

Volunteer Accountants and Consultants Group

As requested by the Long Island Voice of the Faithful

Report of the Independent Third Party Review Group covering

**ANALYSIS OF DIOCESE OF ROCKVILLE CENTRE
2005 FINANCIAL STATEMENTS
PREPARED BY H. RICHARD GRAFER
AND DATED AUGUST 16, 2006**

Friday, June 1, 2007

1. BACKGROUND INFORMATION

In January of this year, members of the Long Island Voice of the Faithful (“LIVOTF”) contacted the undersigned accountants and consultants (“Volunteer Group”) to review the documentation supporting Mr. H. Richard Grafer’s (“HRG”) findings in his report entitled, “How Much Is Enough” dated, August 16, 2006, which focused on unrestricted “free” cash reserves of the Diocese of Rockville Centre (“DORC”). The DORC’s reply to Mr. Grafer’s analysis published in the Long Island Catholic, “Diocesan Reserves Explained” dated, September 6, 2006 was also test reviewed.

This report summarizes our observations and conclusions based on the scope, objectives, and review procedures as discussed below.

2. SCOPE

The scope of this review encompassed: (i) Independent testing of HRG’s supporting documentation covering his analysis of DORC’s audited financial statements for the fiscal year 2005; (ii) Review of DORC’s response to Mr. Grafer’s analysis against the audited financial statements.

3. REVIEW OBJECTIVES

The objectives of the independent testing are:

1. To determine if Mr. Grafer’s analysis and conclusions can be substantiated based on the latest available audited financial statements of the Diocese of Rockville Centre.
2. To determine Long Island Catholic’s consistency of response with the DORC’s audited financial statements.
3. To determine consistency of DORC’s response with Mr. Grafer’s analysis and conclusions.
4. To create a mutually respectful environment between the Diocese of Rockville Centre and the Long Island Voice of the Faithful members by listening to each other.
5. To provide appropriate recommendations to the LIVOTF and to DORC’s management team based on the findings of the review that may eventually lead to more resources being available to those in need in Long Island and ultimately benefit all Long Island Catholics,

most particularly the impoverished parishes, through a more constructive dialogue.

4. REVIEW PROCEDURES

- Review Mr. Grafer's report and compare it with the DORC's audited financial statements.
- Prepare a letter addressed to Bishop William Murphy of DORC requesting his assistance in generating the point by point response to Mr. Grafer's observations.
- Review DORC's response to Mr. Grafer's observations.
- Prepare observations on both Mr. Grafer's analysis and the DORC's response, considering their reasonableness.

5. KEY FINDINGS

The following observations are detailed below:

- There is no disagreement over the existence of unrestricted reserves. Mr. Grafer's analysis puts unrestricted cash and marketable securities at \$187.6 million, and the Diocese's September 6th article puts unrestricted net assets other than plant at \$187.9 million (with another \$12.5 million as unrestricted and undesignated). It is our assessment that the similarity, even though derived from two different starting points, results from the fact that the bulk of Diocesan unrestricted reserves is in cash and cash equivalents.
- On March 26, 2007 our review group sent a letter to the diocese (addressed to Most Reverend William F. Murphy, Bishop of DORC with a copy to Mr. Kevin T. Murphy, Director of Administration of DORC) outlining the issues, and our understanding of the basis on which Mr. Grafer identified unrestricted reserves as "free" cash reserves, or surplus funds. On April 9, 2007, Mr. Sean Dolan, Director of the Office of Public Information for the diocese, responded to our letter. The response was comprised of two documents that were previously published in the Long Island Catholic, namely: (i) Diocesan Reserves Explained, dated September 6, 2006; and (ii) Two pages containing

five bullet points that clarifies Catholic Charities reserves, the reserve methodology, the unreliable sources of income, the composition of finance and audit committee and its function, and concerns on LIVOTF’s public statements that may discourage Catholics’ support. In contrast, the DORC’s response has not completely resolved the six listed concerns we have raised in our letter to Bishop William F. Murphy, dated March 26, 2007.

- The article “The Diocesan Reserves Explained” dated September 6, 2006 contained quite a number of key points that explained the need for reserves. However, there were unclear details that may mislead the reader of this article. They are as follows:

UNCLEAR DETAILS	IMPLICATION(S)
Most of the reserve “designations” do not explain whether they are discretionary or consistent with past practice and experience.	Reader may interpret that most of these reserves are needed for a specific purpose.
There is no consolidated information for all the entities under the DORC.	The financial information for Catholic Health Services may not be included in the analysis. The overall picture of DORC’s financial condition could be misinterpreted.
Does not mention that DORC assets increased \$15 million in the past two years (\$5.5 million in 2005) or that free cash reserves increased \$24 million in the past three years.	Failure to mention these data may mislead the reader into thinking that DORC has a difficult operating environment.
Does not mention that the “quasi-endowment” funds are completely unrestricted and were created from the contributions of and assessments on parishioners who had a right to expect them to be used for current operations, instead of retaining as “quasi-endowment” funds.	Failure to mention this information may mislead the reader into thinking that DORC could not exist comfortably without the “quasi-endowment” funds. DORC should mention that they have the right to “tax” parishes and, therefore, could exist comfortably without the “quasi-endowment” funds.
Fails to mention that the “needs in other entities” of the DORC could be addressed directly with the non-central funds such as the use of excess insurance funds to	Showing that only \$33.3 million of “central diocesan funds” can be tapped to address the needs in other entities (e.g. parishes, schools, ministries, etc.) could be

