

HOW MUCH IS ENOUGH?

AN ANALYSIS OF THE DIOCESE OF ROCKVILLE CENTRE "FREE CASH RESERVES" AS OF AUGUST 31, 2008

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JULY, 2009

INTRODUCTION

"Free cash reserves" ("FCR") are cash reserves that exceed the amount needed to support operations and to pay liabilities and certain future costs. The Diocese of Rockville Centre ("DRVC") has a significant amount of free cash reserves, which it has accumulated over a long period of time. Although it is prudent to maintain a certain amount of free cash reserves for unexpected contingencies, the amount of reserves maintained by the DRVC is excessive by any identifiable standard. The excess could be used to further the spiritual and humanitarian mission of the Church, and I believe it should be used for that purpose. The DRVC disagrees with this, so I continue to calculate the amount of DRVC free cash reserves each year---both the total amount and the excessive portion based upon accepted standards---to determine how much is in question.

I have been making this calculation now for six years in an attempt to hold the Diocese accountable for its accumulation policies. During that time, the Diocese has made some improvements in the quality of its financial reporting but has basically ignored the substance of my analysis---issuing instead a series of weak arguments and misinformation in defense of its policies. In 2007, the DRVC did take some small steps to use its free cash reserves in a more responsible way. However, in 2008, significant market-related losses put an abrupt end to that apparent change in policy with one possible exception discussed later.

In past years I have issued a detailed report on the results of my analysis. Reference is made to these prior year reports for more background information, the methodology used and supporting details. In the current year (fiscal 2008), I have performed the same detailed analysis but have summarized the results of my analysis below without issuing a detailed report.

It should be noted that my analysis relates only to the DRVC Administrative Offices and 13 affiliated entities, all of which issue separate audited financial statements without any combination thereof. This necessitates that I do my own combination of such statements, making certain assumptions along the way. It should also be noted that these statements and my analysis thereof do not include the parishes (since the DRVC does not publish combined parish statements) or Catholic Health Services.

RESULTS OF THE 2008 ANALYSIS

The Amount of Free Cash Reserves

Based upon my analysis of the latest DRVC audited financial statements (fiscal year ended August 31, 2008), free cash reserves now equal \$138.9 million---a \$22.6 million decrease from the prior year but still \$83.9 million in excess of accepted standards. This decrease was attributable primarily to significant market-related losses experienced by the sizable DRVC investment portfolio. See the following section for a more detailed discussion of this decrease.

The prior year (2007) free cash reserve amount was revised to \$161.5 million from \$247.2 million based upon a study the DRVC finally performed (after much urging) to determine how much of the Catholic Cemeteries Permanent Maintenance Fund would be needed to maintain Holy Rood Cemetery after it reaches capacity and can no longer accept new burials. The study determined that the entire Fund (\$85.7 million at August 31, 2007) would be needed for that purpose. Consequently, this had the effect of reducing prior year free cash reserves by \$85.7 million. Although the cemetery study appears to have used some overly conservative assumptions, eliminating the Fund from the free cash reserve category and restating the 2007 free cash reserve amount was deemed appropriate. Obviously, this had a significant impact on free cash reserves in both 2007 and 2008 as can be seen by the following summary. However, free cash reserves are still excessive by at least \$83.9 million based upon the accepted standards discussed later:

Change in Free Cash Reserves From 2007 to 2008 (in millions)

Free cash reserves at August 31, 2007	\$247.2
Less Permanent Maintenance Fund at August 31, 2007	(85.7)
Revised prior year amount	161.5
Less decrease in free cash reserves during 2008	(22.6)
Free cash reserves at August 31, 2008	<u>\$138.9</u>
Excessive portion of FCR at August 31, 2008	<u>\$ 83.9</u>

During the five years before 2008, DRVC free cash reserves increased by \$26.5 million. However, as a result of the \$22.6 million decrease in 2008, free cash reserves have now increased by \$3.9 million during the six years ended August 31, 2008 (a \$26.5 million increase during 2003-2007 less the 2008 decrease of \$22.6 million). Although \$3.9 million is a relatively small cumulative increase, it is still significant when viewed in the context of the absolute amount of free cash reserves and the excessive portion thereof.

Discussion of the 2008 Decrease in Free Cash Reserves and DRVC Operating Results

As noted above, the sizable 2008 decrease in FCR was attributable primarily to significant market-related losses experienced by the DRVC investment portfolio. The

market-related losses approximated \$18.8 million in 2008 (net of dividends and interest). In 2007, the DRVC experienced market gains of approximately \$24.4 million (net of dividends and interest). Thus, the actual “swing” in net investment income from year-to-year approximated \$43.2 million. In other words, the DRVC had to find other income (revenue and/or cost savings) of \$43.2 million in 2008 just to stay even with 2007 from a financial standpoint.

