:

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Levels 3)</u>
Investments:				
Episcopal Endowment Corporation	\$ 7,224,985	\$ -	\$ 7,224,985	\$ -
Patten Trust	420,586	-	420,586	-
Mutual funds	<u>652,848</u>	<u>652,848</u>	<u>-</u>	<u>-</u>
Total investments	8,298,419	652,848	7,645,571	-
Beneficial interest in trust	<u>54,780</u>	<u>-</u>	<u>-</u>	<u>54,780</u>
Total assets, at fair value	<u>\$ 8,353,199</u>	<u>\$ 652,848</u>	<u>\$ 7,645,571</u>	<u>\$ 54,780</u>

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

Fair value of assets and liabilities measured on a recurring basis at December 31, 2015 are as follows:

	<u>Fair Value</u>	Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Levels 3)
Investments:				
Episcopal Endowment Corporation	\$ 6,846,159	\$ -	\$ 6,846,159	\$ -
Patten Trust	382,237	-	382,237	-
Mutual funds	<u>569,724</u>	<u>569,724</u>	<u>-</u>	<u>-</u>
Total investments	7,798,120	569,724	7,228,396	-
 Beneficial interest in trust	 <u>61,874</u>	 <u>-</u>	 <u>-</u>	 <u>61,874</u>
 Total assets, at fair value	 <u>\$ 7,859,994</u>	 <u>\$ 569,724</u>	 <u>\$ 7,228,396</u>	 <u>\$ 61,874</u>

The summary of changes in the fair value of the level 3 assets is as follows for the year ended December 31:

	<u>2016</u>	<u>2015</u>
Balance, beginning of year	\$ 61,874	\$ 75,811
Distribution	(10,658)	(11,713)
Change in present value	<u>3,564</u>	<u>(2,224)</u>
 Balance, end of year	 <u>\$ 54,780</u>	 <u>\$ 61,874</u>

The majority of the Diocese’s investments are held by Episcopal Endowment Corporation Common Trust Fund (“Fund”). The Fund was established in 1933 to receive and manage funds from the Diocese and related parishes, missions and other authorized entities. The Fund primarily invests in mutual funds and common stocks. The Diocese’s investment in the Fund is valued at fair value based upon the quoted market values of the underlying securities held by the Fund. The Diocese has classified its investment in the Fund as Level 2 at December 31, 2016 and 2015.

The Diocese also is the co-trustee of the Patten Trust (the “Trust”), which is held at a financial institution. The Trust’s assets are primarily invested in mutual funds at December 31, 2016 and 2015. The Diocese has valued its investment in the Trust at fair value based upon the value reported by the financial institution. The Diocese has classified its investment in the Trust as Level 2 at December 31, 2016 and 2015.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 2 – FAIR VALUE MEASUREMENTS (Continued)

The Diocese investments in mutual funds are valued based upon quoted market prices and are considered Level 1 investments at December 31, 2016 and 2015.

The beneficial interest in trust is valued using information obtained from third party sources, including investment statements and other information from a detailed listing of holdings from the trust. The valuation is typically performed annually, based on the present value of the estimated future distributions the Diocese expects to receive over the term of the trust. The beneficial interest in trust is considered a Level 3 investment at December 31, 2016 and 2015.

NOTE 3 – INVESTMENT INCOME

Investment income in the statements of activities for 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Investment income:		
Endowment investments	\$ 88,120	\$ 96,381
Other investments	29,096	52,679
Realized and unrealized gains (losses):		
Endowment investments	358,994	(249,836)
Other investments	<u>166,237</u>	<u>(68,746)</u>
	<u>\$ 642,447</u>	<u>\$ (169,522)</u>
Unrestricted	\$ 250,030	\$ (34,990)
Temporarily unrestricted	<u>392,417</u>	<u>(134,532)</u>
	<u>\$ 642,447</u>	<u>\$ (169,522)</u>

NOTE 4 – NOTES RECEIVABLE

Notes receivable consist of the following as of December 31:

	<u>2016</u>	<u>2015</u>
MCMM Residential Real Estate	\$ 195,891	\$ 233,695
Vehicle	6,708	-
MCMM Other	197	1,550
Congregations	<u>-</u>	<u>91,948</u>
	202,796	327,193
Less allowance for uncollectible notes receivable	<u>(87,508)</u>	<u>(87,508)</u>
	<u>\$ 115,288</u>	<u>\$ 239,685</u>

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31:

	2016	2015
Land	\$ 766,102	\$ 766,102
Buildings	997,275	997,275
Office furniture and equipment	337,134	344,744
Less accumulated depreciation	(269,073)	(214,745)
	\$ 1,831,438	\$ 1,893,376

For the years ended December 31, 2016 and 2015, the Diocese had depreciation expense of \$71,461 and \$69,874, respectively.

