

Catholic Education Foundation of The Roman Catholic Archdiocese of Los Angeles

Financial Report
June 30, 2006

McGladrey & Pullen

Certified Public Accountants

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Independent Auditor's Report

To His Eminence
Cardinal Roger M. Mahony
Archbishop of Los Angeles

We have audited the accompanying statement of financial position of the Catholic Education Foundation of The Roman Catholic Archdiocese of Los Angeles (the Foundation), as of June 30, 2006, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Foundation for the year ended June 30, 2005 were audited by other auditors whose report, dated October 1, 2005, expressed an unqualified opinion on those statements.

We conducted our audit 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Archdiocese is involved in numerous lawsuits related to claims of sexual misconduct by certain individuals. The financial impact of these claims is uncertain. See Note 8 for further discussion of this matter.

McGladrey & Pullen, LLP

Pasadena, California
March 27, 2007

Catholic Education Foundation of
The Roman Catholic Archdiocese of Los Angeles

Statements of Financial Position
June 30, 2006 and 2005

Assets	2006				2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Pledges Receivable, net (Note 3)	\$ -	\$ 551,938	\$ 9,940	\$ 561,878	\$ -	\$ 554,388	\$ 22,381	\$ 576,769
Investment in Pooled Funds (Note 4)	43,679,572	6,178,036	6,809,131	56,666,739	42,065,064	5,812,016	6,785,379	54,662,459
Other Investment (Note 5)	59,555,856	-	-	59,555,856	45,889,355	-	-	45,889,355
Total assets	\$ 103,235,428	\$ 6,729,974	\$ 6,819,071	\$ 116,784,473	\$ 87,954,419	\$ 6,366,404	\$ 6,807,760	\$ 101,128,583

Liabilities and Net Assets

Due to Administrative Office (Note 2)	\$ 183,455	\$ -	\$ -	\$ 183,455	\$ 493,322	\$ -	\$ -	\$ 493,322
Program Awards Payable	5,879,246	-	-	5,879,246	5,219,269	-	-	5,219,269
Accounts Payable and Accrued Expenses	12,071	-	-	12,071	8,755	-	-	8,755
Total liabilities	6,074,772	-	-	6,074,772	5,721,346	-	-	5,721,346
Contingencies (Note 8)								
Net Assets (Notes 6 and 7)	97,160,656	6,729,974	6,819,071	110,709,701	82,233,073	6,366,404	6,807,760	95,407,237
Total liabilities and net assets	\$ 103,235,428	\$ 6,729,974	\$ 6,819,071	\$ 116,784,473	\$ 87,954,419	\$ 6,366,404	\$ 6,807,760	\$ 101,128,583

See Notes to Financial Statements.

Catholic Education Foundation of
The Roman Catholic Archdiocese of Los Angeles

Statements of Activities
Years Ended June 30, 2006 and 2005

	2006				2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:								
Donations (Note 3)	\$ -	\$ 2,265,691	\$ 11,311	\$ 2,277,002	\$ -	\$ 1,717,126	\$ 562,381	\$ 2,279,507
Net investment pool gain (Note 4)	3,427,213	1,012,265	-	4,439,478	2,560,712	716,905	-	3,277,617
Dividend income from other investment (Note 5)	2,126,458	-	-	2,126,458	1,835,574	-	-	1,835,574
Unrealized gain on other investment (Note 5)	13,666,502	-	-	13,666,502	10,782,745	-	-	10,782,745
	19,220,173	3,277,956	11,311	22,509,440	15,179,031	2,434,031	562,381	18,175,443
Net assets released from restrictions								
Satisfaction of program restrictions	2,914,386	(2,914,386)	-	-	2,474,504	(2,474,504)	-	-
Total revenues	22,134,559	363,570	11,311	22,509,440	17,653,535	(40,473)	562,381	18,175,443
Expenses:								
Tuition awards program	5,942,246	-	-	5,942,246	4,795,170	-	-	4,795,170
Other tuition program awards	375,950	-	-	375,950	277,905	-	-	277,905
Santa Barbara tuition awards	336,500	-	-	336,500	267,800	-	-	267,800
Total program expenses	6,654,696	-	-	6,654,696	5,340,875	-	-	5,340,875
Employee compensation and benefits	436,349	-	-	436,349	372,627	-	-	372,627
General operating expenses	132,676	-	-	132,676	153,231	-	-	153,231
Fund raising expenses	53,255	-	-	53,255	56,074	-	-	56,074
	622,280	-	-	622,280	581,932	-	-	581,932
Provision for uncollectible pledges (Note 3)	(70,000)	-	-	(70,000)	-	-	-	-
Total operating expenses	552,280	-	-	552,280	581,932	-	-	581,932
Total expenses	7,206,976	-	-	7,206,976	5,922,807	-	-	5,922,807
Increase (decrease) in net assets	14,927,583	363,570	11,311	15,302,464	11,730,728	(40,473)	562,381	12,252,636
Net assets, beginning of year	82,233,073	6,366,404	6,807,760	95,407,237	70,502,345	6,406,877	6,245,379	83,154,601
Net assets, end of year	\$ 97,160,656	\$ 6,729,974	\$ 6,819,071	\$ 110,709,701	\$ 82,233,073	\$ 6,366,404	\$ 6,807,760	\$ 95,407,237

