



Keegan, Linscott & Kenon, PC

Certified Public Accountants

Certified Fraud Examiners

Certified Insolvency & Restructuring Advisors

THE ROMAN CATHOLIC CHURCH
DIOCESE OF TUCSON, A CORPORATION SOLE

FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2009
(WITH SUMMARIZED COMPARATIVE TOTALS FOR THE YEAR
ENDED JUNE 30, 2008)

RSM McGladrey Network

An Independently Owned Member

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INDEPENDENT AUDITORS' REPORT

Board of Directors
The Roman Catholic Church Diocese of Tucson, A Corporation Sole
Tucson, Arizona

We have audited the accompanying balance sheets of The Roman Catholic Church Diocese of Tucson, A Corporation Sole, (the "Organization") as of June 30, 2009 and 2008, and the related statement of operations and changes in net assets (deficits) for the year ended June 30, 2009, and the related statements of cash flows for the years ended June 30, 2009 and 2008. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year's summarized comparative information has been derived from the Organization's June 30, 2008 financial statements and, in our report dated September 8, 2008, we expressed an unqualified opinion on those financial statements.

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 audits 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 Organization as of June 30, 2009 and 2008, and the results of its cash flows for the years then ended, and results of its operations and changes in net assets (deficits) for the year ended June 30, 2009, in conformity with accounting principles generally accepted in the United States of America.

Keegan, Linscott & Kenon, P.C.

Tucson, Arizona
September 22, 2009

KEEGAN, LINSOTT & KENON, PC IS A MEMBER OF RSM MCGGLADREY, INC.

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BALANCE SHEETS
AS OF JUNE 30,

	<u>2009</u>	<u>2008</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,183,392	\$ 2,294,821
Assets limited as to use (insurance reserve)	1,340,016	984,729
Accounts receivable, net of allowance of \$166,303 and \$106,303 in 2009 and 2008, respectively	295,392	155,088
Notes receivable, current	45,123	284,010
Other receivables	150,797	214,777
Investments	5,268,424	6,049,890
Prepaid expenses and other assets	6,389	1,277
Custodial funds held for others	<u>400,537</u>	<u>430,277</u>
Total current assets	9,690,070	10,414,869
Other assets	80,850	80,850
Notes receivable	90,536	855,660
Land, buildings and equipment, net	<u>3,348,590</u>	<u>607,415</u>
Total assets	<u>\$ 13,210,046</u>	<u>\$ 11,958,794</u>
Liabilities and Net Assets		
Liabilities		
Current liabilities:		
Accounts payable	\$ 87,822	\$ 173,550
Accrued expenses	400,556	791,342
Custodial funds held for others	400,537	430,277
Notes payable, current	<u>578,393</u>	<u>591,935</u>
Total current liabilities	1,467,308	1,987,104
Notes payable	4,214,480	4,788,678
Insurance reserve	<u>1,340,016</u>	<u>984,729</u>
Total liabilities	<u>7,021,804</u>	<u>7,760,511</u>
Net Assets		
Unrestricted net assets (deficit)	2,370,833	(157,456)
Temporarily restricted net assets	1,648,588	2,227,913
Permanently restricted net assets	<u>2,168,821</u>	<u>2,127,826</u>
	<u>6,188,242</u>	<u>4,198,283</u>
Total liabilities and net assets	<u>\$ 13,210,046</u>	<u>\$ 11,958,794</u>

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT)
FOR THE YEARS ENDED JUNE 30,