NOTE 6 – LINE OF CREDIT

The Diocese had a \$250,000 line of credit secured by an investment account with a financial institution that was due upon demand with a variable interest rate that equals the LIBOR rate plus 1.50%. As of December 31, 2015, the rate was 1.74%. There were no amounts outstanding on the line of credit as of December 31, 2015. The line of credit was closed during 2016.

NOTE 7 – NOTE PAYABLE

The Diocese’s outstanding debt at December 31, 2016 and 2015 consists of a note payable to the Tennessee Conference of the United Methodist Church (the “Methodist Conference”) based on termination of a 2006 agreement related to the renovations and use of space at St. Augustine Chapel (see Note 11). The note is unsecured and requires interest at the prime rate less two percent (1.50% and 1.25% at December 31, 2016 and 2015, respectively). Principal maturities under the Diocese’s debt arrangement are as follows for the years ending December 31:

2017	\$ 27,000
2018	27,000
2019	27,000
2020	27,000
2021	27,000
Thereafter	116,100
	\$ 251,100

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 8 – ENDOWMENT AND SIMILAR NET ASSETS

Endowment and similar net assets composition by type of fund were as follows at December 31, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (1,818)	\$ 3,344,610	\$ 1,917,435	\$ 5,260,227
Board-designated endowment funds	<u>695,119</u>	<u>-</u>	<u>-</u>	<u>695,119</u>
Total assets at fair value	<u>\$ 693,301</u>	<u>\$ 3,344,610</u>	<u>\$ 1,917,435</u>	<u>\$ 5,955,346</u>

Endowment and similar net assets composition by type of fund were as follows at December 31, 2015:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (3,014)	\$ 3,064,838	\$ 1,913,871	\$ 4,975,695
Board-designated endowment funds	<u>657,398</u>	<u>-</u>	<u>-</u>	<u>657,398</u>
Total assets at fair value	<u>\$ 654,384</u>	<u>\$ 3,064,838</u>	<u>\$ 1,913,871</u>	<u>\$ 5,633,093</u>

Changes in endowment and similar net assets for the year ended December 31, 2016:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment and similar net assets at January 1, 2016	\$ 654,384	\$ 3,064,838	\$ 1,913,871	\$ 5,633,093
Investment income	10,785	77,335	-	88,120
Net realized and unrealized gains	<u>43,912</u>	<u>315,082</u>	<u>-</u>	<u>358,994</u>
Total endowment return	<u>54,697</u>	<u>392,417</u>	<u>-</u>	<u>447,114</u>
Gifts to endowment	13,200	84,785	-	97,985
Change in value of charitable lead trust	-	-	3,564	3,564
Endowment spending for operations	(26,861)	(180,952)	-	(207,813)
Other expenses	<u>(2,119)</u>	<u>(16,478)</u>	<u>-</u>	<u>(18,597)</u>
Endowment and similar net assets at December 31, 2016	<u>\$ 693,301</u>	<u>\$ 3,344,610</u>	<u>\$ 1,917,435</u>	<u>\$ 5,955,346</u>

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 8 – ENDOWMENT AND SIMILAR NET ASSETS (Continued)

Changes in endowment and similar net assets for the year ended December 31, 2015:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment and similar net assets at January 1, 2015	\$ 675,818	\$ 3,393,893	\$ 1,916,095	\$ 5,985,806
Investment income	11,733	84,648	-	96,381
Net realized and unrealized losses	<u>(30,656)</u>	<u>(219,180)</u>	<u>-</u>	<u>(249,836)</u>
Total endowment return	<u>(18,923)</u>	<u>(134,532)</u>	<u>-</u>	<u>(153,455)</u>
Gifts to endowment	26,774	-	-	26,774
Change in value of charitable lead trust	-	-	(2,224)	(2,224)
Endowment spending for operations	(26,978)	(177,853)	-	(204,831)
Other expenses	<u>(2,307)</u>	<u>(16,670)</u>	<u>-</u>	<u>(18,977)</u>
Endowment and similar net assets at December 31, 2015	<u>\$ 654,384</u>	<u>\$ 3,064,838</u>	<u>\$ 1,913,871</u>	<u>\$ 5,633,093</u>

