

The financial statements for the Central Administrative Offices of the Roman Catholic Diocese of San Jose June 30, 2010 and 2009

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 Diocesan Chancery 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 an unqualified opinion from the auditors Berger Lewis and San Jose. A complete copy of the audited financial statements for the fiscal year ended June 30, 2010 and additional schedules referred to in this report are available at <http://www.dsj.org/about-us/financial-reports>.

• Summary

The \$1,334,000 increase in net assets was a significant improvement from the \$5,825,000 decrease in the prior year. The cash flow statement shows a positive cash flow of \$2,927,000, all from operations in the Chancery, Cemeteries and Holy Spirit School. While cash flow from operations increased \$6,413,000, \$1,239,000 of that was used to purchase additional property for the Calvary Cemetery operations and increase securities. Another \$2,246,000 was used to reduce notes and bonds payable and cover some net deposit withdrawals.

Total revenues for the year ended June 30, 2010 were \$48,223,000, nearly a 10% increase from the \$43,940,000 of fiscal year 2009. All of the increase in revenues can be attributed to the increase in the market value of securities held by the CAO. It should be noted that the securities of the CAO are held for specific programs and endowments and that very few are held for the general operations of the Chancery.

Total expenses for the year, prior to changes due to accounting treatment of certain pension costs, decreased \$4,532,000 to \$46,245,000. The sources of the decrease were in interest costs by \$1,785,000 on decreased note and bond principal and a smaller mark-to-market valuation of the SWAP on the outstanding bond. Clergy retirement costs decreased during the year by \$2,097,000 due to funds received from the Catholic Foundation and applied to the Retirement Fund balances. The Supplemental Retirement Fund was fully funded at the end of the fiscal year. This caused a decrease in accruals and will lead to substantial reductions in the annual costs paid toward Clergy Pension in the future.

• The Chancery operations

The audited financial statements of the CAO include those operations at the Chancery that are funded by the Annual Diocesan Appeal, the Diocesan Assessment (Cathedraticum), and various donations and fee reimbursements, as well as the self-funded operations of the Department of Education, the Insurance Operations (Insurance and Risk Management, Compliance, Facilities), Benefits, Payroll, the Deposit and Loan Funds, Clergy Retirement Funds and the Endowment Fund. Financial information about the activities in these non-ADA

funded operations can be found in the supplementary information that is part of the audited financial statements.

• Chancery operations funded by the Annual Appeal and Diocesan Assessment

The chancery operations and programs funded by the ADA and the Annual Assessment are extensive and include the canonically mandated offices of the Bishop, Chancellor (including Records and Archives), Tribunal, Vicar General and Finance (including Accounting and Information Services) as well as the Office for Protection of Children and Vulnerable Adults. The offices that are not mandated by canon law include the Offices of Pastoral Services (Catechetics, Social Justice, Youth and Young Adult Ministries, Hispanic Ministry, Restorative Justice, Liturgy and other family services, ILM (The Institute for Leadership in Ministry), Human Resources, and Chancery building operations as well as the Offices for Clergy, Diaconate Formation, Communications and the Diocesan Newspaper, Vocations and Seminarian training, assessments from the state and national Bishop conferences and the Holy See, as well as costs related to ongoing clergy formation and priests on involuntary leave or 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 were 57 employee positions being funded. There are other employees of the non-ADA funded operations, but the total employee count for those operations has increased only ½ FTE in the past six years. Thus the total employee count in the Chancery remains at 73, the same as in 2004-05. Not only are there fewer employees in 2009-10 funded by the ADA/Annual Assessment but also salaries were frozen for the past two years.

In fiscal year 2010, \$10,783,000 of revenue was used to fund operations in the Chancery that are considered "funded by the Annual Appeal and the Diocesan Assessment." 51% of that revenue was received from the Annual Appeal and another 29% was provided by the Diocesan Assessment (Cathedraticum). Various sources, including grants from the Catholic Foundation, Payroll Fees, and Endowment Fund distributions, Tuitions, fee reimbursements, bequests and Angel Investor funds provided the remaining 20% of revenues. The distribution of revenues and expenses for these operations for the past six fiscal years are shown in the Supplemental Schedules posted on the Diocesan website at <http://www.dsj.org/about-us/financial-reports>.