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2009	Summarized Total 2008
Revenues and Support:					
Annual Catholic Appeal Grant	\$ 2,000,000	\$ -	\$ -	\$ 2,000,000	\$ 2,000,000
Chancery assessment	1,783,300	-	-	1,783,300	1,712,626
Contributions, grants, and bequests	879,805	187,705	40,995	1,108,505	1,719,516
Advertising revenue	98,667	-	-	98,667	119,644
Fees for service	346,241	-	-	346,241	376,812
Insurance billings	783,539	-	-	783,539	912,904
Facilities rentals	50,815	-	-	50,815	49,139
Program fees	206,500	-	-	206,500	209,017
Investment income, net	191,825	13,161	-	204,986	394,051
Other revenues	9,651	-	-	9,651	6,394
Net assets released from restriction	780,191	(780,191)	-	-	-
Total revenues and support	<u>7,130,534</u>	<u>(579,325)</u>	<u>40,995</u>	<u>6,592,204</u>	<u>7,500,103</u>
Expenses and Losses:					
Program Services:					
Vocations, seminarians and other religious personnel	484,325	-	-	484,325	379,779
Vicar for Women Religious	19,866	-	-	19,866	18,022
Pastoral parish programs	338,551	-	-	338,551	388,738
Catholic schools administration	321,523	-	-	321,523	244,419
Parish assistance	827,647	-	-	827,647	598,799
Catholic social missions	61,706	-	-	61,706	63,857
Archives	64,364	-	-	64,364	90,459
Supporting Services:					
Offices of the Bishop, Vicar General, Chancellor & Marriage Tribunal	597,287	-	-	597,287	754,442
Office of child, adolescent, & adult protection	163,894	-	-	163,894	163,544
General administration	735,912	-	-	735,912	595,841
Fiscal and employee services	771,266	-	-	771,266	675,898
Catholic Vision and community relations	301,632	-	-	301,632	285,390
Property management	335,258	-	-	335,258	320,021
Insurance	817,544	-	-	817,544	905,576
Interest expense, net	163,915	-	-	163,915	179,069
Depreciation	67,502	-	-	67,502	46,171
Bad debt expense	320,783	-	-	320,783	69,038
(Gain) Loss on sale of fixed assets	(730)	-	-	(730)	135
Total expenses and losses	<u>6,392,245</u>	<u>-</u>	<u>-</u>	<u>6,392,245</u>	<u>5,779,198</u>
Change in Net Assets (Deficit) before extinguishment of note receivable	738,289	(579,325)	40,995	199,959	1,720,905
Gain on extinguishment of note receivable	1,790,000	-	-	1,790,000	-
Change in Net Assets (Deficit)	2,528,289	(579,325)	40,995	1,989,959	1,720,905
Net Assets (Deficit) - Beginning of Year	(157,456)	2,227,913	2,127,826	4,198,283	2,477,378
Net Assets (Deficit) - End of Year	<u>\$ 2,370,833</u>	<u>\$ 1,648,588</u>	<u>\$ 2,168,821</u>	<u>\$ 6,188,242</u>	<u>\$ 4,198,283</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30,

	2009	2008
Change in Net Assets	\$ 1,989,959	\$ 1,720,905
Adjustments to Reconcile Change in Net Assets to Net Cash (used in) Provided by Operating Activities:		
Depreciation	67,502	46,171
Increase in allowance for accounts receivable	60,000	60,000
Net realized and unrealized gain on investments	151,525	30,886
Gain on extinguishment of note receivable	(1,790,000)	-
Forgiveness of notes payable	(30,000)	(460,000)
Changes in operating assets and liabilities:		
Increase in assets limited as to use	(355,287)	(375,973)
Decrease (increase) in accounts receivable	(200,304)	73,685
Decrease (increase) in other receivables	63,980	(16,178)
Increase in prepaids and other assets	(5,112)	(724)
Increase (decrease) in accounts payable	(85,728)	28,821
Increase (decrease) in accrued expenses	(390,786)	13,803
Increase in insurance reserve	355,287	375,973
Net cash (used in) provided by operating activities	(168,964)	1,497,369
Cash Flows from Investing Activities:		
Purchases of land, buildings and equipment	(58,677)	(474,943)
Proceeds received for repayment of notes receivable	44,011	282,925
Sale of investments, net of purchases	629,941	749,920
Net cash provided by investing activities	615,275	557,902
Cash Flows from Financing Activities:		
Repayment of notes payable	(557,740)	(542,585)
Payment of settlement of tort claims	-	(100,000)
Net cash used in financing activities	(557,740)	(642,585)
Net (decrease) increase in cash and cash equivalents	(111,429)	1,412,686
Cash and cash equivalents at beginning of year	2,294,821	882,135
Cash and cash equivalents at end of year	\$ 2,183,392	\$ 2,294,821
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for interest	\$ 163,915	\$ 179,069
Non-Cash Activities:		
Forgiveness of notes payable	\$ 30,000	\$ 460,000
Net asset increase associated with extinguishment of note receivable	\$ 1,790,000	\$ -

