**Narrative Accompaniment to Archdiocesan Office for Financial Services Audited Financial Statements for Fiscal Year Ended June 30, 2013**

This narrative is intended to be used in connection with a review of the Archdiocese of Philadelphia – Office for Financial Services ("OFS") financial statements in order to provide a reader a more general understanding of the financial situation of OFS.

OFS provides programs and administrative support to the parishes, schools and other related ecclesiastical entities of the Archdiocese. While OFS provides services to multiple entities, for financial reporting purposes, it is considered a wholly-owned subsidiary of the Archdiocese.

A description of the offices and funds that are included in the OFS financial statements can be found in Note A in the audited financial statements for OFS which are available on CatholicPhilly.com.

*Please note that the OFS financial statements do not include financial results for the Office for Catholic Education, Catholic Healthcare Services, Catholic Social Services, Saint Charles Borromeo Seminary, Catholic Charities Appeal or the Heritage of Faith-Vision of Hope Capital Campaign. Audited financial statements for those entities will be posted in the coming weeks.*

*Also note that none of these reports will include financial statements for parishes – and for good reason. All parishes are independent and autonomous entities.*

***Comparison of FY 2013 to FY 2012***

The analysis presented below compares the "Change in Net Assets Before Other Items" for fiscal year 2013 and 2012. The "as reported" surplus of $3.9 million in FY 2013 compares to an "as reported" deficit of $39.2 million in FY 2012. These amounts can be found in the Statements of Activities and Changes in Net Assets under the caption "Change in Net Assets Before Other Items" in the "Unrestricted" column. We believe that the analysis presented below provides a meaningful comparison of each fiscal year after adjusting for the impact of items that are non-recurring in nature.

| **(in millions)** | FY 2013 | FY 2012 |
|---|---|---|
| Change in net assets before other items | $ 3.9 | ($39.2) |
| Non-Recurring Credits | | |
| A Net gain on sale of real estate assets | (10.3) | (15.8) |
| B Gain from Ventnor sale released from restrictions | (2.7) | – |
| C Contribution from Cemeteries Office | (2.0) | (2.0) |
| Fidelity Insurance Recovery | (.7) | – |
| Investment Gains | (.5) | – |
| Non-Recurring Charges | | |
| Increase in Self-Insurance Reserve | – | 13.0 |
| Interest Rate Swap Loss | – | 8.9 |
| Investment Losses | – | 1.8 |
| Increase in Reserve for Loans | 1.9 | – |
| D One Time Pledges/Subsidies | 2.9 | – |
| E Legal and Professional Fees | 1.1 | 11.9 |
| Recurring deficit including depreciation expense | $ (6.4) | $ (21.4) |
| Depreciation expense | 1.5 | 3.8 |
| Recurring deficit excluding depreciation expense | $ (4.9) | $ (17.6) |

***The explanations for the items noted* A *through* E *are included at the end of this narrative.***

The recurring deficit excluding depreciation expense of $4.9 million incurred in FY 2013 compares favorably to the $17.6 million experienced in FY 2012. These amounts represent what has previously been referred to as our "core" (excludes items of a non-recurring nature and depreciation) run rate deficit. You will recall that we took significant steps in June 2012 to begin reducing the core deficit. The actions implemented did have the effect of reducing the deficit to a level in line with our previously disclosed expectations. We expect the core operating deficit for FY 2014 to be below $5 million.

***Discussion of Other Significant Matters***

In connection with the disclosure of our FY 2012 financial statements we provided specific commentary regarding several significant underfunded balance sheet obligations.

Those obligations included the following:

- Trust and Loan Fund
- Insurance Fund
- Lay Employees' Retirement Plan
- Priests' Pension Plan

Please find a more current update for each of these matters below.

**Trust and Loan Fund**

Included in the financial statements for the Office for Financial Services are all assets and liabilities of the Archdiocesan Trust and Loan Fund. The Trust and Loan Fund is a cooperative deposit and loan program established for the benefit of parishes and to assure continuation of the ecclesial goals of the Archdiocese and the parishes. If a parish deposits funds in the Trust and Loan Fund, it receives a competitive interest rate. In turn, these funds are loaned by the Fund to other parishes for construction and other projects. As of May 31, 2012, the Archdiocese executed a promissory note to the Trust and Loan Fund in the amount of $78.9 million, which represented the excess of deposits over assets at May 31, 2012. As of June 30, 2012, deposits in the Trust and Loan Fund exceeded fund assets – *excluding the impact of the promissory note* – by $82.0 million.

Subsequent to June 30, 2012 the promissory note has been amended to increase the principal amount to $82.0 million. The promissory note is collateralized by specific pledged real estate assets which are documented in the note. As pledged properties are sold or monetized, net proceeds from these Trust and Loan collateral transactions will be deposited into the Trust and Loan Fund, in accordance with the provisions of the promissory note. In the event a transaction generates in excess of $20 million in net proceeds, the Archdiocese has discretion regarding alternative uses for the excess so long as remaining pledged assets are at least equal to the then outstanding principal amount owed.

