McGladrey LLP

227 West First Street, Suite 700
Duluth, MN 55802-1926
O 218.727.5025 F 218.727.1438
www.mcgladrey.com

McGladrey

September 29, 2014

Franz Hoefferle, Finance Director
Diocese of Duluth
2830 East 4th Street
Duluth, Minnesota 55812

In accordance with your request, we are transmitting the accompanying PDF file, which contains an electronic final version of the statements of financial position and the related statements of activities and cash flows for the years then ended and the related notes to the financial statements for the years ended June 30, 2014 and 2013, for Diocese of Duluth. We understand that your request for the electronic copy has been made as a matter of convenience. You understand that electronic transmissions are not entirely secure and that it is possible for confidential financial information to be intercepted by others.

These financial statements and our reports on them are not to be modified in any manner. This final version supersedes all prior drafts. Any preliminary draft version of the financial statements previously provided to you in an electronic format should be deleted from your computer, and all printed copies of any superseded preliminary draft versions should likewise be destroyed.

Professional standards and our Firm policies require that we perform certain additional procedures whenever our reports are included, or we are named as accountants, auditors, or “experts” in a document used in a public or private offering of equity or debt securities. Accordingly, as provided for and agreed to in the terms of our arrangement letter, Diocese of Duluth will not include our reports, or otherwise make reference to us, in any public or private securities offering without first obtaining our consent. Any request to consent is also a matter for which separate arrangements will be necessary. After obtaining our consent, Diocese of Duluth also agrees to provide us with printer’s proofs or masters of such offering documents for our review and approval before printing, and with a copy of the final reproduced material for our approval before it is distributed. In the event our auditor/client relationship has been terminated when Diocese of Duluth seeks such consent, we will be under no obligation to grant such consent or approval.

McGladrey LLP

James B. Spreitzer
Partner

Diocese of Duluth

Financial Report
June 30, 2014

McGladrey

Assurance ▪ Tax ▪ Consulting

Contents

McGladrey

Independent Auditor's Report

The Board of Directors
Diocese of Duluth
Duluth, Minnesota

Report on the Financial Statements
We have audited the accompanying financial statements of the Diocese of Duluth, which comprise the statements of financial position as of June 30, 2014 and 2013, 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 Diocese of Duluth as of June 30, 2014 and 2013, 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.

McGladrey LLP

Duluth, Minnesota
September 26, 2014

Diocese of Duluth

Statements of Financial Position
June 30, 2014 and 2013

	2014	2013
Assets		
Current Assets		
Cash and cash equivalents	$ 624,363	$ 1,008,623
Accounts receivable (Note 5)	270,049	211,467
Accrued interest receivable	5,602	5,049
Notes and loan receivable, current maturities (Note 2)	38,523	10,225
Prepaid expenses	34,388	111,500
Total current assets	972,925	1,346,864
Other Assets		
Investments (Note 3)	3,889,959	3,299,090
Notes and loan receivable, less current maturities (Note 2)	24,034	30,687
	3,913,993	3,329,777
Property and Equipment, net (Note 4)	711,781	1,237,750
Total assets	$ 5,598,699	$ 5,914,391
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 157,035	$ 211,854
Accrued payroll and related liabilities	81,205	103,236
Other postretirement and pension benefits	567,057	647,023
Trust accounts	191,174	219,962
Deferred revenue	95,300	97,322
Other current liabilities	60,000	15,000
Total current liabilities	1,151,771	1,294,397
Long-Term Liabilities, other postretirement and pension benefits (Notes 6 and 7)	11,517,663	10,949,431
Total liabilities	12,669,434	12,243,828
Net Assets (Deficit)		
Unrestricted	(7,886,696)	(7,294,706)
Temporarily restricted (Note 9)	715,961	865,269
Permanently restricted (Note 10)	100,000	100,000
Total net deficit	(7,070,735)	(6,329,437)
Total liabilities and net assets	$ 5,598,699	$ 5,914,391

See Notes to Financial Statements.