NOTES TO FINANCIAL STATEMENTS

1. Organization

The Roman Catholic Church Diocese of Tucson, A Corporation Sole (the “Diocese of Tucson”, the “Diocese” or the “Organization”) is a hierarchical religious organization governed by the Code of Canon Law of the Roman Catholic Church. Each office of the Diocese of Tucson performs specific functions in support of the Bishop’s pastoral ministries and in support of the parishes and schools in the territory of the Diocese of Tucson. The offices include:

Office of the Bishop	Tribunal
Chancellor’s Office	Formation
Vocations	Catechesis
Human Resources	Evangelization
Fiscal Services	Catholic Schools
Property and Insurance Services	Catholic Social Mission
Communications	

2. Significant Accounting Policies

Basis of Presentation

The financial statements of the Diocese of Tucson have been prepared on the accrual basis of accounting in accordance with the standards of accounting and financial reporting as promulgated by the American Institute of Certified Public Accountants for Non-Profit Organizations.

The Diocese of Tucson presents its financial statements in accordance with the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 117, *Financial Statements of Not-for-Profit Organizations*. SFAS No. 117 establishes standards for external financial reporting by not-for-profit organizations. Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets that have similar characteristics have been combined into similar categories as follows:

- **Permanently Restricted** – Net assets that are subject to donor-imposed stipulations such that assets must be maintained permanently by the Organization. The donors of these assets permit the Organization to use all of the investment return of these assets in support of the Diocese’s ministries and mission.
- **Temporarily Restricted** – Net assets whose use by the Organization is subject to donor-imposed stipulations that can be fulfilled by actions of the Organization pursuant to those stipulations or that expire through the passage of time. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted support. However, if a restriction is fulfilled in the same time period in which the contribution is received, the Diocese of Tucson reports the support as unrestricted.
- **Unrestricted** – Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor.

NOTES TO FINANCIAL STATEMENTS

Significant Accounting Policies (continued)

Endowment Funds

The Organization's interpretation of the law that underlies the Organization's net asset classification of donor-restricted endowment funds as requiring the preservation of the fair value of the original gift. As a result of this interpretation, the Organization classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by the law.

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by the endowment funds. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity or for donor-specified periods. Under this policy, as approved by the Bishop and the Diocesan Finance Council, the endowment assets are invested in a balanced portfolio comprised of cash, certificates of deposit, fixed income securities, and equities. To satisfy its long-term objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends) while assuming a moderate level of investment risk. The Organization targets a diversified asset allocation that places more emphasis on fixed income securities than equity securities to achieve its long-term return objectives within prudent risk constraints. The Organization expects its endowment funds, over time, to provide an average rate of return of approximately 6.5 percent annually. Actual returns in any given year may vary from that amount.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or current law requires the Organization to retain for a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature that are reported in unrestricted net assets were \$65,932 as of June 30, 2009. These deficiencies resulted from unfavorable market fluctuations. There were no such deficiencies as of June 30, 2008.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all cash balances and highly liquid investments with an original maturity of three months or less. Cash and cash equivalents include short-term certificates of deposit and money market accounts which are stated at market value, which approximates cost.

The Organization places its cash and cash equivalents with high credit quality institutions. At times, such amounts may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

NOTES TO FINANCIAL STATEMENTS

Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable consist principally of uncollateralized amounts due from parishes and schools in the territory of the Diocese of Tucson. Management determines the allowance for doubtful accounts on a specific identification basis. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Investments

Investments are accounted for in accordance with SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Investments in equity and debt securities are valued at their fair values in the accompanying balance sheet. Investment income, gains and losses are reported in the statement of operations and changes in net assets as increases or decreases in net assets. Gains and investment income limited to specific uses by donor-imposed restrictions are reported as increases in unrestricted net assets if the restrictions are met in the same reporting period as the gains and income are recognized. Donated investments are recorded at fair value at the date of donation.