<p>reduce future premiums paid by the parishes and ministries. This is demonstrated by tapping on the \$167.1 million of non-central funds for other purposes, e.g. \$16 million of Catholic Cemetery reserves have been tapped.</p>	<p>misleading.</p>
<p>Fails to mention that the \$64.9 million of unrestricted self-insurance reserves is over and above the amount determined as necessary by the Diocesan independent actuary and independent accountant.</p>	<p>Failure to mention this information suggests that the \$64.9 million of unrestricted self-insurance reserves is needed for “claims, deductibles, uninsurable losses, and loss prevention initiatives.</p>
<p>Fails to mention that the \$19.9 million, designated as a “quasi-endowment fund”, original restrictions on this bequest have lapsed and that it is now completely unrestricted.</p>	<p>Failure to mention this information may mislead the reader that the “quasi-endowment fund” has not been allowed to double instead of being used for the “programs in keeping with the intention of the initial bequest”.</p>
<p>Fails to mention that there is a separate \$55.2 million restricted reserve established to support perpetual care for older cemeteries and mausoleums, as required by the independent auditors other than the \$37.3 million Catholic Cemeteries reserves.</p>	<p>Failure to mention this information may mislead the reader into thinking that only \$37.3 million reserves are needed to support perpetual care for older cemeteries and mausoleums. In addition, the level of historical operating expenses does not justify an additional reserve of this much.</p>
<p>DORC indicated that it will continue to carryout its “mission within the framework of transparent and open financial disclosure”. However, it does not say how the Diocese has met this test of “transparent and open disclosure”.</p>	<p>Failure to issue an audited DORC’s consolidated financial statements may mislead the readers in thinking that all these reserves are needed to exist.</p>

6. CONCLUSIONS

- Mr. Grafer's analysis and report on fiscal 2005 financial statements of the Diocese of Rockville Centre resulting in his finding that existence of "free" cash reserves (or surplus funds) is supportable, and his conclusions are reasonable. We base this determination on the broad discretion the diocese exercises in designating surplus funds as reserves. For example,
 1. The designation is redundant due to the existence of actual liabilities or other reserves for the same purpose.
 2. The reserve has been designated as a "quasi-endowment fund" to produce income to support operations even though it was not donated for that purpose.
 3. Past practices of the diocese suggest that the reserve will not be used for the purpose designated.
 4. Other facts (e.g. historical operating expenses) suggest that the reserve won't be needed for the purpose designated.
 5. The description of the designation is too vague or subjective as to suggest that the reserve, though designated may be excessive.

The Diocese of Rockville Centre appears to have no clear specific and measurable policy regarding the designation of these surplus funds. We recognize that programs that are subsidized by third parties and government agencies may require a more diligent management of financial exposure. Nevertheless, we believe that despite these concerns, free cash reserves continue to grow. Prudent management of these reserves suggests that a much too conservative approach is being taken to the detriment of the needy parishes of the Diocese. As a result, given the lack of a plan, the diocese gradually continues to accumulate additional reserves, whereas a basis for this increasing accumulation can not be justified.

7. RECOMMENDATION

Based on available information and observations, we recommend that the LIVOTF help and support the DORC as well as encourage management of the DORC to adopt a defined plan to better manage unrestricted cash reserves in line with prudent utilization of parishioners' funding of the various Diocesan programs.

Good communication line and listening skills between LIVOTF and DORC could be strengthened to resolve the prevailing issues.

8. USE OF THIS REPORT

This report has been prepared by volunteer accountants and consultants (“VAC”) at the request of Long Island Voice of Faithful’s Finance Committee (“LIVOTF-FC”) members. The report is the property of the VAC and is furnished to LIVOTF-FC and DORC in the hope that it will help LIVOTF and DORC address the issue of free cash reserves in a constructive and collaborative manner.

This report should not be construed to imply a lack of integrity or a lack of good faith by any party and should not be used for that purpose.

In making this review, it should be kept in mind that a review is not the same as an audit, and that this report should not be considered to be an audit report.

Sincerely,

Joseph Finora

Carlos C. Gutierrez

Joseph Claude Harris

Ronald S. Jendras

Distribution: Most Rev. William F. Murphy, Bishop of Rockville Centre
Long Island Voice of the Faithful-Finance Committee

Information: Mr. H. Richard Grafer