As of June 30, 2013 the unfunded obligation in the Trust and Loan Fund was improved slightly over FY 2012's $82 million as noted below:

| | **(in millions)** |
|---|---|
| Deposits | $ 172.6 * |
| T&L Fund Assets (*excl. promissory note & related party receivable* ) | 92.8 |
| Excess of Deposits Over Assets | $ 79.8 |

* includes approximately $300K in Trust and Loan Fund Liabilities.

**Insurance Fund**

The insurance fund is used to account for the risk management program of the Archdiocese. As part of the risk insurance program, levels of self-insurance risk are retained. As of June 30, 2013 insurance related liabilities exceeded dedicated insurance assets, as follows:

| | (in millions) |
|---|---|
| Insurance Related Liabilities | $ 47.6 |
| Insurance Related Assets (*excl. prepaid expenses*) | 17.2 |
| Excess of liabilities over assets | $ 30.4 |

**Lay Employees' Retirement Plan**

The Lay Employees' Retirement Plan is considered a multiemployer plan for financial reporting purposes. As such, the assets and actuarially determined liabilities for these plans are not included in the OFS financial statements.

While not a direct liability of OFS the amount by which the plan liability exceeds plan assets is a liability of the Archdiocese. As of June 30, 2013 the liabilities of the Lay Employees' Retirement Plan exceeded plan assets by $142 million.

On November 5, 2013 the Archdiocese announced that it would freeze the Lay Employees' Retirement Plan effective June 30, 2014.

**Priests' Pension Plan**

The Priests' Pension Plan is also considered a multiemployer plan for financial reporting purposes. As such, the assets and actuarially determined liabilities for this plan are not included in the OFS financial statements.

While not a direct liability of OFS, the amount the plan liability exceeds plan assets in the Priests' Plan is a liability of the Archdiocese. As of June 30, 2013 it is estimated that the Priests' Plan liabilities exceeded plan assets by approximately $92 million.

**Looking Forward**

The core operating deficit for FY 2013 of $4.9 million was greatly improved relative to FY 2012's deficit of $17.6 million. We expect that FY 2014 will show further improvement. We continue to acknowledge that the core deficit needs to be eliminated completely in the very near future.

We remain focused on the balance sheet issues noted above. As previously announced the Lay Employees' Retirement Plan will be frozen effective June 30, 2014. We will continue to fund the shortfall for that plan into the future and project that the plan will be fully funded in 20-30 years. A new, defined contribution plan for eligible employees will be established effective July 1, 2014.

We hope to close on the previously announced cemeteries transaction sometime early in 2014. We plan to use $30 million from the roughly $53 million expected at closing for that transaction for the Trust and Loan Fund shortfall and the balance will be split evenly between the Insurance Fund and the Priests' Pension fund.

One additional update concerns the Archdiocesan property designated as the North Parking Lot of the Archdiocesan Pastoral Center. It had been previously disclosed that this parcel, which includes the Holy Family Center office building and extends the length of Vine Street from 17th Street to 18th Street, was being marketed for sale. Since we were not able to conclude a satisfactory transaction, it has been decided to take this property off of the market for the time being.

At the present time we do not have any more information on other potential transactions we are considering, including the nursing homes. If and when we complete additional transactions we will provide timely updates so that we clearly communicate to the faithful of the Archdiocese how we intend to apply proceeds from transactions to the balance sheet issues disclosed.

Explanations for items noted in analysis

**A** In FY 2013 the amount represents the gain on the sale of the Archbishop's residence; in FY 2012 the amount includes gains on the sales of the Northeast Catholic and Cardinal Dougherty High School properties.

**B** The gain on the sale of the property known as "Villa St. Joseph by the Sea" in Ventnor, New Jersey was approximately $4.2 million. This amount was accounted for as a "Temporarily Restricted" gain and is reflected as such on the Statement of Activities and Changes in Net Assets for the year ended June 30, 2013. The proceeds from the sale are to be used for the benefit of Villa St. Joseph in Darby, Pennsylvania, a residence for retired Archdiocesan priests. Approximately $2.7 million of the gain was used for that purpose in FY 2013.

**C** The $2.0 million annual contribution from the Cemeteries Office will cease after FY 2013.

**D** The $2.9 million includes: $1.5 million of transitional support - $750K in FY 2014 and $750K in FY 2015 – committed to the Independence Mission Schools, a non-profit organization managing 14 Catholic elementary schools; $1.0 million pledged to the World Meeting of Families event to be held in September 2015; and $370K representing the outstanding commitment to the St. Martin de Porres Catholic elementary school.

**E** In fiscal year 2013 the $1.1 million in legal and professional fees is comprised of the following:

| | **(in millions)** |
|---|---|
| Financial and legal costs incurred in connection with potential transactions | $ .5 |
| Fees incurred for supplemental finance office staffing | .3 |
| FY 2012 financial audit over-run costs | .3 |
| | $ 1.1 |

In fiscal year 2012 the $11.9 million in legal and professional fees is comprised of the following:

| | **(in millions)** |
|---|---|
| Investigation of actions by former CFO | $ .5 |
| Investigations related to Priests on Administrative Leave | 4.7 |
| Fees associated with Independent Legal and Financial Assistance/Review; External Debt Retirement; and Criminal Trial | 6.7 |
| | $11.9 |