Diocese of Duluth

Statements of Activities
Years Ended June 30, 2014 and 2013

	2014	2013
Changes in Unrestricted Net Assets		
Revenues	**$ 2,748,739**	$ 3,267,726
Net assets released from time restrictions	**765,313**	719,284
Total unrestricted revenues and net assets released from restrictions	**3,514,052**	3,987,010
Expenses:		
Program	**2,132,172**	2,314,637
General	**1,288,197**	1,471,011
Total operating expenses, excluding unfunded periodic pension and other postretirement health benefit cost	**3,420,369**	3,785,648
Income from operations prior to unfunded periodic pension and other postretirement health benefit cost	**93,683**	201,362
Unfunded periodic pension and other postretirement health benefit cost	**447,252**	960,596
Loss from operations	**(353,569)**	(759,234)
Other changes in unrestricted net assets:		
Unrealized gain on investments	**433,396**	149,869
Realized gain on investments	**38,335**	199,703
Loss on sale of land	**(215,341)**	-
Loss on impairment, land	**(241,964)**	-
(Increase) decrease in additional liabilities:		
Pension benefits (Note 6)	**509,035**	1,491,046
Other post retirement benefits (Note 7)	**(761,882)**	854,367
Increase (decrease) in unrestricted net assets	**(591,990)**	1,935,751
Changes in Temporarily Restricted Net Assets		
United Catholic Appeal:		
Contributions restricted for subsequent fiscal year	**603,913**	679,106
Net assets released from restrictions	**(679,106)**	(596,829)
Flood contributions	**780**	131,527
Other contributions	**11,312**	60,467
Net assets released from restrictions	**(86,207)**	(122,455)
Increase (decrease) in temporarily restricted net assets	**(149,308)**	151,816
Increase (decrease) in net assets	**(741,298)**	2,087,567
Net Assets (Deficit)		
Beginning of year	**(6,329,437)**	(8,417,004)
End of year	**$ (7,070,735)**	$ (6,329,437)

See Notes to Financial Statements.

Diocese of Duluth

Statements of Cash Flows
Years Ended June 30, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities		
Increase (decrease) in net assets	**$ (741,298)**	$ 2,087,567
Adjustments to reconcile increase (decrease) in net assets to net cash provided by (used in) operating activities:		
Depreciation	**101,799**	117,408
Loss on sale of land	**215,341**	-
Loss on impairment, land	**241,964**	-
Newman Center contribution	**-**	170,795
Unrealized gain on investments	**(433,396)**	(149,869)
Changes in assets and liabilities:		
Accounts receivable	**(58,582)**	(54,874)
Accrued interest receivable	**(553)**	(2,160)
Prepaid expenses	**77,112**	29,716
Accounts payable	**(54,819)**	85,921
Accrued payroll and related liabilities	**(22,031)**	61,477
Trust accounts	**(28,788)**	108,698
Deferred revenue	**(2,022)**	(26,837)
Other current liabilities	**45,000**	(390,268)
Other postretirement and pension benefits	**488,266**	(1,438,122)
Net cash provided by (used in) operating activities	**(172,007)**	599,452
Cash Flows from Investing Activities		
Principal payments received on notes and loan receivable	**9,485**	4,456
Capital expenditures	**(109,397)**	(12,877)
Cash received from sale of property and equipment	**45,132**	-
Purchases of investments	**(842,850)**	(1,265,375)
Sales and maturities of investments	**685,377**	1,362,601
Net cash provided by (used in) investing activities	**(212,253)**	88,805
Net increase (decrease) in cash and cash equivalents	**(384,260)**	688,257
Cash and Cash Equivalents		
Beginning	**1,008,623**	320,366
Ending	**$ 624,363**	$ 1,008,623
Supplemental Disclosures		
Contribution of land, building and improvements to the Newman Center	**$ -**	$ 170,795
Sale of land in exchange for promissory note	**$ 31,131**	$ -

See Notes to Financial Statements.

Note 1. Nature of Organization and Significant Accounting Policies

Nature of organization: The Diocese of Duluth (the Diocese), from its offices in Duluth, Minnesota, collaborates in spreading the Catholic Faith with approximately 95 independent parishes/missions located within its diocesan territory. The Diocese provides guidance and some centralized services/benefits to the parish corporations.

A summary of the Diocese's significant accounting policies follows:

The Diocese prepares its financial statements in accordance with generally accepted accounting principles (GAAP) promulgated in the United States of America for not-for-profit entities. The significant accounting policies used by the Diocese are described below to enhance the usefulness and understandability of the financial statements.

