

Financial statements Central Administrative Offices of the Roman Catholic Diocese of San Jose June 30, 2009 and 2008

The financial statements for the Central Administrative Offices (CAO) of the Diocese of San Jose measure the operating results for varied activities managed by the CAO and do not include results of operation of the parishes, of most schools nor of other entities in the Diocese.

The financial statements of the CAO are audited and have received a clean opinion from the auditors. A complete copy of the audited financial statements for the fiscal year ended June 30, 2009 is available at <http://www.dsj.org/about-us/financial-reports>.

The purpose of this discussion and analysis of the CAO financial report is to speak to several indicators of the financial health of the CAO including cash flow, receivables and payables, oversight and adherence to policy and procedure, the health of the parishes and schools, cost containment and future financial challenges.

• Summary

The \$5,825,000 decrease in net assets significantly increased from the \$500,000 deficit in the prior year. However, the cash flow statement, that is an integral part of the audited financial statements referred to herein, reveals that there was a positive cash flow from operations of \$2,526,000. The purchase of land for potential use by a future Catholic high school in Morgan Hill, improvements at the new offices of the Chancery, and pay-downs on bonds and notes resulted in a combined decrease in cash from all operating, financing and investing activities of \$4,288,000 during fiscal year 2009.

The cash flow statement also shows \$5,043,000 in non-cash expenses relating to changes in lay and clergy pension liabilities, \$3,330,000 in unrealized losses on marketable securities and \$1,518,000 in depreciation contributed to the difference between the \$5,825,000 decrease in net assets and the \$2,526,000 in net cash flow from operations. While the depreciation will be an ongoing expense, the significant changes in pension liabilities and unrealized losses on marketable securities were due in large part to the deep recession experienced in our economy. This caused major valuation decreases in securities that are held on the CAO's financial statements either directly or through the various lay and clergy pension funds.

Total revenues for the year ended June 30, 2009 were \$43,940,000, less than a 1/2% decrease from the \$44,072,000 of 2008. Within total revenues, a decrease in the market value of securities caused a \$2,631,000 investment loss which was offset by increases in nearly all other revenue categories.

Total expenses for the year increased \$5,239,200 to \$50,780,000. The Statement of Activities shows that nearly all categories of expense increased year to year. A review of the Cash Flow Statement shows that \$3,060,000 of the increase in expenses was due to an allocation, non-cash, of unfunded liabilities in the pension plans to the Chancery, Cemeteries and Holy Spirit School (based on number of eligible employees versus total employees in the plans). Footnote 14 of the Audited Financial Statement gives more detail about this change. Additional losses of over \$1,750,000 were recognized in the clergy pension plans for similar unfunded liability changes. Interest expenses

increased during the year by a net \$1,370,000 even though total bond and note debt decreased because of the valuation changes in the interest rate SWAP that was placed in 2004 on the debt. An increase in insurance premium costs and in IBNR reserves in all lines of coverage caused the majority of the increase of \$791,000 of insurance premium expenses during FY 2009.

Even though there was a decrease in net assets and in cash, the CAO continued to repay its note and bond debts in a timely manner, continued to achieve or exceed the covenants of those financial instruments and, with a continuing improving economy, should continue to be able to meet all of its obligations. However, there will be continued difficult financial periods in the next year for all of the entities.

• The Chancery operations funded by the Annual Appeal and Diocesan Assessment

The operations of the CAO include those at the Chancery that are funded by the Annual Diocesan Appeal, the Diocesan Assessment/Cathedraticum, and other donations and reimbursements. The self-funded operations of the CAO include the Cemeteries, Holy Spirit School, the Department of Education, the Insurance Operations, the Deposit and Loan Fund, Clergy Retirement Funds and the Endowment Fund. Financial information about the activities in these self-funded operations can be found in the Supplementary Information that is part of the audited financial statements. The following discusses some of the operations and their costs at the Chancery level.

Changes in parish offertory collections occur for many reasons, including but not limited to, the direction of the general economy, the local demographics, and the leadership within the parish. Collections at the parishes for the fiscal year ending June 30, 2009 decreased 3% to \$29,735,000. This was the first decline in collections since June of 2003, which showed a similar 3% decrease from \$26,821,000 in 2002. During this past year of the 53 reporting parishes and oratory twelve parishes experienced from 0% to 12% increases in collections, while remaining parishes experienced 1% to 16% in decreases. Six parishes (the same number as the previous year) had collections over \$1,000,000 during the year, while twelve parishes (down from fourteen the previous year) had collections under \$400,000 for the year.