The DRVC did, in fact, find some additional income through revenue increases and cost savings, but it was not enough to offset the entire “swing” in investment income. Thus, net assets declined by \$25.8 million during the year. Combined revenues in 2008 were \$201.4 million compared to \$184.9 million in 2007 (exclusive in both years of net investment income), or a net increase of \$16.5 million. Combined expenses in 2008 were \$208.4 compared to \$211.4 million in 2007, or a net decrease of \$3.0 million. Thus, exclusive of the negative \$43.2 million “swing” in investment income, operations produced \$19.5 million more income in 2008 than 2007 (the \$16.5 million revenue increase plus the \$3.0 million expense decrease). This \$19.5 million increase in operational income was attributable to the three factors noted in the following reconciliation of changes between 2007 and 2008:

Reconciliation of the Change in Net Assets Between 2007 and 2008 (in millions)

(Decrease) in DRVC net assets in 2007	\$(2.1)
(Decrease) in investment income from 2007 to 2008 (“swing”)	(43.2)
Increase in income from operations (\$19.5 million):	
1. Elimination of moratorium on parish/ministry insurance	7.8
2. Insurance recoveries related to prior years	6.3
3. Other revenue increases/cost savings achieved in 2008	<u>5.4</u>
(Decrease) in DRVC net assets in 2008	<u>\$(25.8)</u>

As can be seen, the \$19.5 million increase in income (exclusive of the investment income “swing”) was attributable to the following three factors:

- (1) In 2007, the DRVC granted a 3 month moratorium (“Jubilee Grant”) on insurance premiums payable by the parishes and ministries to the Diocesan self-insurance funds (which were significantly over-funded from past inflated assessments on the parishes and ministries). This “Jubilee Grant” aggregated \$7.8 million. In 2008, the DRVC discontinued this moratorium, which resulted in a corresponding increase in income of \$7.8 million. Unfortunately, this “income” came at a corresponding cost to the parishes and ministries compared to the prior year.
- (2) Insurance recoveries received by the Protected Self Insurance Program and related to prior years accounted for another \$6.3 million in 2008.

- (3) Finally, the remaining \$5.4 million of additional revenue increases and/or cost savings consisted of relatively insignificant amounts spread throughout the various DRVC entities and affiliates.

Looked at in another way, the decrease in net assets in both years consisted of the following major components:

Major Components of the Decrease in Net Assets in 2008 and 2007 (in millions)

	<u>2008</u>	<u>2007</u>	<u>Change</u>
Investment income (loss)	\$(18.8)	\$24.4	\$(43.2)
Moratorium on parish/ministry insurance assessments	--	(7.8)	7.8
Insurance recoveries related to prior years	6.3	--	6.3
Operating (loss)	<u>(13.3)</u>	<u>(18.7)</u>	<u>5.4</u>
(Decrease) in net assets	<u>\$(25.8)</u>	<u>\$(2.1)</u>	<u>\$(23.7)</u>

Thus, although the DRVC was able to reduce its operating loss and benefit from two one-time insurance items, the investment loss more than offset these positive developments.

Note that the 2008 decrease in net assets of \$25.8 million and the 2008 decrease in free cash reserves of \$22.6 million are almost the same in amount. This is not surprising because DRVC operational results and cash flow closely parallel one another. In other words, the DRVC has little non-cash income and expenses and insignificant amounts of capital expenditures, debt additions or payments and/or working capital changes during each year. So, the change in net assets and free cash reserves should approximate one another as they do in 2008.

The \$138.9 million of free cash reserves at August 31, 2008 were held by the following DRVC entities (with comparative amounts shown as of August 31, 2007):

<u>ENTITY</u>	Revised Increase		
	<u>2008</u>	<u>2007</u>	<u>(Decrease)</u>
	(In millions)		
Administrative Offices	\$ 39.0	\$ 49.8	\$ (10.8)
Mission Assistance Corporation	10.5	6.1	4.4
Protected Self Insurance Program	14.8	17.5	(2.7)
Health Insurance Program	13.5	17.8	(4.3)
Catholic Cemeteries (2007 Restated)	32.5	37.5	(5.0)
Catholic Charities	13.9	20.7	(6.8)
All Other Entities	<u>14.7</u>	<u>12.1</u>	<u>2.6</u>
TOTAL	<u>\$138.9</u>	<u>\$161.5</u>	<u>\$(22.6)</u>

The largest decreases in free cash reserves occurred at those entities with the largest investment portfolios---the Administrative Offices, the two self-insurance funds, Catholic Charities and Catholic Cemeteries. The Mission Assistance Corporation (“MAC”) also

suffered a relatively small investment loss, but this loss was masked by the transfer of \$5 million from the Administrative Offices to the MAC. The Administrative Offices' loss was correspondingly increased by this \$5 million transfer. The Mission Assistance Corporation now has \$10.5 million of free cash reserves as a result of transfers from the Administrative Offices, and it has done almost nothing with these reserves.

