

# McGladrey & Pullen

Certified Public Accountants

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April 8, 2008

To the Board of Directors  
Diocese of Davenport  
Davenport, Iowa

In accordance with your request, we are attaching the accompanying PDF file, which contains an electronic final version of the financial statements for Diocese of Davenport as of and for the years ended June 30, 2007 and 2006. We understand that your request for the electronic copy has been made as a matter of convenience. You understand that the electronic transmission is not entirely secure and that it is possible for confidential financial information to be intercepted by others.

These financial statements and our report on them are not to be modified in any manner. This final version supersedes all prior drafts. Any preliminary draft version of the financial statements previously provided to you in an electronic format should be deleted from your computer, and all printed copies of any superseded preliminary draft versions should likewise be destroyed.

Professional standards and our firm policies require that we perform certain additional procedures whenever our reports are included, or we are named as accountants, auditors or "experts," in a document used in a public or private offering of equity or debt securities. Accordingly, as provided for and agreed to in the terms of our arrangement letter, the Company will not include our reports, or otherwise make reference to us, in any public or private securities offering without first obtaining our consent. Any request to consent is also a matter for which separate arrangements will be necessary. After obtaining our consent, the Company also agrees to provide us with printer's proofs or masters of such offering documents for our review and approval before printing and with a copy of the final reproduced material for our approval before it is distributed. In the event our auditor/client relationship has been terminated when the Company seeks such consent, we will be under no obligation to grant such consent or approval.

Thank you for the opportunity to serve the Diocese of Davenport.

**McGladrey & Pullen, LLP**



Sandra S. Moore, Partner

Attachment

# Diocese of Davenport

Financial Report

06.30.2007

**McGladrey & Pullen**  
Certified Public Accountants

McGladrey & Pullen, LLP is a member firm of RSM International –  
an affiliation of separate and independent legal entities.

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# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

To the Board of Directors  
Diocese of Davenport  
(Debtor-in-Possession)  
Davenport, Iowa

We have audited the accompanying balance sheets of the Diocese of Davenport (Debtor-in-Possession) as of June 30, 2007 and 2006, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Diocese's management.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

As described in Note 11, on October 10, 2006, the Diocese filed a voluntary petition under Chapter 11 of the Bankruptcy Act, and Trustees in Reorganization assumed control. The accompanying financial statements do not give effect to possible adjustments, to be determined in the future as the result of court approved actions of the Trustees, which would result had the outcome of these matters been known.

Due to the magnitude of the potential effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding paragraph been known, we do not express an opinion on the financial statements referred to above.

*McGladrey & Pullen, LLP*

Davenport, Iowa  
April 2, 2008

**Diocese of Davenport  
(Debtor-in-Possession)**

**Balance Sheets  
June 30, 2007 and 2006**

Assets	2007		
	Operating	Insurance Fund	Total
Cash and Cash Equivalents:			
Unrestricted	\$ 1,282,730	\$ 667,142	\$ 1,949,872
Temporarily restricted	-	-	-
	<u>1,282,730</u>	<u>667,142</u>	<u>1,949,872</u>
Receivables:			
Due from parishes, Annual Diocesan Appeal	666,538	-	666,538
Marriage tribunal, less allowance for doubtful amounts 2007 and 2006 \$2,700	2,410	-	2,410
Priests and former seminarians, less allowance for doubtful amounts 2007 \$241,827; 2006 \$241,296	15,173	-	15,173
Insurance recovery	-	10,940	10,940
Other receivable	102,721	29,448	132,169
Investments (Note 2):			
Investments held by bankruptcy trustee	5,687,834	-	5,687,834
Commingled investment fund	-	-	-
Omer Woltering Trust	656,974	-	656,974
Temporary investment fund	-	-	-
Land, Buildings and Equipment, net of accumulated depreciation (Note 3)	110,848	-	110,848
Prepaid Assets	65,395	195	65,590
Assets Waiting Disposition (Note 11)	618,533	-	618,533
	<u>7,926,426</u>	<u>40,583</u>	<u>7,967,009</u>
<b>Total assets</b>	<u>\$ 9,209,156</u>	<u>\$ 707,725</u>	<u>\$ 9,916,881</u>
<b>Liabilities and Net Assets</b>			
Liabilities:			
Accounts payable and accrued expenses	\$ 390,666	\$ -	\$ 390,666
Claims and legal fees payable (Note 11)	14,218,554	-	14,218,554
Accounts payable, special collections	103,869	-	103,869
Accounts payable, insurance claims	-	16,243	16,243
Due to parishes, Annual Diocesan Appeal	-	-	-
<b>Total liabilities</b>	<u>14,713,089</u>	<u>16,243</u>	<u>14,729,332</u>
Contingency (Notes 8, 10 and 11)			
Net Assets:			
Unrestricted	(7,997,610)	691,482	(7,306,128)
Temporarily restricted (Note 5)	2,220,302	-	2,220,302
Permanently restricted (Note 6)	273,375	-	273,375
<b>Total net assets</b>	<u>(5,503,933)</u>	<u>691,482</u>	<u>(4,812,451)</u>
<b>Total liabilities and net assets</b>	<u>\$ 9,209,156</u>	<u>\$ 707,725</u>	<u>\$ 9,916,881</u>