The Organization invests in professionally managed portfolios that contain equity and fixed income securities. Such investments are exposed to various risks such as market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the financial statements.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. The Organization employs a systematic methodology on an annual basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, and our intent and ability to hold the investment. The Organization also considers specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, operational and financing cash flow factors, and rating agency actions. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established.

Land, Buildings and Equipment, Net

Land, buildings and equipment are stated at cost if purchased, or fair value, if donated. Depreciation and amortization are calculated using the straight line basis over the estimated useful lives of the related assets, which range from 3 to 40 years.

Acquisitions of land, buildings and equipment and repairs or betterments that materially prolong the useful lives of assets in excess of \$5,000 are capitalized. Repairs and maintenance for normal upkeep are charged to expense as incurred.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Organization periodically reviews the carrying value of long-lived assets held and used, and assets to be disposed of, for possible impairment when events and circumstances warrant such a review.

NOTES TO FINANCIAL STATEMENTS

Significant Accounting Policies (continued)

Donated Property and Equipment

Donations of property and equipment are recorded at their estimated fair value at the date of donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. The Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service or as instructed by the donor. The Organization reclassifies temporarily restricted net assets to unrestricted net assets at the time the assets are placed in service.

Custodial Funds Held for Others

Custodial funds held for others represent amounts held by the Diocese that are earmarked to be distributed to specific parishes and/or other related Catholic entities. These funds are reported as assets and liabilities in the accompanying balance sheets.

Income Taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and is also exempt from state income taxes. Accordingly, no provision is made for income taxes in the accompanying financial statements. Management is not aware of any matters which would cause the Organization to lose its tax-exempt status.

Prior Year Information

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended June 30, 2008, from which the summarized information was derived.

3. New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return including positions that the organization is exempt from income taxes or not subject to income taxes on unrelated business income. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Organization's policy is to disclose or recognize income tax positions based on management's estimate of whether it is reasonably possible or probable, respectively, that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*.

The Organization has elected to defer the application of Interpretation 48 in accordance with FASB Staff Position ("FSP") FIN 48-3. This FSP defers the effective date of Interpretation 48 for nonpublic enterprises included within its scope to the annual financial statements for fiscal years beginning after December 15, 2008. The Organization will be required to adopt FIN 48 in its fiscal year 2010 annual financial statements. The provisions of FIN 48 are to be applied to all tax positions upon initial application of this standard.

NOTES TO FINANCIAL STATEMENTS

New Accounting Pronouncements (continued)

Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. The adoption of FIN 48 is not expected to have a material impact on the Organization's financial statements.

However, the Organization's conclusions regarding FIN 48 may be subject to review and adjustment at a later date based on on-going analyses of tax laws, regulations, and interpretations thereof and other factors.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* ("FSP 157-2"), which permits a one-year deferral for the implementation of SFAS No. 157 with regard to non-financial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Organization adopted SFAS No. 157 for the fiscal year beginning July 1, 2008, except for non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value in the financial statements on a nonrecurring basis for which delayed application is permitted until the fiscal year beginning July 1, 2009. The adoption of the remaining provisions of SFAS No. 157 is not expected to have material impact on the Organization's financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items will be required to be reported in earnings in the current period. SFAS No. 159 also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. During fiscal year 2009, the Organization reviewed items eligible for fair value adoption per SFAS No. 159 and has elected not to adopt the SFAS No. 159 option.

