

Catholic Education Foundation of the Roman Catholic Archdiocese of Los Angeles

Financial Report
June 30, 2007

McGladrey & Pullen
Certified Public Accountants

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McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

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

We have audited the accompanying statements of financial position of the Catholic Education Foundation of the Roman Catholic Archdiocese of Los Angeles (the Foundation) as of June 30, 2007 and 2006, and the related statements of activities and cash flows for the years 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 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 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In July 2007, the Roman Catholic Archdiocese of Los Angeles reached an agreement in principle to settle numerous lawsuits related to claims of sexual misconduct by certain individuals. The settlement was finalized on November 30, 2007. See Note 8 for further discussion of this matter.

McGladrey & Pullen, LLP

Pasadena, California
December 20, 2007

Catholic Education Foundation of
the Roman Catholic Archdiocese of Los Angeles

Statements of Financial Position
June 30, 2007 and 2006

Assets	2007				2006			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Accounts Receivable	\$ 131,780	\$ -	\$ -	\$ 131,780	\$ -	\$ -	\$ -	\$ -
Pledges Receivable, net (Note 3)	-	973,966	12,938	986,904	-	551,938	9,940	561,878
Investment in Pooled Funds (Note 4)	49,975,194	7,941,587	7,350,323	65,267,104	43,679,572	6,178,036	6,809,131	56,666,739
Other Investment (Note 5)	79,240,634	-	-	79,240,634	59,555,856	-	-	59,555,856
Prepaid Expenses	7,133	-	-	7,133	-	-	-	-
Total assets	\$ 129,354,741	\$ 8,915,553	\$ 7,363,261	\$ 145,633,555	\$ 103,235,428	\$ 6,729,974	\$ 6,819,071	\$ 116,784,473
Liabilities and Net Assets								
Due to the Administrative Office (Note 2)	\$ 948,235	\$ -	\$ -	\$ 948,235	\$ 183,455	\$ -	\$ -	\$ 183,455
Program Awards Payable	7,287,501	-	-	7,287,501	5,879,246	-	-	5,879,246
Accounts Payable and Accrued Expenses	19,109	-	-	19,109	12,071	-	-	12,071
Total liabilities	8,254,845	-	-	8,254,845	6,074,772	-	-	6,074,772
Commitment and Contingencies (Notes 8 and 10)								
Net Assets	121,099,896	8,915,553	7,363,261	137,378,710	97,160,656	6,729,974	6,819,071	110,709,701
Total liabilities and net assets	\$ 129,354,741	\$ 8,915,553	\$ 7,363,261	\$ 145,633,555	\$ 103,235,428	\$ 6,729,974	\$ 6,819,071	\$ 116,784,473

See Notes to Financial Statements.

Catholic Education Foundation of
the Roman Catholic Archdiocese of Los Angeles

Statements of Activities
Years Ended June 30, 2007 and 2006

	2007				2006			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:								
Donations	\$ -	\$ 4,199,212	\$ 544,190	\$ 4,743,402	\$ -	\$ 2,265,691	\$ 11,311	\$ 2,277,002
Net investment pool gain (Note 4)	7,194,727	2,165,094	-	9,359,821	3,427,213	1,012,265	-	4,439,478
Dividend income from other investment (Note 5)	2,286,945	-	-	2,286,945	2,126,458	-	-	2,126,458
Unrealized gain on other investment (Note 5)	19,684,778	-	-	19,684,778	13,666,502	-	-	13,666,502
	<u>29,166,450</u>	<u>6,364,306</u>	<u>544,190</u>	<u>36,074,946</u>	<u>19,220,173</u>	<u>3,277,956</u>	<u>11,311</u>	<u>22,509,440</u>
Net assets released from restrictions:								
Satisfaction of program restrictions	4,178,727	(4,178,727)	-	-	2,914,386	(2,914,386)	-	-
Total revenues	<u>33,345,177</u>	<u>2,185,579</u>	<u>544,190</u>	<u>36,074,946</u>	<u>22,134,559</u>	<u>363,570</u>	<u>11,311</u>	<u>22,509,440</u>
Expenses:								
Tuition awards program	7,530,999	-	-	7,530,999	5,942,246	-	-	5,942,246
Other tuition program awards	466,752	-	-	466,752	375,950	-	-	375,950
Santa Barbara tuition awards	338,680	-	-	338,680	336,500	-	-	336,500
Total program expenses	<u>8,336,431</u>	<u>-</u>	<u>-</u>	<u>8,336,431</u>	<u>6,654,696</u>	<u>-</u>	<u>-</u>	<u>6,654,696</u>
Employee compensation and benefits (Note 10)	520,842	-	-	520,842	436,349	-	-	436,349
General operating expenses	194,576	-	-	194,576	132,676	-	-	132,676
Fund raising expenses	354,088	-	-	354,088	53,255	-	-	53,255
	<u>1,069,506</u>	<u>-</u>	<u>-</u>	<u>1,069,506</u>	<u>622,280</u>	<u>-</u>	<u>-</u>	<u>622,280</u>
Provision for uncollectible pledges (Note 3)	-	-	-	-	(70,000)	-	-	(70,000)
Total operating expenses	<u>1,069,506</u>	<u>-</u>	<u>-</u>	<u>1,069,506</u>	<u>552,280</u>	<u>-</u>	<u>-</u>	<u>552,280</u>
Total expenses	<u>9,405,937</u>	<u>-</u>	<u>-</u>	<u>9,405,937</u>	<u>7,206,976</u>	<u>-</u>	<u>-</u>	<u>7,206,976</u>
Increase in net assets	<u>23,939,240</u>	<u>2,185,579</u>	<u>544,190</u>	<u>26,669,009</u>	<u>14,927,583</u>	<u>363,570</u>	<u>11,311</u>	<u>15,302,464</u>
Net assets, beginning 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
Net assets, end of year	<u>\$ 121,099,896</u>	<u>\$ 8,915,553</u>	<u>\$ 7,363,261</u>	<u>\$ 137,378,710</u>	<u>\$ 97,160,656</u>	<u>\$ 6,729,974</u>	<u>\$ 6,819,071</u>	<u>\$ 110,709,701</u>