Endowment and similar net assets classified as unrestricted net assets include unrestricted gifts from donors and other funds designated by the Diocese as quasi-endowment for the long-term support of the Diocese, including any accumulated income and appreciation thereon. Temporarily restricted endowment net assets include accumulated income and appreciation on permanently restricted endowment funds. Permanently restricted endowment funds and similar net assets consist of those funds designated by donors to be invested in perpetuity to provide a permanent source of income. Endowment and similar net assets are primarily used to fund missions, support for clergy and other programs within the Diocese.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 9 – COMMITMENTS

Guaranty

The Diocese is a guarantor on notes which had outstanding balances as follows at December 31:

	<u>2016</u>	<u>2015</u>
Church of the Good Shepherd	\$ 2,499,275	\$ 2,597,144
Church of the Holy Spirit	<u>569,118</u>	<u>591,819</u>
Total	<u>\$ 3,068,393</u>	<u>\$ 3,188,963</u>

The Diocese has not provided any debt assistance in 2016 or 2015 and does not anticipate providing assistance on these notes in the future. Therefore, no accrual for debt assistance is included in the 2016 or 2015 financial statements.

Retirement Plans

The Diocese makes contributions to the Church Pension Fund of the Episcopal Church for clergy members serving on the Diocesan staff. The Church Pension Fund provides a pension at retirement, disability retirement benefits, and lump sum death payments. The Episcopal Canons require every church unit engaging clergy services to pay an assessment based on compensation. This applies to full-time, part-time, supply, or interim work performed by clergy that continues for at least three months and where the clergy is paid more than \$200 during a 3-month consecutive period. The Fund's Trustees have set the assessment rate at 18% of annual compensation plus certain benefits. The expenses related to this plan were \$64,874 and \$61,040 in 2016 and 2015, respectively.

The Diocese also participates in the Episcopal Church Lay Employees' Retirement Plan, which is available to lay employees who have completed one year of service and have attained the age of twenty-five. The Diocese contributes a percentage of the employee's earnings, and employees become fully vested after five years of service. The expenses related to this plan were \$15,694 and \$25,581 in 2016 and 2015, respectively.

NOTE 10 – CONCENTRATIONS

The Diocese receives a substantial amount of its contributions from two parishes. The contributions from these two parishes comprised approximately 29% and 39% of total contributions during 2016 and 2015, respectively. Also, the Diocese received a bequest that comprised approximately 21% of total contributions during 2016. A significant reduction in the level of this support, if this were to occur, could have an adverse impact on the Diocese's programs and services.

**THE CONVENTION OF THE PROTESTANT EPISCOPAL
CHURCH IN THE DIOCESE OF TENNESSEE
NOTES TO FINANCIAL STATEMENTS (Continued)
December 31, 2016 and 2015**

NOTE 10 – CONCENTRATIONS (Continued)

At December 31, 2016 and 2015, investments totaled \$8,298,419 and \$7,798,120, respectively. Investments are primarily invested in mutual funds and common stocks. Investments are not insured by FDIC or any other government agency and are subject to investment risk, including loss of principal. Investments are insured by the Securities and Investor Protection Corporation, which covers investor losses, in some cases, attributable to bankruptcy or fraudulent practices of brokerage firms.

NOTE 11 – ST. AUGUSTINE’S CHAPEL JOINT STUDENT MINISTRY AGREEMENT

In 2006, the Diocese entered into an agreement with the Tennessee Conference of the United Methodist Church (the “Methodist Conference”) related to the renovations and use of space of St. Augustine’s Chapel (the “Chapel”), a church governed by the Diocese. Prior to the agreement, the ministries of the Methodist Conference and the Diocese had an ecumenical ministry at the Chapel for over 15 years. In connection with the agreement, the Methodist Conference received a \$500,000 gift from a donor to be specifically used for renovations at the Chapel. In order to ensure that their ministry would continue at the Chapel, the Methodist Conference agreed to donate the \$500,000 gift for renovations of the Chapel. In exchange for the gift, the Diocese guaranteed the use of space for the ministry of the Methodist Conference for 18 ½ years. The agreement includes a termination clause whereby either party could terminate the agreement on July 1 of any year after 2007 by giving written notice to the other party before the preceding January 15th. The termination clause includes repayment of a portion of the original donation based on a pro rata formula. The Methodist Conference informed the Diocese prior to January 15, 2014 that it would be terminating the agreement on July 1, 2014. The remaining principal amount due to the Methodist Conference for the repayment portion of the termination clause at December 31, 2016 and 2015 is \$251,100 and \$278,100, respectively, and is included as a note payable (See Note 7).