Net assets: The financial statements report net assets and changes in net assets in three classes that are based upon the existence or absence of restrictions on use that are placed by its donors, as follows:

- *Unrestricted net assets.* Unrestricted net assets are resources available to support operations. The only limits on the use of unrestricted net assets are the broad limits resulting for the nature of the Diocese, the environment in which it operates, the purposes specified in its corporate documents and its application for tax-exempt status, and any limits resulting from contractual agreements with creditors and others that are entered into in the course of its operations.
- *Temporarily restricted net assets.* Temporarily restricted net assets are resources that are restricted by a donor for use for a particular purpose or in a particular future period. The Diocese’s unspent contributions are classified in this class if the donor limited their use, as are the unspent appreciation of its donor-restricted endowment funds. When a donor’s restriction is satisfied, either by using the resources in the manner specified by the donor or by the passage of time, the expiration of the restriction is reported in the financial statements by reclassifying the net assets from temporarily restricted to unrestricted net assets. Net assets restricted for acquisition of buildings or equipment (or less commonly, the contribution of those assets directly) are reported as temporarily restricted until the specified asset is placed in service by the Diocese, unless the donor provides more specific directions about the period of its use.
- *Permanently restricted net assets*. Permanently restricted net assets are resources whose use by the Diocese is limited by donor-imposed restrictions that neither expire by being used in accordance with a donor’s restriction nor by the passage of time. The portion of the Diocese’s donor-restricted endowment funds that must be maintained in perpetuity are classified in this net asset class.

Basis of accounting and reporting: The Diocese's policy is to prepare its financial statements on the accrual basis of accounting. If an expenditure results in the acquisition of an asset having an estimated useful life which extends substantially beyond the year of acquisition, the expenditure is capitalized.

Cash and cash equivalents: Substantially all cash and cash equivalents consist of money market funds held by one financial institution. For purposes of reporting the statement of cash flows, the Diocese considers the money market funds to be cash equivalents. The Diocese maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Diocese has not experienced any losses in such accounts. The Diocese believes it is not exposed to any significant credit risk on cash and cash equivalents.

Accounts receivable: The Diocese extends credit to the independent parish corporations and others located within its territory, primarily on an unsecured basis, on terms that are established for each account. The Diocese establishes allowances for doubtful accounts based on the status of the receivables at year-end, historical losses, and existing economic conditions. Uncollectible receivables are written off in the year that amounts are determined to be uncollectible. Accounts are considered past due if payment is not received according to agreed-upon terms.

Certificates of deposit: Certificates of deposit are carried at cost which approximates fair value.

Investments: Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Fair value 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. Investment income or loss (including gains and losses on investments, interest, and dividends) is included in the statement of activities as increases or decreases in unrestricted net assets unless the income or loss is restricted by donor or law.

Fair value measurements: The Diocese reports its fair value measures using a three-level hierarchy that prioritizes the inputs used to measure fair value. This hierarchy, established by GAAP, requires that entities maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs used to measure fair value are as follows:

- *Level 1.* Quoted priced for identical assets or liabilities in active markets to which the Diocese has access at the measurement date.
- *Level 2.* Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include:
    - quoted prices for similar assets or liabilities in active markets;
    - quoted prices for identical or similar assets in markets that are not active;
    - observable inputs other than quoted prices for the asset or liability (for example, interest rates and yield curves); and
    - inputs derived principally from, or corroborated by, observable market data by correlation or by other means.
- *Level 3.* Unobservable inputs for the asset or liability should be used to measure the fair value to the extent that observable inputs are not available.

When available, the Diocese measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. However, Level 1 inputs are not available for many of the assets and liabilities that the Diocese is required to measure at fair value (for example, unconditional promises to give and in-kind contributions).

The primary uses of fair value measures in the Diocese’s financial statements are:

- initial measurement of noncash gifts, including gifts of investment assets and unconditional promises to give.
- recurring measurement of investments (Note 3).

Changes in fair value levels: To assess the appropriate classification of investments within the fair value hierarchy, the availability of market data is monitored. Changes in economic conditions or valuation techniques may require the transfer of investments from one fair value level to another. In such instances, the transfer is reported at the end of the reporting period.

The significance of transfers between levels is evaluated based upon the nature of the investment and size of the transfer relative to total net assets available for benefits. For the year ended June 30, 2014, there were no transfers in or out of Levels 1, 2, or 3.

Property and equipment: Property and equipment are stated at cost, or if acquired by donation, the fair market value at date of donation. Depreciation is computed using the straight-line method.

Trust accounts: Trust accounts are used as clearing or agency accounts for the receipt and disbursement of money for various organizations or functions where the Diocese functions solely as an intermediary in handling such funds.

Deferred revenue: The Diocese receives an administrative fee on the insurance program that covers parishes and schools located within its diocesan territory. Deferred revenue represents amounts received on this program that have not yet been earned.