Offertory collections generally equal 55% to 60% of total revenues at a parish. The Annual Diocesan Appeal goal is a function of each parish's collections as they relate to the total collections of all parishes. The Diocesan Assessment is set at 10% of a parish's offertory collections. The Annual Diocesan Appeal (ADA) process has been used by many parishes to raise additional funds (the rebates are equal to 100% of all funds collected in excess of a parish's goal).

The table below shows the history of the Annual Diocesan Appeal since 2004 and the rebates generated during those appeals. Monies raised by the ADA and the Diocesan Assessment become the budget for the majority of the Chancery operations for the subsequent year. Of interest is that the number of donors to the ADA has decreased by approximately 10%, or 2,000 donors. Mass counts show a decrease of 3%, or 3,460 participants, over that period.

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		(Dollars shown in 000's)					
		Annual Diocesan Appeal					
		2004	2005	2006	2007*	2008	2009 (Ytd Oct)
ADA Goal	\$	4,831	\$ 4,990	\$ 5,126	\$ 5,250	\$ 5,389	\$ 5,389
Total Pledged	\$	6,696	\$ 6,872	\$ 7,446	\$ 5,250	\$ 6,706	\$ 6,535
Total Collected	\$	6,390	\$ 6,614	\$ 7,135	\$ 5,250	\$ 6,308	\$ 5,691
Net Uncollected Goal	\$	-	\$ -	\$ -	\$ -	\$ 73	\$ 309
ADA Rebates Paid	\$	1,561	\$ 1,489	\$ 1,809	\$ -	\$ 993	\$ 601
* From Catholic Foundation Capital Campaign							
Number of Donors		22,781	22,931	22,872	21,000	19,500	20,794
		Offertory / Diocesan Assessment					
		2004	2005	2006	2007	2008	2009
Parish Offertory (as of FYE 6/30)	\$	27,170	\$ 28,028	\$ 29,263	\$ 3,044	\$ 30,792	\$ 29,735
Diocesan Assessment	\$	2,139	\$ 2,610	\$ 2,717	\$ 2,803	\$ 2,926	\$ 3,079
Number of Parishes		52	52	52	53	53	53
October Mass Count		100,980	99,498	102,102	96,610	102,983	97,514

The Chancery operations funded by the ADA and Assessment include the canonically required offices of the Bishop, Chancellor, Tribunal, Vicar General and Finance as well as the Office for Protection of Children and Vulnerable Adults. The non-canonically required offices include the Office of Parish Services (Catechetics, Social Justice, Youth, Young Adults, Hispanic Ministry, Detention Ministry, Liturgy and other family services, ILM (Institute for Leadership in Ministry)), plus the Personnel Office, and Chancery building operations as well as the Offices for Clergy, Diaconate Formation, Communications and Vocations and Seminarian training, assessments from the state and national Bishops conferences and the Vatican as well as Priests on Involuntary Leave / Special Assignment.

The staffing levels in the Chancery offices have been constant over the years. In 2004-05 58 employee positions were funded by the ADA and Diocesan Assessment. In 2009-10 there are 57 employee positions being funded. Additionally, there are the self-funded programs of the Office of Education, Payroll, Benefits, Risk and Insurance, Facilities and the Clergy Retirement Home that had an increase of 1.5 employees since 2004 (in Compliance and Building Inspections). Thus the total employee count in the Chancery is at the same level as in 2004-05 and there are fewer employees in 2009-10 funded by the ADA / Annual Assessment and salaries were frozen for this year because the ADA was not increased over the prior year.

Chancery costs, as do the costs of schools and parishes, continue to increase. Even holding personnel costs in place, benefit costs, insurance costs, building operating costs, and other program costs all have increased over the past five years. A major contributor to the swing in the Chancery costs from year to year is the number of Seminarians and Deacons in training. In 2004-05 there were 29 seminarians with an average cost of \$25,000. For 2010-11 there are an expected 21 seminarians (an increase of 4 from the current year) but the average cost is expected to be between \$37,000 and \$40,000 each. The change in the average cost since 2004-05 is due to increases in health, room and board and tuition. Another contributor to the increase in the Chancery budget is the cost of Priests on Involuntary Leave or Special Assignment. The total

of these costs has more than doubled to over \$500,000 per year since the end of fiscal year 2004.

The Chancery moved from rented offices to owned space in April of 2009, but the fiscal impact of this move was not significant in 2009 because of the continuation of the prior leases through the end of calendar year 2009. In fiscal year 2010-11 the reduction of rent will be in full effect and will contribute over \$300,000 in annual cost savings.

In summary, excluding the non-cash allocations of the lay pension fund and SWAP expense, the Chancery's operations funded by the ADA and Diocesan Assessment have been maintained on a breakeven or better basis.