In July 2006 the National Conference of Commissioners on Uniform State Laws approved the Uniform Prudent Management of Institutional Funds Act of 2006 (the "UPMIFA"). This Act is a modernized version of the Uniform Management of Institutional Funds Act of 1972 ("UMIFA"), the model act on which most states have based their laws governing the investment and management of donor-restricted endowment funds by not-for-profit organizations. The UPMIFA shifts its focus from the prudent spending of the net appreciation of the fund to the entirety of a donor-restricted endowment fund. The UPMIFA eliminates UMIFA's historic-dollar-value threshold, an amount below which an organization could not spend from the fund, in favor of a more robust set of guidelines about what constitutes prudent spending, explicitly requiring consideration of the duration and preservation of the fund. To provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the UPMIFA (Arizona adopted UPMIFA in 2008), the FASB has issued FSP No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* ("FSP 117-1"). The FSP requires a not-for-profit organization that is subject to an enacted version of the UPMIFA to classify a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets. The amount classified as permanently restricted is the amount of the fund (a) that must be retained

NOTES TO FINANCIAL STATEMENTS

New Accounting Pronouncements (continued)

permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization's governing board determines must be retained permanently under the relevant law. FSP 117-1 also requires improved disclosures about an organization's endowment (both donor-restricted and board-designated funds) and whether or not the organization is subject to the UPMIFA. The FSP requires a not-for-profit organization to disclose information to enable financial statement users to understand the net asset classification, net asset composition, changes in net asset composition, spending policies, and related investment policies of its endowment funds (both donor-restricted and board-designated). The provisions of FSP 117-1 are effective for fiscal years ending after December 15, 2008. The Organization adopted FSP 117-1 for the fiscal year beginning July 1, 2008.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ("SFAS No. 165"), which codifies the guidance regarding the disclosure of events occurring subsequent to the balance sheet date. SFAS No. 165 does not change the definition of a subsequent event (i.e., an event or transaction that occurs after the balance sheet date but before the financial statements are issued) but requires disclosure of the date through which subsequent events were evaluated when determining whether adjustment to or disclosure in the financial statements is required. SFAS No. 165 is effective for interim or annual periods ending after June 15, 2009. The Organization evaluated subsequent events through September 22, 2009, which represents the date the financial statements were available to be issued.

4. Fair Value Measurements

Effective July 1, 2008, the Organization adopted FASB Statement No. 157, *Fair Value Measurements* ("SFAS 157") for financial assets and liabilities measured at fair value on a recurring basis. This statement provides a definition of fair value which focuses on an exit price rather than an entry price, establishes a framework for measuring fair value which emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and requires expanded disclosure about fair value measurements. In accordance with SFAS 157, the Organization may use valuation techniques consistent with the market, income, and cost approach to measure fair value. The adoption of SFAS 157 did not have a material impact on the Organization's balance sheet or results of operations on the effective date.

To increase consistency and comparability in fair value measurements and related disclosures, the Organization utilizes the fair value hierarchy required by SFAS 157 which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1	Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Organization has the ability to access at the measurement date;
Level 2	Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.
Level 3	Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurement (continued)

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Organization in determining fair value is greatest for instruments categorized in level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Organization's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Organization uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3.

The Organization defines active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalization for the instrument. The Organization defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

During 2009, the Organization's financial assets are generally classified within level 1 or level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include most U.S. government and sovereign obligations, investment-grade corporate bonds, and active listed equities. Such instruments are generally classified within level 1 of the fair value hierarchy. The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most government agency securities, corporate bonds, certain mortgage products, less liquid listed equities, state, municipal and provincial obligations and certain certificates of deposit. Such instruments are generally classified within level 2 of the fair value hierarchy.

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurement (continued)

The following table represents the Organization's financial assets and liabilities that are measured at fair value on a recurring basis at June 30, 2009, consistent with the fair value hierarchy provisions of SFAS No. 157:

Description	6/30/2009	Fair Value Measurements at June 30, 2009 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 3,053,568	\$ 3,053,568	\$ -	\$ -
Certificates of deposit	2,818,473	-	2,818,473	-
Corporate bonds	2,081,810	2,081,810	-	-
Government bonds	768,247	-	768,247	-
Common stocks	451,256	451,256	-	-
Other investments	19,015	-	19,015	-
Total	<u>\$ 9,192,369</u>	<u>\$ 5,586,634</u>	<u>\$ 3,605,735</u>	<u>\$ -</u>

Reconciliation of fair value hierarchy to balance sheet as of June 30, 2009 is as follows:

Assets	6/30/2009
Cash and cash equivalents	\$ 2,183,392
Investments	5,268,424
Custodial funds held for others	400,537
Assets limited as to use	1,340,016
	<u>\$ 9,192,369</u>