See Notes to Financial Statements.

2006		
Operating	Insurance Fund	Total
\$ 180,598	\$ 621,020	\$ 801,618
196,543	-	196,543
377,141	621,020	998,161
336,049	-	336,049
4,245	-	4,245
23,762	-	23,762
-	3,636	3,636
534,929	34,488	569,417
-	-	-
5,533,726	-	5,533,726
554,045	-	554,045
10,982	-	10,982
1,050,032	-	1,050,032
-	165	165
-	-	-
8,047,770	38,289	8,086,059
\$ 8,424,911	\$ 659,309	\$ 9,084,220
\$ 139,981	\$ -	\$ 139,981
1,650,316	-	1,650,316
265,853	-	265,853
-	16,850	16,850
5,416	-	5,416
2,061,566	16,850	2,078,416
(573,967)	642,459	68,492
6,663,937	-	6,663,937
273,375	-	273,375
6,363,345	642,459	7,005,804
\$ 8,424,911	\$ 659,309	\$ 9,084,220

Diocese of Davenport  
(Debtor-in-Possession)

Statements of Activities  
Years Ended June 30, 2007 and 2006

	2007			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
<b>Support and Revenue:</b>				
Annual Diocesan Appeal	\$ 2,570,227	\$ -	\$ -	\$ 2,570,227
Support revenue for special collections	-	60,570	-	60,570
Contributions and bequests	261,710	5,000	-	266,710
Insurance revenue, net of expenses (Note 8)	49,023	-	-	49,023
<b>Investment income:</b>				
Interest and dividends, net of fees	4,730	183,990	-	188,720
Net realized gains on sale of investments	11,219	768,897	-	780,116
Change in net unrealized gains (losses) on investments (Note 2)	(7,618)	(342,486)	-	(350,104)
Gain on sale of property	238,078	-	-	238,078
Rental and other income	618,589	-	-	618,589
Net assets released from restrictions, satisfaction of program restrictions (Note 7)	5,119,606	(5,119,606)	-	-
<b>Total support and revenue</b>	<b>8,865,564</b>	<b>(4,443,635)</b>	<b>-</b>	<b>4,421,929</b>
<b>Expenses:</b>				
Chancery office	363,161	-	-	363,161
Marriage tribunal office	152,911	-	-	152,911
Pastoral services office	817,012	-	-	817,012
Vocations and clergy support	47,553	-	-	47,553
Support of special collections	145,978	-	-	145,978
Retirement and assistance of clergy (health benefits)	282,642	-	-	282,642
University hospital chaplains	89,570	-	-	89,570
National, regional, local councils and organizations	113,950	-	-	113,950
Seminarian education, assistance ministry	334,289	-	-	334,289
Stewardship and development office	26,115	-	-	26,115
Communications office	261,152	-	-	261,152
Administration and finance office	332,776	-	-	332,776
St. Vincent's Center	288,412	-	-	288,412
Bankruptcy claims and legal fees (Note 11)	12,907,526	-	-	12,907,526
Depreciation	77,137	-	-	77,137
<b>Total expenses</b>	<b>16,240,184</b>	<b>-</b>	<b>-</b>	<b>16,240,184</b>
<b>Change in net assets</b>	<b>(7,374,620)</b>	<b>(4,443,635)</b>	<b>-</b>	<b>(11,818,255)</b>
Net assets at beginning of year	68,492	6,663,937	273,375	7,005,804
Net assets at end of year	\$ (7,306,128)	\$ 2,220,302	\$ 273,375	\$ (4,812,451)