• Other Chancery Operations

Chancery operations not funded by the Annual Diocesan Appeal and Diocesan Assessment include Clergy Retirement Funds, Department of Education, Payroll, Risk, Insurance and Facilities, Endowment Funds and the Deposit and Loan Funds.

The Clergy Retirement Funds decrease in net assets of \$1,800,000 during FY 2009 was \$286,000 larger than the decrease in FY 2008 because the decrease in the market value of assets of the funds by over \$1,200,000 in FY 2009 and the increase of the unfunded pension liability of \$638,000 were only partially offset by increases in revenues and by the \$1,200,000 of distributions from the Catholic Foundation. The Catholic Foundation distributions were applied to the Supplemental Retirement Fund, and with the distributions received subsequent to fiscal year end, that Supplemental Fund is now fully funded. This will enable a \$1,225 per priest, or 8%, decrease in the clergy pension cost for FY 2010-11.

The Department of Education operates on a breakeven or better basis every year. However since 2004 there has been a steady decline in the number of students in the elementary schools in the diocese from 9,992 to 9,343 and one school closure in the past year to 28 elementary schools today. This 6% decline in students is equivalent to the average size of two schools. Tuition costs have steadily increased to an average of \$6,090 per student, as operating costs, composed principally of salaries, have

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continued to increase over the same period. The amount of tuition assistance granted from endowed funds held at the diocese has remained fairly constant at an average of \$166,000 per year—spread across the elementary schools. That was supplemented by \$120,000 from the Catholic Foundation this year and an expected \$180,000 for the subsequent year. The elementary schools are also recipients of tuition assistance from parishes and from funds outside of the Diocese as well as operating/financial aid from the Daughters of Charity who assist in the running of two schools situated in low-income areas of the Diocese. For the current fiscal year, less than 15% of total applicant need was funded by these tuition assistance sources.

The Risk, Insurance, Benefits and Facilities operations operated under the Office of Financial Services are funded from insurance premiums paid by parishes, schools and other affiliated operations. These departments show an increase of net assets of \$1,022,000 in FY 2009 as compared to an increase of \$1,477,000 in the prior year. The decrease was due to additional IBNR reserves and decreases in the market value of assets held on reserve for the self-insured portion of the various insurance coverages. The biggest risk of loss continues to be from earthquake, where reserves do not yet equal the self-insured risk. Insurance for full earthquake coverage of all Diocesan-owned properties is not available in the marketplace. Health insurance premiums increased 3% in the fiscal year; however, the small increase (relative to state and national health care increases of over 10%) was due to rebates received from the health insurance trust of which the Diocese is a member. Those rebates will not be present in the coming years and increases in cost in line with the national averages are to be expected.

The Deposit and Loan Fund of the Diocese continues to face significant problems collecting on loans from several parishes. There are \$38,368,000 in outstanding loans at fiscal year-end 2009. At that date \$25,592,000, or 67%, of these loans, which were from four parishes and two schools, were on zero-interest. However, all but one parish, representing \$3,632,000 of total loans, were paying down on principal on these loans. Commencing in the current fiscal year, one parish, representing \$4,285,000 of total loans, began paying both principal and interest, though at a reduced rate. Of the decrease in net assets of \$2,106,000 in the Deposit and Loan Funds in FY 2009, \$1,488,000 was due to the recognition of the cost of the difference in interest rates on the SWAP on the bond.

• Other CAO operations not part of the Chancery

The operations of Catholic Cemeteries of the Diocese of San Jose (Gate of Heaven and Calvary Cemeteries) and Holy Spirit School are audited and included in the statements of the CAO.

For the fiscal year ended June 30, 2009 the Cemeteries' increase in net assets was \$238,000 compared to \$530,000 in the prior fiscal year. For the FY 2009 \$538,000 of unfunded lay pension liability was recognized. During FY 2009, \$697,000 of income from collections for long-term Cemetery care and earnings on long-term Cemetery care funds were included in operations.

In FY 2009 the operations of Holy Spirit School recognized \$822,000 of unfunded lay pension liability that caused the decrease in net assets of the school by \$706,000. The school continues to be at full enrollment. Holy Spirit Parish provides substantial tuition subsidies for the school. The financial statements of the school are included in the CAO audited statements because the school was originally built with over \$13,800,000 in loans and accumulated interest from the Diocesan Deposit and Loan Fund using proceeds from a bond issued by the Diocese. There is currently \$11,550,000 outstanding on that debt due to substantial cash pay-downs by the school since 2004. While making substantial reductions in principal this loan is currently at a zero-interest rate. This loan represents nearly 70% of the bond debt (excluding SWAP valuation) recognized in the Deposit and Loan Fund.