See Notes to Financial Statements.

Catholic Education Foundation of
The Roman Catholic Archdiocese of Los Angeles

Statements of Cash Flows
Years Ended June 30, 2006 and 2005

	2006	2005
Cash Flows from Operating Activities		
Increase in net assets	\$ 15,302,464	\$ 12,252,636
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Realized and unrealized investment pool gain	(3,236,181)	(2,130,326)
Unrealized gain on other investment	(13,666,501)	(10,782,745)
Decrease in allowance for uncollectible pledges	(70,000)	-
Amortization of pledge discounts	32,141	(36,252)
Assets contributed for long-term investments	(11,311)	(562,381)
Decrease in pledges receivable	52,750	155,899
(Increase) decrease in due to Administrative Office	(309,867)	321,500
Increase (decrease) in program awards payable	659,977	(320,231)
Increase (decrease) in accounts payable and accrued liabilities	3,317	(1,512)
Total adjustments	(16,545,675)	(13,356,048)
Net cash used in operating activities	(1,243,211)	(1,103,412)
Cash Flows from Investing Activities		
Additions to investment in pooled funds	(6,589,634)	(6,029,130)
Redemptions from investment in pooled funds	7,821,534	6,570,161
Net cash provided by investing activities	1,231,900	541,031
Cash Flows from Financing Activities		
Assets contributed for long-term investments	11,311	562,381
Net change in cash and cash equivalents	-	-
Cash and Cash Equivalents, beginning of year	-	-
Cash and Cash Equivalents, end of year	\$ -	\$ -

See Notes to Financial Statements.

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies

Nature of organization: The Catholic Education Foundation (the Foundation) of the Roman Catholic Archdiocese of Los Angeles (the Archdiocese) was formed in 1987 as a trust for charitable purposes. It continues to have a primary mission to provide tuition assistance to the most financially deserving students attending Parish elementary schools in the Archdiocese or Catholic high schools within the Archdiocese that particularly assist a financially deserving population. The Foundation's revenues are derived from contributions from individuals, corporations and foundations and from earnings on investments.

A summary of significant accounting policies is as follows:

Basis of accounting: The financial statements of the Foundation have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Basis of presentation: The financial statements of the Foundation have been presented in accordance with accounting principles applicable to nonprofit organizations generally accepted in the United States of America. These principles state that net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation and changes therein are classified and reported as follows:

Unrestricted net assets: Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted net assets: Includes amounts for which donor imposed restrictions have not been met and pledges receivable for which the ultimate purpose of the proceeds is not permanently restricted. All temporarily restricted net assets are available to fund future tuition and other awards. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently restricted net assets: Includes gifts and pledges, which require, by donor restriction, that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions. All permanently restricted investments provide investment income, which is temporarily restricted until utilized for tuition awards.

The permanently restricted endowment funds of the Foundation are invested in the investment pool of the Archdiocese (see Note 4).

Pledges receivable: In accordance with Financial Accounting Standards Board (FASB) Statement No. 116, *Accounting for Contributions Received and Contributions Made*, unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using a risk-free interest rate applicable to the years in which the promises are received. This discount rate used is the risk-free interest rate on treasury notes, which was 5.31% and 4.28% for 2006 and 2005, respectively. Amortization of the discounts is included in donations revenues. Conditional promises to give are not included in pledges receivable until the conditions are met. Pledges deemed uncollectible by management are included in the allowance for uncollectible pledges. If a restriction is fulfilled in the same time period in which the contribution is received, the Foundation reports the support as unrestricted.

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies, Continued

Investments: The Foundation has an investment in the Archdiocese investment pool (the Pool) (see Note 4), which is recorded at fair value for investments in equity securities with readily determinable fair values and investments in debt securities. The Foundation is allocated income (loss) based upon its allocation of the total return earned on invested equity and debt securities held by the Pool, including realized and unrealized gains and losses. Investments in equity securities with non-readily determinable fair values are reported at fair values based upon certain industry standard valuation methodology. Gains and losses on investments are reported in the statement of activities as increases or decreases in unrestricted net assets unless their use is temporarily restricted by explicit donor stipulations.