The Supplemental Schedules posted on the Diocesan website shows the history of the Annual Diocesan Appeal and Diocesan Assessment since 2005 and the rebates generated by the parishes for their use during the ADA appeal process. Monies raised by the ADA and the Diocesan Assessment become part of the budget for the majority of the Chancery operations for the subsequent year. Of interest is that the number of donors to the ADA

in 2010 increased approximately 3%, or 600 donors, even though Mass attendance appears to have remained constant (final 2010 Mass attendance data are not ready for publication).

Chancery costs, like the costs of operating schools and parishes, continue to increase. Even while holding lay personnel counts in place, benefit costs, insurance costs, building operating costs, and other program costs all have increased over the past five years. These costs can and have been mitigated by cutting back on some programs as well as making operations more efficient enabling more to be done with the same personnel count.

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 FY 2010-11 less than 15 seminarians are expected but the average cost is projected 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, and expected added costs for "accent acquisition," assessment and training. Thus even though the number of seminarians is about half of prior counts, the total costs are down less than 25%. In the table (in the Supplemental Schedules on the website) showing the Net Change in Assets by Program/Services the line for Seminarians shows a large decline in net expenses from \$795,000 in FY 2009 to \$245,000 in FY 2010. This decline is due to fewer seminarians, the large one-time contribution by the Angel Investors, and increasing grants from the Seminarian Endowment Fund at the Catholic Foundation.

Another contributor to the increase in the Chancery budget is the cost of Priests on Involuntary Leave/Special Assignment, Continuing Education and Missionary assignment to Jamaica. The total of these costs has increased by over \$300,000 since the end of fiscal year 2004 to nearly \$700,000 in FY 2010. Even though other Chancery cost increases have been mitigated, the increases in this portion of the budget have offset many of those savings. Refer to the Change in Net Assets by Program/Service report in the Supplemental Schedules for more detail.

The net change in assets for all of the departments in the Office of Pastoral Services (OPS) declined from (\$1,548,000) in FY 2009 to (\$1,200,000) in FY 2010 due to a combination of factors: some one-time costs of closing two departments in OPS were not repeated in FY 2010, saving \$150,000, and there was a staff reduction in ILM and the location of ILM's operations were moved. Some of these savings were offset by shifting of staff from Catechetic to the Hispanic Apostolate (which reaches out to the Hispanic community in through the Diocese and provides programs and trainings).

There were increases in grants received from the Catholic Foundation during the year which enabled these departments to depend less on the ADA funds. During the year several depart-

ments were restructured but services not curtailed, as evidenced by the recent attendance of over 2,000 people at the Faith Formation Conference.

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 (part of FY 2010). In fiscal year 2010-11 the reduction of rent will be in full effect. This has enabled programs and services to parishes and schools to be continued without increasing the 2011 ADA.

Also contributing to the costs of operation in the past few years has been the allocation, according to accepted accounting practices, of unfunded lay pension costs. These costs are allocated to locations throughout the diocese based on the number of lay personnel. In FY 2010 this allocation to the operations funded by the ADA and Assessment was \$760,000, down slightly from \$778,000 in FY 2009 yet significantly increased over the \$66,000 of FY 2008. The change in FY 2009 was due to a reduction in the market value of the Plan's assets. The change in FY 2010 was due to a reduction in interest rates that the future value of liabilities are discounted at which more than offset the increase in market value of assets. These costs represent recognition of the difference between the market value of assets in the lay pension fund and the discounted future liability of the fund to lay employees covered by the plan. The unfunded liability can increase or shrink in any year depending on market interest rates, market valuation of investments in the fund and contributions to the fund.

In summary, excluding the non-cash allocations of the lay pension fund, the Chancery's operations funded by the ADA and Diocesan Assessment continue to be maintained - above break-even in FY 2010.

• 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, Compliance and Facilities, Endowment Funds and the Deposit and Loan Funds.

The Clergy Retirement Funds decrease in net assets, prior to the effect of adoption of a change in accounting principle, of \$426,000 in FY 2010 was substantially less than the decrease of \$1,800,000 during FY 2009. This change is due to the increase in market valuation of the various Clergy Pension Fund assets, and the continued receipt of distributions from the Catholic Foundation (over \$400,000 in FY 2010 - which funds were used to bring the Supplemental Retirement Fund to be fully funded). The application of the Catholic Foundation distributions to the Supplemental Retirement Fund in FY 2010 and the application of expected receipts from that Foundation in FY 2011 will enable a further reduction by over \$2,000 in FY 2011-12 of the annual cost per priest, which is paid by each priest's source of salary.