Postretirement benefits: The Diocese provides certain healthcare benefits for its retired priests. The Diocese follows the Financial Accounting Standards Board (FASB) issued guidance Compensation – Retirement Benefits Topic (Defined Benefit Plans – Pension Subtopic), of the FASB Accounting Standards Codification (ASC), to account for the costs of those benefits. Guidance on this topic requires detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. The Topic also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period.

Fundraising expenses: Fundraising expenses for the years ended June 30, 2014 and 2013, were $151,160 and $140,602, respectively, and are included in general expenses.

Current accounting developments: In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers.* ASU 2014-09 supersedes the revenue recognition requirements in *Revenue Recognition (Topic 605*), and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for fiscal years beginning on January 1, 2018, including interim periods within that reporting period. Management is currently evaluating the effect that adopting this new accounting guidance will have on the statements of activities, cash flows and financial position. Management does not, at this time, anticipate a material impact to the financial statements once implemented.

Use of estimates in the preparation of financial statements: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent events: Management has evaluated subsequent events through September 26, 2014, which is the date the financial statements were available to be issued.

Note 2. Notes and Loans Receivable

Notes and loans receivable consist of the following at June 30,

	2014	2013
Promissory notes	$ 62,556	$ 40,911
Loans receivable	1	1
	62,557	40,912
Less current maturities	38,523	10,225
	$ 24,034	$ 30,687

The Diocese, at the inception of St. Ann's Home (a HUD financed facility for elderly housing), loaned approximately $260,000 for working capital of which approximately $78,000 has been repaid through June 30, 2014. Although a portion of the $182,000 balance may be repaid, collection is doubtful and the Diocese values the receivable at the nominal amount of $1.

Note 3. Investments

Investments consist of the following at June 30,

	2014	2013
Certificates of deposit	$ -	$ 75,000
Mutual funds	2,894,765	2,599,077
Corporate bonds and notes	127,288	51,434
U.S. Government obligations	77,407	113,897
Alternative investments	-	117,330
Real asset funds	418,847	338,426
Complimentary strategies	371,652	3,926
	$ 3,889,959	$ 3,299,090

The following summarizes the levels in the fair value hierarchy of the Diocese's investments carried at fair value at June 30, 2014 and 2013.

	2014			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Domestic	$ 1,700,435	$ -	$ -	$ 1,700,435
International	1,194,330	-	-	1,194,330
Corporate bonds and notes	-	127,288	-	127,288
U.S. Government obligations	-	77,407	-	77,407
Real asset funds	418,847	-	-	418,847
Complimentary strategies	371,652	-	-	371,652
	$ 3,685,264	$ 204,695	$ -	$ 3,889,959

	2013			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Domestic	$ 1,610,419	$ -	$ -	$ 1,610,419
International	988,658	-	-	988,658
Corporate bonds and notes	-	51,434	-	51,434
U.S. Government obligations	-	113,897	-	113,897
Alternative investments	-	-	117,330	117,330
Real asset funds	338,426	-	-	338,426
Complimentary strategies	3,926	-	-	3,926
	$ 2,941,429	$ 165,331	$ 117,330	$ 3,224,090

The changes in investments measured at fair value for which the Diocese has used Level 3 inputs to determine fair value are as follows:

		Alternative Investments
Balance June 30, 2013	$	117,330
Sales and settlements		(101,392)
Net realized losses		(15,938)
Balance June 30, 2014	$	-

The Diocese also makes fair value disclosures as it relates to the Company-sponsored defined benefit pension plan (Note 6).

Note 4. Property and Equipment

A summary of property and equipment is as follows at June 30,

		2014		2013	Lives (Years)
Land	$	77,469	$	599,783	
Buildings and improvements		2,591,386		2,543,526	10-40
Furniture and fixtures		166,193		166,193	5
Equipment and vehicles		243,073		243,373	5-10
		3,078,121		3,552,875	
Less accumulated depreciation		2,366,340		2,315,125	
	$	711,781	$	1,237,750	

During 2014 the Diocese had a market value appraisal performed with regard to certain land. Based on the appraisal the Diocese recorded a loss on impairment of $241,964 which is included in other changes in unrestricted net assets in the Statements of Activities. There was no impairment in 2013.

Note 5. Accounts Receivable

		2014		2013
Accounts receivable	$	541,549	$	425,067
Less allowance for doubtful accounts		271,500		213,600
	$	270,049	$	211,467

Note 6. Pension Plans

The Diocese has a defined contribution pension plan for any lay employees hired subsequent to the July 1, 2009, freezing of the Diocese lay defined benefit pension plan. The Diocese and parishes will make a base contribution of 3 percent and up to an additional 3 percent match of base compensation for eligible employees who have completed at least one year of service. Pension expense for the plan was $85,486 and $57,768 for the years ended June 30, 2014 and 2013, respectively, which was primarily reimbursed by the parishes and other supported programs.