Income taxes: As a Trust of the Archdiocese, the Foundation is exempt from Federal income and California franchise taxes under sections 501(c)(3) of the Internal Revenue Code and 23701(d) of the California Revenue and Taxation Code, respectively.

Use of estimates: In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses, including allocations to various program costs, during the reporting period. Actual results could differ from those estimates. The Foundation's management considers the allowance for uncollectible pledges to be such an estimate. The Foundation's management also makes an annual estimate for a reduction in liability for award programs triggered by a decrease in student enrollment between the time the awards are committed and the time the awards are paid out. That estimate is set at 5% of the award commitment.

Note 2. Due to Administrative Office

The Administrative Office of The Roman Catholic Archdiocese of Los Angeles (the Administrative Office) receives and disburses funds on behalf of the Foundation primarily for program awards and employee-related expenses. Funds received by the Foundation are processed through the Administrative Office for deposit in the investment pool. Funds disbursed by the Administrative Office are reimbursed by the Foundation within a short period of time after payment. Reimbursements due to the Administrative Office were \$183,455 and \$493,322 at June 30, 2006 and 2005, respectively. Additionally, the Foundation occupies an office at the Administrative office, for which no rent is being charged to the Foundation.

Catholic Education Foundation of
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Notes to Financial Statements

Note 3. Pledges Receivable

Included in pledges receivable are the following as of June 30:

	2006	2005
Pledges receivable, before unamortized discount and allowance for uncollectible pledges	\$ 1,696,729	\$ 1,749,479
Less unamortized discount	(84,851)	(52,710)
	<u>1,611,878</u>	<u>1,696,769</u>
Less allowance for uncollectible pledges	(1,050,000)	(1,120,000)
Pledges receivable, net	<u>\$ 561,878</u>	<u>\$ 576,769</u>
	2006	2005
Amounts due in:		
Less than one year	\$ 168,247	\$ 161,500
One to five years	264,453	312,949
More than five years	1,264,029	1,275,030
	<u>\$ 1,696,729</u>	<u>\$ 1,749,479</u>

The discount rate applied in determining the unamortized discount is 5.31% and 4.28% for 2006 and 2005, respectively, which is the rate for the 20-year treasury notes.

Reconciliation of pledges receivable and donation revenue is as follows for the years ended June 30:

	2006	2005
Pledges receivable, net, beginning of year	\$ 576,769	\$ 696,416
Donation income:		
New pledges	282,317	213,743
Cash contributions in addition to pledges	2,026,826	2,029,512
Amortization of present value discount	(32,141)	36,252
Total donation income	<u>2,277,002</u>	<u>2,279,507</u>
Payments received during the year	(2,291,893)	(2,399,154)
Pledges receivable, net, end of year	<u>\$ 561,878</u>	<u>\$ 576,769</u>

Pledges receivable totaling \$509,883 and \$256,030 at June 30, 2006 and 2005, respectively, were receivable from related parties, net of allowance for uncollectible pledges of \$1,000,000. Related parties include Trustees of the Foundation and entities owned by those Trustees.

Notes to Financial Statements

Note 4. Investment in Pooled Funds

In November 1986, the Archdiocese established an investment pool, which administers assets in trust, as agent and through independent custodial arrangements for the benefit of the various entities of the Archdiocese. The Foundation has participated in the investment pool since its formation in 1987. The funds deposited by or on behalf of each participant are the sole property of that participant and are processed by the investment pool service providers and the Archdiocese as agents, custodians and trustees for the participants. Servicing and custodial arrangements for the investment pool allow for direct fund access and reporting for all participants. The investment pool has two separate pools, the Balanced Pool and the Income Pool. The Balanced Pool was established to provide participants with long-term objectives of capital appreciation combined with capital preservation. Assets of the Balanced Pool, as of June 30, 2006 and 2005, are invested 66% and 60% in equities, 31% and 37% in fixed income securities, 2% and 2% in cash and cash equivalents and 1% and 1% in other assets, respectively.

The Income Pool was established to provide shorter-term objectives of current income with low risk of fluctuation in principal value. Assets of the Income Pool as of June 30, 2006 and 2005 are invested 85% and 83% in fixed income securities, 12% and 13% in notes receivable, 2% and 3% in cash and cash equivalents and 1% and 1% in other investments, respectively.

As of June 30, 2006 and 2005, the Foundation invested \$56,331,608 and \$54,339,055 in the Balanced Pool and \$335,131 and \$323,404 in the Income Pool, respectively.