In FY 2010, the Office of Parish

Financial Services and Compliance was formed, and is funded by a portion of the premiums received on the package insurances, to provide accounting guidance and assistance to parishes and schools, oversee the collection of annual financial data and the self-review and reporting requirements, provide guidance to locations regarding their financial processes and procedures, oversee the annual process and procedure reviews done of parishes and schools by a third party accounting firm and to follow-up with the locations reviewed on the recommendations provided by the third party firm, respond in reports of financial fraud and mismanagement (either direct notices or notices through the Ethics Point reporting program available on the Diocesan website at <http://www.dsj.org/about-us/report-financial-mismanagement>, and oversee the implementation of a secure, third-party hosted site for the QuickBooks accounting software required to be used by all parishes and schools. Nearly one-third of parishes and schools are now hosted on this site - at little to no cost. During the course of the year this office responded to multiple notices of potential fraud and mismanagement - only two of which resulted in actual losses at parishes totaling less than \$15,000. The office was able to recommend changes in office procedures, principally around the receipt, counting and depositing of cash from offertory and fees.

The Office of Facilities provides oversight of the construction process for those projects that cost over \$10,000 by offering guidance in the structure of RFPs (Requests for Proposal), bid collection, job walks, guidance through the Building Committee process, and payment processing so as to avoid contractor liens. During FY 2010 86 projects, an increase from 76 projects in FY 2009, were processed with a value in excess of \$8,000,000. This office also offers guidance in the structure of five-year repair, maintenance and replacement plans for buildings and equipment at all the diocesan locations, and also oversees the semi-annual inspections of sites for asbestos at schools as required by the State of California. In doing these inspections at the schools, inspections at schools and parishes for compliance with OSHA standards are also made. Follow-up with the sites is provided to guide them through the process of compliance with any findings.

The Department of Education operates on a break-even or better basis every year. Since 2004 there was a steady decline in the number of students in the elementary schools in the diocese which included the effect of the closure in FY 2009 of one elementary school. For FY 2011, a nominal increase in students at the elementary level is expected - this due to the opening of several pre-Ks at the schools. Enrollment at Catholic High Schools in the Diocese did not increase during the year.

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The Risk, Insurance, Benefits and Facilities operations operated under the Office of Financial Services are funded from insurance premiums paid by parishes, schools and others. These departments show an increase of net assets of \$2,567,000 in FY 2010 as compared to an increase of \$1,022,000 in the prior year. The increase was substantially due to increased market valuation of assets held on reserve for the self-insured portion of the various insurance coverages. The biggest potential 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 properties is not available in the marketplace. This department offers trainings for employees and site administrators throughout the year on various aspects of safety and compliance with OSHA standards. Trainings have been in both English and Spanish. Several courses have enabled facilities managers to become OSHA certified.

Health insurance premiums charged to the locations for their employees did not increase in the fiscal year due to rebates received from the 35,000 member health insurance trust of which the Diocese is a Trustor. Those rebates will not be present in the coming years and increases in line with the national averages for medical costs are to be expected. During FY 2010 the process for the annual enrollment in Benefits by employees was converted from a 'paper' process to an online process. A history of medical premiums charged locations is shown in the Supplemental Schedules posted on the Diocesan website.

The Deposit and Loan Fund of the Diocese continued to face significant problems collecting on loans from several parishes. Including the loan to Holy Spirit School (which is current on its payments) there is \$37,065,000 in outstanding loans at fiscal year-end 2010, a 3% decrease from the prior year. At FYE 2010 \$22,810,000, or 56%, of these loans, which were from three parishes and two schools, were on zero-interest accrual. While this is a decrease from the \$25,922,000 of zero-interest loans in the prior year, the difference is a loan to one parish that is on a program of incrementally increasing interest rates, and whose current rate is substantially below the rates of other borrowers in the Fund. However, all but one parish, representing \$3,632,000 of total loans, were paying down on principal on these loans, most nominally. Of the decrease in net assets of \$683,000 in the Deposit and Loan Funds in FY 2010, \$600,000 was due to the recognition of the cost of the difference in interest rates on the SWAP on the bond. The Fund was also a recipient of nearly \$700,000 in distributions from the Catholic Foundation during the year. These funds reduced principal 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, 2010, the Cemeteries' increase in net assets was \$1,037,000 compared to \$238,000 in the prior fiscal year. For the FY 2010 \$499,000 of unfunded lay pension liability was recognized. Also during FY 2010, \$730,000 of income from collections for long-term Cemetery care and earnings on long-term Cemetery care funds were included in operations. This is equal to 70% of the total change in net assets of the Cemeteries.