See Notes to Financial Statements.

2006

Unrestricted	Temporarily Restricted	Permanently Restricted	Total
\$ 2,570,447	\$ -	\$ -	\$ 2,570,447
-	91,043	-	91,043
70,031	375,322	-	445,353
31,878	-	-	31,878
2,855	116,410	-	119,265
6,637	540,970	-	547,607
(2,527)	19,717	-	17,190
-	-	-	-
464,360	-	-	464,360
479,155	(479,155)	-	-
3,622,836	664,307	-	4,287,143
450,744	-	-	450,744
145,240	-	-	145,240
868,461	-	-	868,461
43,676	-	-	43,676
215,171	-	-	215,171
213,660	-	-	213,660
86,128	-	-	86,128
116,620	-	-	116,620
220,476	-	-	220,476
39,368	-	-	39,368
272,925	-	-	272,925
525,190	-	-	525,190
254,940	-	-	254,940
1,536,000	-	-	1,536,000
82,530	-	-	82,530
5,071,129	-	-	5,071,129
(1,448,293)	664,307	-	(783,986)
1,516,785	5,999,630	273,375	7,789,790
\$ 68,492	\$ 6,663,937	\$ 273,375	\$ 7,005,804

Diocese of Davenport  
(Debtor-in-Possession)

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

	2007	2006
Cash Flows from Operating Activities:		
Change in net assets	\$ (11,818,255)	\$ (783,986)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	77,137	82,530
(Gain) loss on sale of property and equipment	(238,078)	115,401
Net realized (gains) on sale of investments	(780,116)	(547,607)
Change in net unrealized (gains) losses on investments	350,104	(17,190)
Interest and dividends, net of fees	(188,720)	(125,720)
Changes in assets and liabilities:		
(Increase) decrease in receivables	116,794	(533,888)
(Increase) decrease in prepaid assets	(65,425)	10,108
Increase in accounts payable and accrued expenses	12,656,232	1,305,249
Increase (decrease) in due to parishes	(5,416)	4,326
<b>Net cash provided by (used in) operating activities</b>	<b>104,257</b>	<b>(490,777)</b>
Cash Flows from Investing Activities:		
Investment proceeds	6,041,708	1,062,703
Investment in Kingdom Co	(141,730)	(2,479,802)
Purchase of investments	(5,545,098)	-
Proceeds from sale of investments	10,982	37,402
Proceeds from sale of land, buildings and equipment	520,302	1,797,106
Purchase of equipment	(38,710)	(49,191)
<b>Net cash provided by investing activities</b>	<b>847,454</b>	<b>368,218</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>951,711</b>	<b>(122,559)</b>
Cash and cash equivalents:		
Beginning	998,161	1,120,720
Ending	<b>\$ 1,949,872</b>	<b>\$ 998,161</b>

See Notes to Financial Statements.

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### Note 1. Nature of Organization and Significant Accounting Policies

##### Nature of organization:

The Diocese of Davenport is an Iowa nonprofit corporation. This financial report includes all known funds and all known major assets and liabilities of the Diocese of Davenport (see Note 4).

##### Significant accounting policies:

The financial statements of the Diocese of Davenport have been prepared in accordance with *Accounting Principles and Reporting Practices for Churches and Church-Related Organizations*, adopted by the National Conference of Catholic Bishops, United States Catholic Conference, which is consistent with accounting principles generally accepted in the United States of America in all material respects.