See Notes to Financial Statements.

Catholic Education Foundation of
the Roman Catholic Archdiocese of Los Angeles

Statements of Cash Flows
Years Ended June 30, 2007 and 2006

	2007	2006
Cash Flows from Operating Activities		
Increase in net assets	\$ 26,669,009	\$ 15,302,464
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Realized and unrealized investment pool gain	(7,890,545)	(3,236,181)
Unrealized gain on other investment	(19,684,778)	(13,666,501)
Decrease in allowance for uncollectible pledges	-	(70,000)
Amortization of pledge discounts	28,798	32,141
Assets contributed for long-term investments	(544,190)	(11,311)
Increase in accounts receivable	(131,780)	-
(Increase) decrease in pledges receivable	(453,824)	52,750
Increase in prepaid expenses	(7,133)	-
Increase (decrease) in due to the Administrative Office	764,780	(309,867)
Increase in program awards payable	1,408,255	659,977
Increase in accounts payable and accrued expenses	7,038	3,317
Total adjustments	(26,503,379)	(16,545,675)
Net cash provided by (used in) operating activities	165,630	(1,243,211)
Cash Flows from Investing Activities		
Additions to investment in pooled funds	(8,658,222)	(6,589,634)
Redemptions from investment in pooled funds	7,948,402	7,821,534
Net cash (used in) provided by investing activities	(709,820)	1,231,900
Cash Flows from Financing Activities, assets contributed for long-term investments	544,190	11,311
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 program 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 of Financial Accounting Standards (SFAS) 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 5.21% and 5.31% for 2007 and 2006, respectively. Amortization of the discounts is included in donation revenue. 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.

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

Investments: The Foundation has an investment in the Investment Pool of the Roman Catholic Archdiocese of Los Angeles (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 in invested equity and debt securities held by the Pool, including realized and unrealized gains and losses. Investments in equity securities whose value is not readily determinable are valued through independent appraisal. 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.

Program awards payable: Includes tuition assistance and other donor designated programs for students attending Archdiocesan elementary and high schools. Tuition assistance is granted to students prior to year end for the following academic year.

Insurance: The Foundation is insured for various risks associated with the operations by an Archdiocesan self-insurance program of Archdiocesan participation in a captive mutual insurance company. The Administrative Office of the Roman Catholic Archdiocese of Los Angeles (the Administrative Office) assesses the Foundation with its portion of the estimated insurance expense. Claims currently payable by the Foundation plus an estimated amount for incurred but not reported claims have been accrued as Administrative Office liabilities at June 30, 2007.

Income taxes: 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 8% and 5% of the award commitment in 2007 and 2006, respectively.

Recent accounting pronouncements: In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 does not require any new fair value measurements; rather, it specifies valuation methods to be applied when fair value measurements are required under existing or future accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early application of SFAS No. 157 is encouraged and, generally, will be applied prospectively. The Foundation is currently evaluating the impact of SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115*. This standard permits an entity to measure financial instruments and certain other items at estimated fair value as of specified election dates with changes in fair value recognized in earnings at each subsequent reporting period. SFAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Foundation is currently evaluating the impact of SFAS No. 159.

Catholic Education Foundation of
the Roman Catholic Archdiocese of Los Angeles

Notes to Financial Statements

Note 2. Due to the Administrative Office

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 \$948,235 and \$183,455 at June 30, 2007 and 2006, respectively. Additionally, the Foundation occupies an office at the Administrative office, for which no rent is being charged to the Foundation.