5. Investments

Investments consist of the following as of June 30:

	2009	2008
Restricted Investment Pool - Catholic Foundation	\$ 288,525	\$ 320,321
Certificates of Deposit	1,930,980	2,280,784
Corporate Bonds	2,001,436	2,208,181
Government Bonds	751,063	794,781
Common Stocks and Options	296,420	445,823
	<u>\$ 5,268,424</u>	<u>\$ 6,049,890</u>

Included in investment income, net:

	2009	2008
Investment income	\$ 356,511	\$ 424,937
Realized loss, net	(114,163)	(121,939)
Unrealized (loss) gain, net	(37,362)	91,053
	<u>\$ 204,986</u>	<u>\$ 394,051</u>

NOTES TO FINANCIAL STATEMENTS

6. Assets Limited as to Use

Pursuant to a liability insurance program, which the Diocese along with Parishes and other Catholic organizations are members, have established a risk retention insurance layer as specified in the respective insurance policies (refer to Note 14). The Diocese, as the insurance program manager, assesses a proportionate share to the various parishes and other participating Catholic organizations to fund this risk retention insurance layer. These amounts are therefore reported as assets limited as to use and insurance reserve liability in the accompanying financial statements and are available to fund any future claims that might arise pertaining to any insurance program member.

Assets limited as to use consist of the following as of June 30:

	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	\$ 471,523	\$ 984,729
Certificates of Deposit	868,493	-
	<u>\$ 1,340,016</u>	<u>\$ 984,729</u>

7. Notes Receivable

Notes receivable consist of the following as of June 30:

	<u>2009</u>	<u>2008</u>
Note receivable, collateralized by a deed of trust on certain property, was renegotiated in January 2007. Original terms included interest payments due quarterly at 3% and principal due in full on December 1, 2006. Renegotiated terms include interest payments due quarterly at 5.5% and equal annual principal payments of \$240,000, maturing December 2011. Debtor defaulted on the note receivable in December 2008 and the property that was collateralized was received by the Organization as full satisfaction of the note receivable balance.	\$ -	\$ 960,000
Note receivable, \$4,000 monthly principal and interest payments, was renegotiated in July 2007. Original terms included interest payments at the "parish rate" plus 1.5% (6.19% at June 30, 2007) until paid in full. Renegotiated terms include interest payments at the fixed rate of 2.5% until paid in full.	<u>135,659</u>	<u>179,670</u>
	135,659	1,139,670
Current portion	<u>(45,123)</u>	<u>(284,010)</u>
Notes receivable, noncurrent portion	<u>\$ 90,536</u>	<u>\$ 855,660</u>

NOTES TO FINANCIAL STATEMENTS

Notes Receivable (continued)

In June 2004, St. Augustine Catholic High School (“St. Augustine”) purchased the Regina Cleri Center (the “Property”) from the Diocese for \$3.0 million. St Augustine paid \$600,000 in cash and executed a promissory note to the Diocese in the amount of \$2.4 million. The note was secured by a first priority deed of trust on the Property. In February 2009, due to financial challenges resulting from limited enrollment, St. Augustine defaulted on the note and conveyed title to the Property back to the Diocese in full satisfaction of the note. The Diocese recorded the Property at its estimated fair value of \$2.75 million. The note receivable had a carrying amount of \$960,000 which was written off at the time of conveyance, resulting in a \$1,790,000 gain, which is shown as a gain on extinguishment of note receivable in the accompanying statement of operations and changes in net assets.

As part of the agreement, St. Augustine will lease (rent free) from the Diocese a portion of the Property from the date of the conveyance through June 2023. In addition, the Diocese will pay the costs of casualty and liability insurance associated with the operation of the school and commencing in 2009-2010, the Diocese will provide an annual cash subsidy in an amount not to exceed \$250,000 in any school year. The total of the cash subsidies will not exceed \$500,000 in the aggregate.