Catholic Charities appears to have maintained the level of its services during 2008 despite a significant operating and market-related loss. In other words, it dipped into its free cash reserves to maintain its services at the prior year level rather than cut back as has been done elsewhere within the Diocese. Catholic Charities should be commended for this decision since its services are now needed more than ever. (Note: Subsequent to the issuance of my report, I learned that Catholic Charities may be making significant cutbacks in its services in 2009.)

DRVC Response to the Market Losses

So, how has the DRVC been responding to the current market meltdown and its \$43.2 million "swing" in investment income? On May 23, 2009, Newsday reported that Bishop William Murphy was "freezing salaries for Diocese of Rockville Centre workers" and "directing the Diocese to eliminate jobs and expenses wherever possible". Translation: Many of the services provided to those in need on Long Island may have to be reduced at a time they can ill afford to be reduced. Although this is certainly the way a private enterprise would and should react, I personally believe a spiritual/charitable enterprise should react somewhat differently, particularly given the free cash reserves that remain. As noted above, Catholic Charities did act differently in 2008, maintaining services despite suffering a significant loss. I hope the DRVC follows its lead and also allows Catholic Charities to continue doing what it's doing in 2009 and beyond. (Note: Subsequent to the issuance of my report, I learned that Catholic Charities may be making significant cutbacks in its services in 2009.)

Why Are Free Cash Reserves Still Considered Excessive?

The total amount of free cash reserves maintained by the DRVC is still significant as is the portion that can be considered excessive based upon accepted standards. The facts presented above and below support this statement as follows (derived from the 2008 financial statements):

- 1. \$138.9 million of total free cash reserves and \$83.9 million of excessive free cash reserves exist**---The \$138.9 million of free cash reserves is equivalent to 2.5 years of annual un-reimbursed (not self-funded) operating expenses vs. an accepted industry standard of no more than 1 year. Thus, free cash reserves exceed the industry standard by 1.5 years or \$83.9 million.
- 2. \$78.5 million of unrestricted net assets in excess of a Better Business Bureau industry standard exist**---The DRVC has unrestricted net assets of

\$243.5 million, which is \$78.5 million more than the maximum allowed by a Better Business Bureau Wise-Giving Alliance “Standard of Charity Accountability”. As a result, the DRVC does not qualify for the BBB “Wise Giving Seal” because it has accumulated unrestricted net assets far in excess of the maximum allowed. The BBB discourages donors from giving to a cause that fails this test on the premise that the charity is not using its resources for their intended (by the donors) purpose or the mission of the organization.

- 3. \$93.4 million of unrestricted cash and marketable securities in excess of total liabilities exist**---In other words, the DRVC could pay-off all its liabilities and still be left with all of its tangible assets plus \$93.4 million of cash and marketable securities. That’s before considering the appreciated but unrecorded value of certain of its assets, such as the Seminary of the Immaculate Conception.
- 4. A cumulative increase in free cash reserves during the 2003-2008 period of \$3.9 million occurred**---The DRVC increased its free cash reserves by \$26.5 million during the 2003-2007 period. Although market-related losses reduced this cumulative increase to \$3.9 million by 2008, this increase is still significant when viewed in the context of the total amount of free cash reserves and the amount of such reserves deemed excessive. In addition, the market correction since the end of the year has undoubtedly increased cash reserves further.
- 5. Key ratios suggest excessive liquidity**---Long-term debt as a percentage of total net assets is only 5%. This is extremely low even by not-for-profit standards. In addition, the DRVC decreased its long-term debt in 2008 while making capital expenditures of \$8.7 million. In other words, the DRVC was able to pay for all its capital expenditures without incurring new debt and while retiring some old debt. In addition, the current ratio (current assets divided by current liabilities) is 2.3 vs. the industry standard of 2.0.

Although a significant portion of the free cash reserves has been “designated” for future use (\$100.1 million), such designations are discretionary (not required under generally accepted accounting principles) and merely indicate a possible use for such reserves in the future. In addition, most of the “designations” are quite vague, unspecific, general, redundant and/or inconsistent with past DRVC practice. In other words, the DRVC may not need and, in my opinion, does not need all these unrestricted but “designated” reserves for the purposes described.