In FY 2010, the operations of Holy Spirit School recognized \$764,000 of unfunded lay pension liability causing the decrease in net assets of the school by \$555,000. 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 \$11,100,000 outstanding on that debt, due to substantial cash pay-downs by the school since 2004. Even though substantial annual principal reductions of \$450,000 are made, 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.

• About the Diocese

Changes in parish offertory collections can be attributed to many reasons, including but not limited to, direction of the general economy, the local demographics, and pastoral leadership within the parish. The Supplemental Schedules posted on the website shows the history of Offertory Collections in various parishes over the past eleven years. Collections at the parishes for the fiscal year ending June 30, 2010 decreased 0.4% to \$29,496,000. While this was a decline for the second year in a row, the decline was nominal relative to the 3% decrease in FY 2009.

A further review of the Supplemental Schedules posted on the Diocesan website shows that 10 of the 52 parishes have experienced a decrease in annual Offertory Collections over the whole 11 year period, some as much as 1.74% on an average annual basis since 1999, whereas over the same period the Diocese as a whole experienced an average annual increase of 1.6% in Offertory Collections. Short-term trends can be deceiving as they can reflect recent pastor changes, recessionary impact on geographical areas, demographics of various areas and so on. Yet there is a parish, Christ the King, which experienced Offertory Collection increases, over 14% average annually over the entire 11 year period despite having three pastors in those years and facing the same challenging local demographic problems as other parishes. Other parishes noted in those Supplemental Schedules as ranking high in Offertory Collection growth in the 5 and 10 years periods are Our Lady Star of the Sea, Holy Spirit, Our Lady of Peace, Most Holy Trinity, Sacred Heart-Saratoga and Holy Korean Martyrs. These parishes are in diverse geographical locations and have

total Offertory of under a \$100,000 per year to over \$1,150,000 per year.

Offertory collections generally equal 50% of total revenues at a parish. Through 2008 the Annual Diocesan Appeal goal for a parish was set as a function of one parish's collections relative to the total collections of all parishes. In 2009 the ADA goals were not increased. In 2010, the 2009 goals were raised 2% to cover the costs of providing and implementing the Parishsoft program Diocese-wide. The cost for the Parishsoft program is an ongoing cost that is covered by the ADA. **For 2011, once again the ADA goals will not be increased.** The Annual Diocesan Appeal (ADA) process has been used by many parishes to raise additional funds for special projects or to cover the cost of the Diocesan Assessment (the ADA rebates are equal to 100% of all funds collected in excess of a parish's goal).

The Diocesan Assessment is set at 10% of a parish's offertory collections –as Offertory Collections increase or decrease, so does this revenue source for the Chancery.

• Looking Forward

The fiscal year 2011 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 weak. The results of collections of the 2010 ADA could be short over \$100,000 from forecast. A positive note is that the grants from the Catholic Foundation are expected to increase during the year. This will help supplant some of the reduced net revenues from the ADA.

Interest rates on deposit accounts were lowered in an effort to curtail the deficit in the Deposit and Loan Fund and to reflect changes in the marketplace for deposits. 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. Due to non- or nominal-payment of large loans by three parishes the D&L Fund continues to be unable to offer loans to other parishes.

The consolidated CAO financial statements had a positive change in net assets principally due to earnings at the Cemetery and to increasing reserves in the insurance fund that are being held against the likelihood of future catastrophic events. The Chancery operations over time continue at break-even. Areas to cut spending and consolidate operations are being reviewed as well as the need to provide for clergy and staff salary increases after two years of a salary freeze are being considered. Increased participation in the ADA is being promoted not as a means to increase funding for the central operations but to use the efforts made during that ADA process to raise additional funds for the parishes. There is still a need for new parishes in some areas of the Diocese where over ten Masses on a weekend are insufficient for the demand, but there are also parishes that show continued declines in Mass Attendance and need to find ways to work closely with adjoining parishes to maintain a high level of service to and involvement with the community.