The investments in both funds are carried at market value. The investment pool is operated under the total return concept, under which each participant is allocated income (loss) based upon the total return earned on invested funds, including realized and unrealized gains and losses. Participant allocation of income earned and realized and unrealized gains and losses in the Balance Pool and Income Pool are based upon the time and dollar-weighted method under which participants are assigned a weighted value for the time that the funds have been held in the respective pools.

Catholic Education Foundation of
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Notes to Financial Statements

Note 4. Investment in Pooled Funds, Continued

The average annual return and net realized and unrealized gain or (loss) related to these investments for the years ended June 30 are as follows:

	<u>2006</u>	<u>2005</u>
Average annual return:		
Balanced pool	8.50%	6.30%
Income pool	3.60%	2.50%
Interest and dividend income:		
Balanced pool	\$ 1,586,929	\$ 1,466,187
Income pool	12,212	11,888
Total interest and dividend income	<u>1,599,141</u>	<u>1,478,075</u>
Net realized and unrealized gain (loss):		
Balanced pool	3,235,837	2,131,879
Income pool	344	(1,553)
Total net realized and unrealized gain	<u>3,236,181</u>	<u>2,130,326</u>
Investment expenses	<u>(395,844)</u>	<u>(330,784)</u>
Total investment income	<u>\$ 4,439,478</u>	<u>\$ 3,277,617</u>

Note 5. Other Investment

Other investment includes the investment in Watson Land Company (501,523 shares owned in 2006 and 2005), which was donated to the Foundation in 1991. Fair value of the investment is based upon certain industry standard valuation methodology, including the methodology used for land holdings of other publicly traded real estate investment trusts. The fair values were \$59,555,856 and \$45,889,355 at June 30, 2006 and 2005, respectively.

Gain on investment in Watson Land Company was \$13,666,502 and \$10,782,745 for the years ended June 30, 2006 and 2005, respectively. Dividend income on Watson Land Company shares was \$2,126,458 and \$1,835,574 for the years ended June 30, 2006 and 2005, respectively. The Foundation's investment in Watson Land Company stock represents 51.2% and 45.6% of total investments at June 30, 2006 and 2005, respectively, and therefore, presents a concentration of credit risk.

Note 6. Revocable Living Trusts and Bequests

The Foundation has received certain pledges of net estate assets characterized as living trusts or bequests by will. As it is not practicable to determine a value for the gifts and bequests, and because the trusts are revocable at the discretion of the trustor, the aggregate value of these trusts is not reported on the accompanying statements of financial position.

Notes to Financial Statements

Note 7. Irrevocable Deferred Gifts

The Foundation is the designated beneficiary of certain gift annuities that are not reported in the accompanying statements of financial position. The principal amount of these gift annuities total \$702,740 and \$668,081 at June 30, 2006 and 2005, respectively, and are disclosed in the financial statements of the Annuity Fund. Amounts received from gift annuities are recorded as revenue when received and may be less than the principal amount.

Note 8. Contingencies

The Archdiocese is involved in numerous currently pending lawsuits relating to claims of sexual misconduct by certain individuals. The Foundation is not a named party in any of these lawsuits. The Archdiocese does not currently believe that the assets of the Foundation will be impacted by losses, which could arise if the claims are not resolved within insurance policy limits or with other assets available from the Administrative Office. The financial impact from these claims to the Foundation, if any, is uncertain and, in accordance with accounting principles generally accepted in the United States of America, no accrual has been made in these financial statements.

The Archdiocese is subject to various other lawsuits and claims, including general litigation. Various lawsuits and claims, not related to the sexual misconduct claims, are pending against the Archdiocese. There are no such claims against the Foundation and the resolution of such claims against the Archdiocese is not expected to have any financial impact on the Foundation.

Note 9. Fair Value of Financial Instruments

The following summarizes the major methods and assumptions used in estimating the fair values of financial instruments:

Investment in pooled funds: The carrying amounts of these financial instruments are a reasonable estimate of their fair value due to the short-term to maturity and readily available markets for the investments.

Investment in other investments: The fair value of the other investments in nonpublicly traded equity securities is determined by independent appraisal.

Pledges receivable: The fair values of the pledges receivable are determined by analyzing discounted cash flow, using the interest rate used for the 20-year treasury notes. The carrying amount approximates the fair value.

Amounts due to Administrative Office: The carrying amounts approximate fair value based on the terms of payment to the Administrative Office.

Accounts payable, accrued liabilities and grants payable: The carrying amounts approximate fair value based on the terms of payment to the Foundation's vendors and grantees.