8. Land, Buildings and Equipment

Land, buildings and equipment consist of the following as of June 30:

	2009	2008
Land	\$ 7,200	\$ 7,200
Buildings and improvements	140,841	140,841
Property	2,750,000	-
Furniture and equipment	206,518	195,386
Vehicles	80,945	62,795
Leasehold improvements	414,846	-
	3,600,350	406,222
Less - accumulated depreciation	(251,760)	(189,238)
	3,348,590	216,984
Construction in progress	-	390,431
	<u>\$ 3,348,590</u>	<u>\$ 607,415</u>

NOTES TO FINANCIAL STATEMENTS

9. Long-Term Debt

Long-term debt as of June 30, is summarized as follows:

	<u>2009</u>	<u>2008</u>
Unsecured note payable, due in monthly installments of \$44,738, including interest of 2.5% through September 2015.	\$ 3,103,287	\$ 3,556,167
Unsecured note payable, due in monthly installments of \$15,400, including interest of 4.5% through September 2012, at which time all remaining principal will become due.	1,629,006	1,737,829
Unsecured non-interest bearing demand notes	-	30,000
Other	<u>60,580</u>	<u>56,617</u>
Total	4,792,873	5,380,613
Less current portion of long-term debt	<u>(578,393)</u>	<u>(591,935)</u>
Long-term debt	<u><u>\$ 4,214,480</u></u>	<u><u>\$ 4,788,678</u></u>

The scheduled maturities of long-term debt at June 30, 2009 are as follows:

<u>Year</u>	<u>Total</u>
2010	\$ 578,393
2011	595,370
2012	612,885
2013	1,832,908
2014	513,377
Thereafter	<u>659,940</u>
Total	<u><u>\$ 4,792,873</u></u>

10. Letter of Credit

The Diocese of Tucson has entered into an agreement with a financial institution for a \$300,000 letter of credit, collateralized by certificates of deposits, issued in favor of the Industrial Commission of Arizona pursuant to its workers compensation self-insurance program (see Note 14). No amounts were outstanding as of June 30, 2009 and 2008.

11. Retirement Plans

Lay Employees Pension Plan

The Diocese of Tucson participates in a non-contributory multi-employer defined benefit pension plan. The plan was established July 1, 1983 and covers all eligible lay employees of the Diocese of Tucson and participating Catholic entities. The plan is currently under funded; however, information is not available from the plan to allow the Organization to determine its share of funded or unfunded vested benefits. The plan was frozen to new participants as of December 31, 2006.

NOTES TO FINANCIAL STATEMENTS

Retirement Plans (continued)**403(b) Plans**

On March 1, 2003, the Diocese of Tucson adopted a 403(b) qualified defined contribution plan. This is a multi-employer plan that covers all eligible lay employees of the Diocese of Tucson and participating Catholic entities. Employees are eligible for plan participation on their date of hire and contribute to the plan through salary deferrals. Employees are eligible to receive employer contributions upon completion of two years of continuous service. Employer contributions are equal to 25% of the employee's contribution up to a maximum of \$1,000 annually. Employees are 100% vested in employee and employer contributions at all times. The plan was frozen to new participants as of December 31, 2006.

Effective January 1, 2008, the Diocese of Tucson adopted a new 403(b) qualified defined contribution plan for employees hired subsequent to December 31, 2006. Employees are eligible for plan participation on their date of hire and contribute to the plan through salary deferrals. Employees are eligible to receive employer contributions upon completion of two years of continuous service. Employer contributions equal 4% of each eligible employee's gross wage and will be paid annually to the plan. Employees are 100% vested in employee and employer contributions at all times.

The Diocese of Tucson's contributions for the above plans totaled \$85,418 and \$84,396 for the years ended June 30, 2009 and 2008, respectively.

12. Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following as of June 30:

	<u>2009</u>	<u>2008</u>
Capital improvements	\$ 39,197	\$ 45,100
Seminarians/Diaconate	352,794	287,639
Retired religious women	79,017	89,466
Indian missions	2,766	9,344
Evangelization	221,532	221,532
Formation programs	23,725	23,271
Parish life and ministry programs	2,664	10,460
Catholic schools administration	61,243	69,057
Human development	37,631	45,695
Priests' programs	36,838	36,883
Safe environment programs	528,707	616,429
Other miscellaneous programs	262,474	773,037
	<u>\$ 1,648,588</u>	<u>\$ 2,227,913</u>

NOTES TO FINANCIAL STATEMENTS

13. Permanently Restricted Net Assets

Permanently restricted net assets consist of the following as of June 30:

	2009	2008
Seminarian Education	\$ 1,172,882	\$ 1,131,887
Endowed Care - Regina Cleri	605,393	605,393
Scholarship assistance	80,095	80,095
Mass foundations	73,428	73,428
Catholic Foundation Social Mission	2,000	2,000
Catholic Foundation Hughes Vision Diocesan newspaper	150,000	150,000
Catholic Foundation Catholic Schools - General funds for Catholic School Department	85,023	85,023
	<u>\$ 2,168,821</u>	<u>\$ 2,127,826</u>

Endowment net asset composition by type of fund as of June 30, 2009:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (65,932)	-	\$ 2,168,821	\$ 2,102,889
Total funds	<u>\$ (65,932)</u>	<u>\$ -</u>	<u>\$ 2,168,821</u>	<u>\$ 2,102,889</u>

Changes in endowment net assets for the fiscal year ended June 30, 2009:

Endowment net assets, June 30, 2008	\$ -	\$ 84,312	\$ 2,127,826	\$ 2,212,138
Investment return:				
Investment income	-	36,074	-	36,074
Net appreciation / (depreciation)	-	(176,338)	-	(176,338)
Total investment return	-	(140,264)	-	(140,264)
Contributions	-	-	40,995	40,995
Other changes	-	(9,980)	-	(9,980)
Transfer between funds	(65,932)	65,932	-	-
Endowment net assets, June 30, 2009	<u>\$ (65,932)</u>	<u>\$ -</u>	<u>\$ 2,168,821</u>	<u>\$ 2,102,889</u>

Permanently restricted net assets are included in cash and cash equivalents and investments in the accompanying balance sheets.

NOTES TO FINANCIAL STATEMENTS

14. Commitments and Contingencies

The Diocese of Tucson administrative offices are leased under an operating lease agreement that expires in June 2053. Annual lease expense totaled \$185,475 and \$179,590 during the years ended June 30, 2009 and 2008, respectively. The lease has an annual inflationary adjustment clause and requires the Diocese of Tucson to pay property taxes, insurance, and normal maintenance and repair costs.

The minimum future rentals on the non-cancelable operating lease as of June 30, 2009 for the next five fiscal years are as follows:

<u>Year</u>	<u>Total</u>
2010	\$ 191,039
2011	196,770
2012	202,673
2013	208,754
2014	215,016

The Diocese is partially self-insured for workers' compensation, property and crime claims. The self-insured retention is \$50,000 for both property and crime and \$75,000 for workers' compensation per claim. The Diocese has obtained insurance coverage for claims in excess of the individual claim retention limits and annual aggregates of \$175,000, for workers compensation claims, and \$450,000 for property and crime claims. A portion of the insurance coverage is provided by BPIC ("Bishops Plan Insurance Corporation"), a captive insurance company in which the Diocese retained an ownership interest as of June 30, 2006, which totaled \$80,850.

On July 31, 2006, BPIC converted to a non-profit entity and converted its shares to subordinated surplus notes. Accordingly, the Diocese has a note receivable from BPIC in the amount \$80,850 as of June 30, 2009 and 2008. The note balance and ownership interest are included in other assets in the accompanying balance sheets as of June 30, 2009 and 2008.

The Bishop has guaranteed the debt of eight separately incorporated parishes: San Felipe Parish, St Elizabeth Ann Seton Parish, St Mark the Evangelist Parish, St Odilia Parish, St Andrew the Apostle Parish, St Pius Parish, St John Neumann Parish, and Holy Angels Parish. Guaranteed debt outstanding as of June 30, 2009 and 2008 is approximately \$7,109,000 and \$9,145,000, respectively. The Organization believes the likelihood of having to make payments under the guarantee is remote and no liabilities are reported at June 30, 2009 and 2008 in the accompanying financial statements.