A non-paid, independent “Volunteer Accountants and Consultants Group”, which reviewed my 2005 report, agreed with me on this point and went on to say that, “The Diocese of Rockville Centre appears to have no clear, specific and measurable policy regarding the designation of these surplus funds.” The Volunteer Accountants and

Consultants Group also determined that my overall findings were “supportable” and my conclusions “reasonable”.

In addition, in a September, 2006 article published in The Long Island Catholic, the DRVC basically confirmed that it does, in fact, have approximately \$200 million of unrestricted cash reserves (including the Permanent Maintenance Fund noted earlier) although it continued to argue that most of these funds were needed for future “designated” purposes. As noted above, most of these “designations” are discretionary, and many appear to lack substance.

Possible Impact of Pending Legislation

Recent developments on the New York State legislative front may be giving the DRVC an uneasy feeling about the adequacy of its reserves. Until 2008, there appeared little chance of sexual abuse legislation passing with a “one year statute of limitations window” for the filing of all past claims. The odds have shifted somewhat in favor of such legislation, so the DRVC might be reluctant to use reserves now to expand or even preserve services. But, let’s hope that’s not just an excuse to be followed by another excuse when the legislative picture becomes clearer.

An open-ended, retroactive statute of limitations would, in my opinion, have a significant negative impact on many dioceses throughout the state, including the DRVC. Although the DRVC might be able to absorb the cost of such litigation, it would probably be inclined to make significant cutbacks in services as a result. I believe this happened on the West Coast where a number of states passed such legislation. (Note: Some have argued this did not happen but have not presented meaningful empirical evidence supporting this argument.)

It’s unfortunate that neither side has proposed one of several compromise approaches tried in other venues that could be fair and reasonable to all. The DRVC could have unilaterally adopted one of these compromise approaches a long time ago. It had the resources but apparently not the will; it could have seen the fairness but apparently lacked the vision. It now faces considerable uncertainty and risk as a result. On the other hand, those who advocate for a “one year window” without guidelines or limitations fail to understand the potential impact on thousands of others in need who would become the victims of cutbacks. They could have similarly advocated for one of the compromise approaches but apparently didn’t and now face considerable uncertainty themselves.

QUESTIONS RAISED BY THE RESULTS

Regardless of the outcome of pending legislation, Long Island Catholics need to ask and the DRVC needs to answer several important questions about the free cash reserves maintained by the DRVC, including the following:

1. Why doesn’t the DRVC have an effective mechanism in place to balance the growing human and parish needs in the community with its apparent tendency to

- accumulate more excess reserves? The lack of such a mechanism represents questionable stewardship in an organization that prides itself on foundational Christian principles.
2. Do guidelines exist to determine when reserves become excessive and/or when existing reserves should be spent on high priority human needs, even if this means temporarily dipping into such reserves during difficult times? Guidelines are particularly important now that market losses have eroded free cash reserves somewhat. There is a natural tendency to cut services at a time like this when such programs are needed more than ever.
 3. If reserves are “adequate”, as the Chairman of the Finance Council admitted several years ago, then why not utilize subsequent increases for high priority social and humanitarian needs?
 4. Why doesn't the DRVC publish combined financial statements to make it easier for LI Catholics to understand the true financial condition of the Diocese and its affiliates? Publishing financial statements for each legal entity (14 in total) without combining them in some fashion certainly inhibits transparency and understandability.
 5. If total free cash reserves of \$138.9 million are not enough, then **HOW MUCH IS ENOUGH?** If excess cash reserves of \$83.9 million are not enough, then **HOW MUCH IS ENOUGH?** If reserves that are several times annual operating expenses and which far exceed industry and Better Business Bureau standards, are not enough, then **HOW MUCH IS ENOUGH?**

The DRVC might argue that these questions are now academic due to the 2008 market downturn with its negative impact on DRVC reserves. I would argue that the questions are now more important than ever. If there were ever a time when the DRVC should be dipping into its reserves to maintain and even increase its humanitarian and parish support programs, now is the time. Most of the DRVC cash reserves are long-term in nature, i.e. they won't be needed for many years, if ever. Our parishioners and communities need help now, and the need is real--not like the possible, future needs “designated” by the DRVC for its cash reserves. Therefore, I encourage the DRVC to look beyond its 2008 market losses and not allow them to become an excuse to marginalize the needs of its parishioners and clients.

Please feel free to communicate any comments you have on this analysis by email to Dick Grafer at richardgrafer@aol.com. If you'd like to see a description of the methodology or any of the supporting details, please feel free to request them from me.