Note 3. Pledges Receivable

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

	<u>2007</u>	<u>2006</u>
Pledges receivable, before unamortized discount and allowance for uncollectible pledges	\$ 2,150,553	\$ 1,696,729
Less unamortized discount	(113,649)	(84,851)
	<u>2,036,904</u>	<u>1,611,878</u>
Less allowance for uncollectible pledges	(1,050,000)	(1,050,000)
Pledges receivable, net	<u>\$ 986,904</u>	<u>\$ 561,878</u>
	<u>2007</u>	<u>2006</u>
Amounts due in:		
Less than one year	\$ 370,648	\$ 168,247
One to five years	516,876	264,453
More than five years	1,263,029	1,264,029
	<u>\$ 2,150,553</u>	<u>\$ 1,696,729</u>

The discount rate applied in determining the unamortized discount is 5.21% and 5.31% for 2007 and 2006, respectively, which is the rate for the 20-year treasury securities.

Pledges receivable totaling \$787,030 and \$509,883 at June 30, 2007 and 2006, 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. During the year ended June 30, 2004, the servicing and custodial arrangements for the investment pool were enhanced to allow for direct fund access and reporting for all participants. These enhancements continue to be updated to provide better participant services. 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, 2007 and 2006, respectively, are invested 69% and 66% in equities, 28% and 31% in fixed income securities, 2% and 2% in cash and cash equivalents and 1% and 1% in other assets.

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, 2007 and 2006 are invested 75% and 80% in fixed income securities, 10% and 12% in notes receivable, 14% and 7% in cash and cash equivalents and 1% and 1% in other investments, respectively.

As of June 30, 2007 and 2006, the Foundation invested \$64,913,666 and \$56,331,608 in the Balanced Pool and \$353,438 and \$335,131 in the Income Pool, respectively.

The investments in both pooled 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.

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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>2007</u>	<u>2006</u>
Average annual return:		
Balanced pool	16.90%	8.50%
Income pool	5.50%	3.60%
Interest and dividend income:		
Balanced pool	\$ 1,875,577	\$ 1,586,929
Income pool	17,004	12,212
Total interest and dividend income	<u>1,892,581</u>	<u>1,599,141</u>
Net realized and unrealized gain:		
Balanced pool	7,888,403	3,235,837
Income pool	2,142	344
Total net realized and unrealized gain	<u>7,890,545</u>	<u>3,236,181</u>
Investment expenses	<u>(423,305)</u>	<u>(395,844)</u>
Total investment income, net	<u>\$ 9,359,821</u>	<u>\$ 4,439,478</u>

Note 5. Other Investment

Other investment includes the investment in Watson Land Company (501,523 shares owned in 2007 and 2006), 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 \$79,240,634 and \$59,555,856 at June 30, 2007 and 2006, respectively.

The unrealized gain on investment in Watson Land Company was \$19,684,778 and \$13,666,502 for the years ended June 30, 2007 and 2006, respectively. Dividend income on Watson Land Company shares was \$2,286,945 and \$2,126,458 for the years ended June 30, 2007 and 2006, respectively. The Foundation's investment in Watson Land Company stock represents 54.8% and 51.2% of total investments at June 30, 2007 and 2006, 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.

Catholic Education Foundation of
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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 \$722,740 and \$702,740 during the years ended June 30, 2007 and 2006, 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 and Subsequent Events

The Archdiocese has been involved in numerous lawsuits related to claims of sexual misconduct by certain individuals. Most of the claims were filed after legislation was adopted in 2002 in California to allow otherwise time-barred claims to be brought in 2003. The claims were coordinated in the Superior Court of California as the Clergy I coordinated proceedings and were administered in the Los Angeles Superior Courts (Clergy I Litigation). The Foundation was not a named party in any of the claims brought in the Clergy I Litigation. In December 2006, the Archdiocese resolved certain of the Clergy I Litigation claims. The Archdiocese reached an agreement in principle to settle the remaining Clergy I Litigation claims against it in July 2007 and the settlement was fully documented and effective on November 30, 2007 with initial funding on December 3, 2007.

No assets of the Foundation were or will be used to fund the settlements. The Archdiocese does not currently believe that the operations of the Foundation will be impacted by the settlement. In accordance with accounting principles generally accepted in the United States of America, the amounts committed to resolve the settlement have been accrued at June 30, 2007 on the financial statements of the Administrative Office of the Archdiocese of Los Angeles and, accordingly, no accrual has been made in these financial statements.

The Archdiocese is subject to various other lawsuits and claims, including general litigation and claims of sexual misconduct, not addressed in Clergy I. 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 securities. The carrying amount approximates the fair value.

Notes to Financial Statements

Note 9. Fair Value of Financial Instruments, Continued

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

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

Note 10. Pension Plan

The Foundation participates in an Archdiocesan defined benefit pension plan covering substantially all full-time lay employees. Benefits are based upon an employee's years of service and compensation. The Administrative Office administers the pension plan and assesses the Foundation its portion of the annual estimated pension cost. The Archdiocese has partially funded the pension plan and has accrued liabilities for unfunded pension cost in the Administrative Office's financial statements in accordance with SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. Assessed pension cost for the Foundation was \$13,636 and \$18,602 for the years ended June 30, 2007 and 2006, respectively.