Net assets: The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. The three classes are based on the presence or absence of donor-imposed restrictions. Temporarily restricted net assets include net assets restricted by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

Accounting 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents: For purposes of reporting cash flows, the Diocese includes all cash accounts, which are not subject to withdrawal restrictions or penalties, and money market funds with an original maturity of three months or less, excluding commingled investment fund cash and cash of the Omer Woltering Trust, to be cash and cash equivalents.

Receivables: Receivables are carried at original amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and considers the financial condition and history. Receivables are written off when deemed uncollectible. Recoveries of previously written off receivables are recorded when received. Bad debts (recoveries), net were approximately \$6,000 and \$(5,000) for the years ended June 30, 2007 and 2006, respectively.

Investments: Investments in the commingled investment fund and other marketable equity and debt securities are carried at fair value based on quoted market prices. Gains and losses on investments are included in the statements of activities.

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### Note 1. Nature of Organization and Significant Accounting Policies (Continued)

Land, buildings and equipment: Land, buildings and equipment are stated at cost if purchased or at estimated fair value at the date of donation if received as a gift.

Depreciation is computed using the straight-line method over the estimated useful lives of the various classifications of buildings and equipment as follows:

	<u>Years</u>
Buildings and building improvements	10 - 40
Equipment, automobiles and furnishings	5 - 10

Annual Diocesan Appeal: The Diocese of Davenport derives a substantial portion of its support and revenue from the Annual Diocesan Appeal which is an annual parish-level diocesan fund drive. Amounts due from parishes pursuant to this annual drive are recognized as support and revenue when the parishes are assessed.

Contributions: The Diocese reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

The Diocese reports gifts of land, buildings and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Diocese reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

#### Note 2. Investments

Commingled investment fund: The Diocese of Davenport participated in and administers a voluntary commingled investment program (Kingdom Co) for the benefit of those Diocesan affiliates who request to participate in the program. The Diocese of Davenport withdrew all of their funds in December 2007 from the Kingdom Co commingled investment fund, and as of year-end did not have a financial interest in Kingdom Co.

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### Note 2. Investments (Continued)

A summary of changes in the Diocese of Davenport's equity for the year ended June 30, 2007 is as follows:

Diocese's equity, June 30, 2006	\$	5,533,726
Add:		
Equity investments		141,730
Dividend and interest income		29,210
Net realized gains		771,923
Change in net unrealized gains		(458,933)
Deduct:		
Distributions to Diocese of Davenport		(5,998,284)
Fees		(19,372)
Diocese's equity, June 30, 2007	\$	-

Omer Woltering Trust: The Omer Woltering Trust was created in 1991 by a \$250,000 bequest from the estate of Omer Woltering. The Diocese is trustee and beneficiary of the trust.

The assets of this trust as of June 30, 2007 and 2006 are as follows:

	2007	2006
Cash	\$ 2,597	\$ 1,505
Marketable securities, mutual funds, at fair value	654,377	552,540
	<u>\$ 656,974</u>	<u>\$ 554,045</u>

For the years ended June 30, 2007 and 2006 the change in the gross unrealized gains and (losses) for all marketable equity securities included in the accompanying statements of activities are as follows:

	2007	2006
Gross unrealized gains	\$ 274,790	\$ 606,265
Gross unrealized (losses)	(624,894)	(589,075)
<b>Change in net unrealized gains</b>	<u>\$ (350,104)</u>	<u>\$ 17,190</u>

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### Note 3. Land, Buildings and Equipment

A summary of land, buildings and equipment as of June 30, 2007 and 2006 is as follows:

<u>Asset Description</u>	<u>2007</u>	<u>2006</u>
Davenport, Iowa:		
St. Vincent's property, including land of \$195,559 and buildings	\$ -	\$ 2,235,235
Chancery office equipment and automobiles	528,535	489,825
Bishop's residence, Scott Street	28,065	200,860
Residence, Telegraph Road, including land of \$146,511 and buildings	-	221,511
	<u>556,600</u>	<u>3,147,431</u>
Less accumulated depreciation	445,752	2,097,399
	<u>\$ 110,848</u>	<u>\$ 1,050,032</u>