• Looking Forward

The fiscal year 2010 will be another difficult financial year for the Diocese. Even though there has been a rebound in market valuation of securities, the general economy continues to be weak. The results of collections of the 2009 ADA could be short by over \$200,000 from forecast. A positive note is that the grants from the Catholic Foundation are expected to increase during the year. This will help supplement some of the reduced revenues from the ADA. In addition a group of "Angel Investors" raised over \$150,000 to offset Seminarian costs during the current fiscal year.

Interest rates on deposit accounts were lowered in an effort to curtail the deficit in the Deposit and Loan Fund and continuing efforts are being made to restructure this Fund and some of the underlying assets to help those parishes and schools with debts to return to paying principal and interest.

The Chancery operations will continue to be reviewed so that services to parishes and schools are not severely impacted while staying within expected reduced cash flows.

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Central Administrative Office of the Diocese of San Jose

Summary Financial Information

Statement of Activities

	For the years ending	
	June 30, 2009	June 30, 2008
Revenues		
Gifts, bequests, collections	\$ 9,039	\$ 8,260
Fees	2,852	2,472
Diocesan assessments	3,043	2,925
Education	4,467	4,390
Rental income	661	999
Investment income	(2,632)	(437)
Loan Income	669	750
Insurance	19,849	18,916
Newspaper	367	367
Cemetery	5,322	5,229
Other income	303	202
Total Revenues	43,940	44,073
Expenses		
Pastoral	4,098	4,363
Clergy and Seminarians, Personnel	3,020	2,794
Education	5,325	4,329
Priest retirement	4,398	2,646
Administrative	3,710	3,757
Depreciation	1,518	1,502
Interest expense	4,857	3,487
Insurance	17,410	16,619
Newspaper	453	397
Cemetery	4,880	4,626
Fundraising	1,108	1,018
Total Expenses	50,777	45,538
Increase in Net Assets before FASB No. 158	\$ (6,837)	\$ (1,465)
Effect of adoption of FASB No. 158	1,012	965
Increase (decrease) in net assets	\$ (5,825)	\$ (500)

Statement of Financial Position

	As of	
	June 30, 2009	June 30, 2008
Assets		
Cash and cash equivalents	\$ 30,045	\$ 34,333
Marketable securities	14,678	18,494
Accounts and pledges receivable, net	7,556	4,675
Deposits and prepaid expenses	215	435
Inventory	8,852	9,264
Loans receivable, net	23,123	24,561
Bond issuance costs, net	410	425
Marketable securities held for long term	3,683	3,596
Investment in real estate	839	839
Assets held in trust	2,797	1,286
Land, buildings and equipment, net	52,189	45,771
Total assets	\$ 144,387	\$ 143,679

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Liabilities and Net Assets

Liabilities

Accounts payable	\$	2,094	\$	1,528
Pledges payable to parishes and others		1,061		1,075
Accrued liabilities		23,586		20,539
Deposits payable		29,689		29,293
Debentures payable		24,166		23,276
Notes payable		1,937		2,339
Trust assets held for parish		2,797		1,286
Held for parishes and institutions		6,575		8,175
Deferred revenue		15,647		13,508
Total liabilities		107,552		101,019

Net assets

Unrestricted

Undesignated	9,680	15,058
Designated	8,049	7,192
Designated Cemetery Long-Term Care	6,436	5,738

Total unrestricted net assets	24,165	27,988
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Temporarily restricted	8,873	11,052
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Permanently restricted	3,797	3,620
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Total net assets	36,835	42,660
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Total liabilities and net assets	\$ 144,387	\$ 143,679
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Summary Statement of Cash Flows

	For the years ending	
	June 30, 2009	June 30, 2008
Increase (decrease) in cash and cash equivalents		
Change in net assets from operations prior to effect of FASB 158	\$ (6,837)	\$ (1,465)
Adjustments to reconcile cash		
Depreciation	1,518	1,500
Provision for losses on loans and receivables	(5)	831
Investment gains (losses)	3,333	1,760
Cost of unfunded pension liability	5,043	1,737
Amortization of bond costs	16	16
Changes in operating assets and liabilities	(542)	1,400
Net Cash provided by operating activities	2,526	5,779
Cash flows from investing activities		
Purchase of plant assets	(7,936)	(291)
Advances and proceeds for / from loans	1,736	2,860
Purchase / proceeds from marketable securities	397	(2,041)
Net Cash used in investing activities	(5,803)	528
Cash flows from financing activities		
Deposits payable	396	1,423
Payments on notes and bonds	(1,494)	(1,858)
Contributions restricted for permanent endowment	87	154
Net cash used in financing activities	(1,011)	(281)
Net increase (decrease) in cash and cash equivalents	\$ (4,288)	\$ 6,026