Central Administrative Office of the Diocese of San Jose

Summary Financial Information

Statement of Activities

\$ 000's

For the years ending

June 30, 2010 June 30, 2009

	June 30, 2010	June 30, 2009
Revenues		
Gifts, bequests, collections	\$ 8,623	\$ 9,039
Fees	2,932	2,852
Diocesan assessments	3,089	3,043
Education	4,479	4,467
Rental income	490	661
Investment income	1,834	(2,632)
Loan Income	667	669
Insurance	19,605	19,849
Newspaper	355	367
Cemetery	5,736	5,322
Other income	413	303
Total Revenues	48,223	43,940
Expenses		
Pastoral	\$ 4,300	4,098
Clergy and Seminarians, Personnel	3,251	3,020
Education	5,395	5,325
Priest retirement	2,301	4,398
Administrative	2,979	3,710
Depreciation	1,590	1,518
Interest expense	3,072	4,857
Insurance	16,944	17,410
Newspaper	399	453
Cemetery	4,948	4,880
Fundraising	1,066	1,108
Total Expenses	46,245	50,777
Increase in Net Assets before effect of changes in accounting	\$ 1,978	\$ (6,837)
Effect of adoption of changes in accounting principles	(644)	1,012
Increase (decrease) in net assets	\$ 1,334	\$ (5,825)

Statement of Financial Position

\$ 000's

As of

June 30, 2010 June 30, 2009

	June 30, 2010	June 30, 2009
Assets		
Cash and cash equivalents	\$ 32,971	\$ 30,045
Marketable securities	16,552	14,678
Accounts and pledges receivable, net	6,989	7,556
Deposits and prepaid expenses	227	215
Inventory	8,719	8,852
Loans receivable, net	22,840	23,123
Bond issuance costs, net	394	410
Marketable securities held for long term	3,861	3,683
Investment in real estate	232	839
Assets held in trust	2,921	2,797
Land, buildings and equipment, net	53,111	52,189
Total assets	\$ 148,817	\$ 144,387
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 2,831	\$ 2,094
Pledges payable to parishes and others	992	1,061
Accrued liabilities	26,498	23,586
Deposits payable	29,396	29,689
Debentures payable	23,036	24,166
Notes payable	1,504	1,937
Trust assets held for parish	2,921	2,797
Held for parishes and institutions	7,257	6,575
Deferred revenue	16,213	15,647
Total liabilities	110,648	107,552
Net assets		
Unrestricted		
Undesignated	9,235	9,680
Designated	8,538	8,049
Designated Cemetery Long-Term Care	7,165	6,436
Total unrestricted net assets	24,938	24,165
Temporarily restricted		
	9,298	8,873
Permanently restricted		
	3,933	3,797
Total net assets	38,169	36,835
Total liabilities and net assets	\$ 148,817	\$ 144,387

Summary Statement of Cash Flows

\$ 000's

For the years ending

June 30, 2010 June 30, 2009

	June 30, 2010	June 30, 2009
Increase (decrease) in cash and cash equivalents		
Change in net assets from operations prior to effect of changes in accounting principles	\$ 1,978	\$ (6,837)
Adjustments to reconcile cash		
Depreciation	1,590	1,518
Provision for losses on loans and receivables	(593)	(5)
Investment gains (losses)	(1,864)	3,333
Cost of unfunded pension liability/Bond SWAP	4,189	5,043
Amortization of bond costs	16	16
Changes in operating assets and liabilities	1,096	(542)
Net Cash provided by operating activities	6,412	2,526
Cash flows from investing activities		
Purchase of plant assets	(1,905)	(7,936)
Advances and proceeds for/from loans	853	1,736
Purchase/proceeds from marketable securities	(187)	397
Net Cash used in investing activities	(1,239)	(5,803)
Cash flows from financing activities		
Deposits payable	(292)	396
Payments on notes and bonds	(2,132)	(1,494)
Contributions restricted for permanent endowments	178	87
Net cash used in financing activities	(2,246)	(1,011)
Net increase (decrease) in cash and cash equivalents	\$ 2,927	\$ (4,288)