Eligible lay employees of the Diocese and members of the Diocese clergy are included in separate trustee administered defined benefit pension plans which include employees and clergy of the parishes, and other programs supported by the Diocese. The plan covering lay employees was frozen on January 1, 2009, and no new employees hired after that date may participate in the plan. The pension plans are noncontributory for employees. Currently, the Diocese's policy is to fund pension costs and allocate the cost to the parishes, and other supported programs based on the participants. Pension cost reimbursed by these entities was $603,201 and $508,210 for the years ended June 30, 2014 and 2013, respectively.

In accordance with the provisions set forth in the Compensation – Retirement Benefits Topic (Defined Benefit Plans – Pension Subtopic) of the FASB ASC, employers are required to recognize the overfunded or underfunded status of defined benefit pension and postretirement plans as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through the statement of activities. The funded status of a benefit plan is measured as the difference between the fair value of plan assets and the accumulated postretirement benefit obligation. The amounts recognized as other changes in unrestricted net assets in the statements of activities include costs associated with actuarial gains or losses, prior service costs or credits, and transition assets or obligations that resulted during the period but were not recognized as a component of net periodic benefit cost. These amounts, recognized as other changes in unrestricted net assets, are adjusted as they are subsequently recognized as components of net periodic benefit costs.

The following shows the Plans' funded status and amounts recognized in the accompanying balance sheets at June 30, 2014:

	Lay Plan	Clergy Plan
Change in projected benefit obligation:		
Projected benefit obligation, beginning	$ 11,512,157	$ 7,929,661
Service cost	307,550	133,650
Interest cost	504,772	344,685
Actuarial (gain) loss	699,005	142,120
Benefits paid	(538,412)	(396,979)
Projected benefit obligation, ending	12,485,072	8,153,137
Change in plan assets:		
Plan assets at fair value, beginning	7,982,143	4,744,360
Actual return on assets	1,081,503	636,547
Company contributions	540,044	304,441
Benefits paid	(538,412)	(396,979)
Plan assets at fair value, ending	9,065,278	5,288,369
Funded status	$ (3,419,794)	$ (2,864,768)

The components of the Diocese's net periodic benefit cost for the fiscal year ended June 30, 2014, consists of the following:

	Lay Plan	Clergy Plan
Service cost	$ 307,550	$ 133,650
Interest cost	504,772	344,685
Expected return on plan assets	(539,612)	(300,111)
Amortization of unrecognized:		
Prior service cost	-	88,980
Net actuarial loss	224,941	157,912
Net periodic benefit cost	$ 497,651	$ 425,116

Actuarial assumptions: The weighted-average assumptions used to determine benefit obligations at June 30, 2014, are shown below:

	Lay Plan	Clergy Plan
Discount rate	4.25%	4.25%
Rate of compensation increase	3.46%	N/A

The weighted-average assumptions used to determine net periodic benefit cost for the year ended June 30, 2014, follow:

	Lay Plan	Clergy Plan
Discount rate	4.50%	4.50%
Expected long-term rate of return on plan assets	7.00%	7.00%
Rate of compensation increase	3.50%	N/A

Plan assets: The Diocese's asset allocation strategy and process consists of a long-term, risk-controlled approach using diversified investment options with a minimal exposure to volatile investment options like derivatives. The long-term strategy is foremost preserving plan assets from the downside market risk. The investment process uses a diversified allocation of equity, debt, and real estate exposures that are customized to each plan's cash flow benefit needs.

The plan administrator reviews each plan's assets and liabilities with an emphasis on forecasting each plan's cash flow needs. This forecast calculates the allocation percentage of fixed income assets to cover the liabilities needs. The model is quantitatively based and evaluates the plan's current assets plus 5-years of deposit projections and compares it to the current monthly benefit payments with the emerging benefit-liabilities for the next ten years. The data for the deposits and emerging liabilities is provided from the plan's actuarial valuation while the current assets and monthly benefit payments data is provided from the plan administrator's retirement plan accounting system.

	June 30, 2014	
	Lay Plan	Clergy Plan
Equity securities	41%	41%
Debt securities	46%	46%
Balanced/Asset Allocation	5%	5%
Real estate	8%	8%
	100%	100%

In accordance with the Defined Benefit Plans – Pension Subtopic, management assessed the investments in the defined benefit pension plan and determined the fair value hierarchy as discussed in Note 3.

The following shows by level, within the fair value hierarchy, the plan's investments at fair value as of June 30, 2014 and 2013:

	Lay Plan Investments at Fair Value as of June 30, 2014			
	Level 1	Level 2	Level 3	Total
Large US Equity	$ -	$ 2,262,362	$ -	$ 2,262,362
Small/Mid US Equity	-	564,464	-	564,464
International Equity	-	921,914	-	921,914
Balanced/Asset Allocation	-	465,905	-	465,905
Multi-Strategy - real estate	-	679,585	-	679,585
Fixed Income	-	4,171,048	-	4,171,048
	$ -	$ 9,065,278	$ -	$ 9,065,278

	Lay Plan Investments at Fair Value as of June 30, 2013			
Large US Equity	$ -	$ 2,003,475	$ -	$ 2,003,475
Small/Mid US Equity	-	515,139	-	515,139
International Equity	-	1,188,334	-	1,188,334
Fixed Income	-	4,275,195	-	4,275,195
	$ -	$ 7,982,143	$ -	$ 7,982,143

	Clergy Plan Investments at Fair Value as of June 30, 2014			
Large US Equity	$ -	$ 1,322,111	$ -	$ 1,322,111
Small/Mid US Equity	-	329,880	-	329,880
International Equity	-	538,681	-	538,681
Balanced/Asset Allocation	-	272,264	-	272,264
Multi-Strategy - real estate	-	397,074	-	397,074
Fixed Income	-	2,428,359	-	2,428,359
	$ -	$ 5,288,369	$ -	$ 5,288,369

	Clergy Plan Investments at Fair Value as of June 30, 2013			
Large US Equity	$ -	$ 1,200,316	$ -	$ 1,200,316
Small/Mid US Equity	-	308,703	-	308,703
International Equity	-	476,448	-	476,448
Balanced/Asset Allocation	-	235,138	-	235,138
Fixed Income	-	2,523,755	-	2,523,755
	$ -	$ 4,744,360	$ -	$ 4,744,360

The Diocese and the independent parish corporations located within its territory expect to contribute $283,929 to the Lay Plan and $194,400 to the Clergy Plan during 2015.

Estimated future benefit payments:

Years Ending June 30,	Lay Plan	Clergy Plan
2015	$ 590,000	$ 530,000
2016	620,000	520,000
2017	630,000	530,000
2018	820,000	510,000
2019	720,000	500,000
2020-2024	4,540,000	2,470,000

The following shows the Plans' funded status and amounts recognized in the accompanying balance sheets at June 30, 2013:

	Lay Plan	Clergy Plan
Change in projected benefit obligation:		
Projected benefit obligation, beginning	$ 11,346,807	$ 8,243,566
Service cost	341,744	138,329
Interest cost	469,914	338,664
Actuarial gain	(212,863)	(351,882)
Benefits paid	(433,445)	(439,016)
Projected benefit obligation, ending	11,512,157	7,929,661
Change in plan assets:		
Plan assets at fair value, beginning	7,426,972	4,633,386
Actual return on assets	655,846	404,413
Company contributions	332,770	145,577
Benefits paid	(433,445)	(439,016)
Plan assets at fair value, ending	7,982,143	4,744,360
Funded status	$ (3,530,014)	$ (3,185,301)

The components of the Diocese's net periodic benefit cost for the fiscal year ended June 30, 2013, consists of the following:

	Lay Plan	Clergy Plan
Service cost	$ 341,744	$ 138,329
Interest cost	469,914	338,664
Expected return on plan assets	(483,126)	(289,544)
Amortization of unrecognized:		
Prior service cost	-	88,980
Net actuarial loss	329,195	220,537
Net periodic benefit cost	$ 657,727	$ 496,966

Actuarial assumptions: The weighted-average assumptions used to determine benefit obligations at June 30, 2013, are shown below:

	Lay Plan	Clergy Plan
Discount rate	4.50%	4.50%
Rate of compensation increase	3.50%	N/A

The weighted-average assumptions used to determine net periodic benefit cost for the year ended June 30, 2013, follow:

	Lay Plan	Clergy Plan
Discount rate	4.25%	4.25%
Expected long-term rate of return on plan assets	7.00%	7.00%
Rate of compensation increase	3.58%	N/A

Plan assets:

	June 30, 2013	
	Lay Plan	Clergy Plan
Equity securities	46%	42%
Debt securities	44%	48%
Balanced/Asset Allocation	5%	5%
Real estate	5%	5%
	100%	100%

Note 7. Other Postretirement Benefits

The Diocese provides certain healthcare and dental benefits for retired priests. The program is noncontributory. An annual projected rate of increase in healthcare and life insurance costs for pre-65 beneficiaries of 7.5 percent was assumed by management, reduced 0.5 percent per year until 2020 and 4.5 percent thereafter. An annual projected rate of increase for post-65 beneficiaries of 5.5 percent was assumed by management, reduced 0.5 percent per year until 2017 and 4.5 percent thereafter.

The accrued liability for these benefits was $5,800,158 and $4,881,139 at June 30, 2014 and 2013, respectively, of which $88,728 in 2014 and $96,198 in 2013 is reported in current liabilities under other postretirement and pension benefits.

The discount rate used in the calculation of future liabilities decreased to 4.25 percent for the year ended June 30, 2014, compared to 4.50 percent for the year ended June 30, 2013. This change resulted in an increase in benefit obligation. In addition, the mortality table was updated to reflect the annual changes to the IRS Prescribed Mortality tables and the medical trend was updated to reflect current expectations of medical cost growth. These assumption changes increased the benefit obligation by $973,112.

The following shows the Plan's funded status and amounts recognized in the accompanying balance sheets at June 30, 2014 and 2013.

	2014	2013
Change in accumulated postretirement benefit obligation:		
Benefit obligation, beginning	$ 4,881,139	$ 5,504,561
Service cost	167,523	183,203
Interest cost	215,601	229,694
Actuarial (gain) loss	596,240	(961,602)
Benefits paid	(60,345)	(74,717)
Accumulated postretirement benefit obligation, ending	5,800,158	4,881,139
Change in plan assets:		
Plan assets at fair value, beginning	-	-
Company contributions	60,345	74,717
Benefits paid	(60,345)	(74,717)
Plan assets at fair value, ending	-	-
Funded status	$ (5,800,158)	$ (4,881,139)

The components of the Diocese's net periodic postretirement benefit cost for the fiscal years ended June 30, 2014 and 2013, consist of the following:

	2014	2013
Service cost	$ 167,523	$ 183,203
Interest cost	215,601	229,694
Amortization of unrecognized net actuarial gain	(84,260)	(25,853)
Amortization of prior service cost	(81,382)	(81,382)
Net periodic benefit cost	$ 217,482	$ 305,662

Actuarial assumptions: The weighted-average assumptions used to determine postretirement benefit obligations at June 30, 2014 and 2013, are shown below:

	2014	2013
Discount rate	4.25%	4.50%
Rate of compensation increase	N/A	N/A

The weighted-average assumptions used to determine net periodic postretirement benefit cost for the year ended June 30, 2014 and 2013, follow:

	2014	2013
Discount rate	4.50%	4.25%

As of June 30, 2014, there were 18 eligible retired priests receiving benefits and 53 active priests who are eligible to receive benefits at retirement.

Note 8. Income Taxes

The Diocese is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and similar laws of the State of Minnesota.

Note 9. Temporarily Restricted Net Assets

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

	2014	2013
United Catholic Appeal for subsequent periods	$ 603,913	$ 679,106
Other contributions for future program expenses	37,048	111,163
Fr. Joseph Hughes bequest for the benefit of children	75,000	75,000
	$ 715,961	$ 865,269

Note 10. Permanently Restricted Net Assets

Permanently restricted net assets are held in perpetuity, the income from which is expendable for the following purposes at June 30,

	2014	2013
Margueritte Rinn Trust, education and missions	$ 100,000	$ 100,000

The Diocese has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to operations of the Diocese by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Diocese must hold in perpetuity. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce a reasonable rate of return. Actual returns in any given year may vary. The board annually appropriates for expenditure any investment earnings.

From time to time, the fair value of endowment funds associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Diocese to retain as a fund in perpetual duration, (i.e. underwater endowments). Losses on permanently restricted endowment investments are first used to reduce previous investment income and gains which have not been expended. Any additional losses are shown as a reduction in unrestricted net assets.

Note 11. Risks and Uncertainties

The Diocese invests in various securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investments securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that those changes could materially affect the amounts reported in the financial statements.

The Diocese of Duluth is involved in various lawsuits relating to claims of alleged sexual misconduct by certain deceased priests and is diligently defending these matters and will continue to do so in a manner consistent with the norms established by the U.S. Conference of Catholic Bishops and with all due respect to the victims of childhood sexual abuse. The Diocese has or will tender the defense of these claims to its insurers. At this time, the Diocese has no practical means to determine the likely outcome or the amount of any damages that may be awarded in the various lawsuits and therefore, no provision has been made for potential loss, if any, that may result from resolution of these matters, however, losses from claims could be substantial. No amounts have been accrued for such claims as losses cannot be determined.

Unknown claims can go back many years where insurance may not have been available or coverage limits were minimal. Also certain types of damages, such as punitive damages, may not be covered by insurance. No amounts have been accrued for unknown claims as losses are unknown and cannot be determined.

Note 12. Related Parties

The Diocese is related to the Seminarian Endowment Fund of the Diocese of Duluth (Seminarian Endowment Fund). The Diocese received no contributions from the Seminarian Endowment Fund for costs related to the education of future priests for 2014 and received contributions of $120,653 for 2013.

The Diocese is also related to the Catholic Religious Education Endowment Fund of the Diocese of Duluth (CREED Fund). The Diocese received contributions from the CREED Fund for various purposes totaling $95,687 and $49,606 during 2014 and 2013, respectively.

During 2013, the Diocese transferred land, building and improvements to the Newman Catholic Campus Ministries at U.M.D., a related party, with a net book value of $171,000. There were no such transfers in 2014.

During 2014, the Diocese sold certain land to a Parish within the diocesan territory at fair value through cash and a note receivable resulting in a loss of $215,341.

McGladrey

Independent Auditor's Report on the Supplementary Information

The Board of Directors
Diocese of Duluth
Duluth, Minnesota

We have audited the financial statements of the Diocese of Duluth as of and for the years ended June 30, 2014 and 2013, and have issued our report thereon which contains an unmodified opinion on those financial statements. See page 1. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information 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 audits 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.

McGladrey LLP

Duluth, Minnesota
September 26, 2014

Diocese of Duluth

Schedules of Revenues
Years Ended June 30, 2014 and 2013

	2014	2013
United Catholic Appeal, contributions received during the current fiscal year	$ 1,437,674	$ 1,521,867
Interest and dividends, net of expenses	78,608	55,003
Grant income	218,090	237,516
Insurance program	126,954	156,600
Program registration revenue	129,914	142,811
Contributions		
Seminarian Appeal	221,411	159,693
Bequest	101,249	488,843
Other	26,630	27,364
Other income:		
Grants from related parties	95,687	170,259
Hospital Ministry	131,128	138,268
Priest and Deacon retreats and conferences	68,831	35,578
Ministry fees and materials	44,004	29,956
Duluth Area Catholic Schools reimbursements	29,389	28,207
Calvary Cemetery reimbursements	10,843	12,046
Northern Cross rebates	15,955	15,247
Other	12,372	48,468
Total revenues	$ 2,748,739	$ 3,267,726

Diocese of Duluth

Schedules of Program and General Expenses
Years Ended June 30, 2014 and 2013

	2014	2013
Program Expenses		
Office of the Bishop	$ 118,628	$ 114,722
Office of the Vicar General	32,901	17,911
Marriage Tribunal	62,670	51,440
Office for Catechists	74,331	80,723
Campus Ministry at UMD	105,467	84,540
Hospital Ministry	134,660	139,130
Office for Catholic Schools	134,688	135,494
Youth and Young Adult	222,486	215,652
Office for Continuing Formation of Priests	212,919	132,972
Office for Vocations	326,877	437,099
Office for Permanent Diaconate	132,055	105,947
Office for Liturgy	27,482	26,497
Office for Safe Environment	26,618	24,072
Communications Office	268,885	267,556
Office for Marriage and Family Life	60,395	41,254
Office for Native American Ministry	71,156	91,285
TV Mass	26,295	27,751
Office for the Social Apostolate of the Church	51,319	57,045
Flood relief	42,296	92,710
Newman Center contribution	-	170,795
Other	44	42
	$ 2,132,172	$ 2,314,637
General Expenses		
Diocesan dues and donations	$ 109,247	$ 92,339
Business Office	202,908	189,145
Pastoral Center, building and grounds	193,171	198,597
Pastoral Care of Priests	165,635	331,147
Audit and legal	138,702	55,795
Development Office	151,160	140,602
Depreciation	101,799	117,408
Bad debts	61,717	136,695
Insurance	119,944	164,534
Other	43,914	44,749
	$ 1,288,197	$ 1,471,011