#### Note 4. Affiliations

The Diocese of Davenport is affiliated with numerous other Iowa nonprofit corporations because the Bishop of the Diocese of Davenport, as Ordinary of the Catholic Church activities in southeast Iowa, serves as president of this and the following affiliated corporations:

- Approximately 100 parish and school corporations
- The Catholic Messenger
- St. Ambrose University
- The Priests Aid Society, Inc.
- St. Vincent's Home Corporation
- Newman Catholic Student Center of Iowa City, Iowa

The Bishop of the Diocese of Davenport also serves as Chairman of the Board of Kahl Home for the Aged and Infirm.

None of the assets and liabilities of these affiliated corporations, or any other related organizations, are included in this financial report.

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### Note 5. Temporarily Restricted Net Assets

Temporarily restricted net assets as of June 30, 2007 and 2006 are available for the following purposes:

	2007	2006
Seminary education	\$ 854,978	\$ 5,250,118
Catholic charity	683,678	735,178
Special collections, Campaign for Human Development	4,156	4,406
Special collections, Volunteer Program in Latin America	6,197	84,523
Special collections, Works of Charity	14,319	30,904
Omer Woltering Trust, Clergy Education	656,974	554,045
Parish perpetual care	-	4,763
	<u>\$ 2,220,302</u>	<u>\$ 6,663,937</u>

Due to the bankruptcy discussed in Note 11, certain assets underlying these restrictions have been seized by the bankruptcy trustee.

#### Note 6. Permanently Restricted Net Assets

Permanently restricted net assets are restricted to investment in perpetuity, the income from which is expendable to support seminary education.

#### Note 7. Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors.

	2007	2006
Purpose restrictions accomplished:		
Special collections, Campaign for Human Development	\$ 9,753	\$ 14,002
Special collections, Volunteer Program in Latin America	98,072	120,543
Special collections, Works of Charity	47,906	94,628
Catholic charity	71,250	64,427
Seminary education (A)	4,887,755	160,000
Parish perpetual care	4,870	555
Special account	-	25,000
<b>Total assets released from restrictions</b>	<u>\$ 5,119,606</u>	<u>\$ 479,155</u>

(A) Management believes the release of these funds is appropriate to assist with satisfaction of the legal claims discussed in Note 11.

Diocese of Davenport (Debtor-in-Possession)

Notes to Financial Statements

**Note 8. Insurance Funds and Contingency**

The Diocese established an insurance fund to provide uniform property and casualty, worker's compensation and blanket liability coverage under one comprehensive plan for all parishes and affiliates of the Diocese of Davenport. The fund collects fees from subscribers and remits premiums to the insurance carriers during the policy year. The various insurance policies have deductibles ranging from none to \$25,000.

The Diocese also established a self-insurance fund to provide medical insurance for parishes and affiliates of the Diocese of Davenport. The fund collects fees from subscribers and remits premiums to the insurance carrier during the policy year. As of June 30, 2007, the specific deductible per participant was \$50,000 and the aggregate deductible was approximately \$265,000.

The Diocese is responsible for the excess of the claims paid over premiums received for both of the insurance funds.

Activity in these funds for the years ended June 30, 2007 and 2006 was as follows:

	Property Insurance Fund	Medical Insurance Fund	Total
<u>2007</u>			
Fees collected	\$ 791,324	\$ 397,347	\$ 1,188,671
Interest earned	8,700	1,635	10,335
Premiums paid	(724,672)	(135,899)	(860,571)
Recoveries	161,513	1,699	163,212
Claims expense	(180,760)	(271,795)	(452,555)
Other	(26)	(43)	(69)
	<u>\$ 56,079</u>	<u>\$ (7,056)</u>	<u>\$ 49,023</u>
<u>2006</u>			
Fees collected	\$ 751,293	\$ 365,637	\$ 1,116,930
Interest earned	5,459	998	6,457
Premiums paid	(719,115)	(122,075)	(841,190)
Recoveries	126,063	1,666	127,729
Claims expense	(148,524)	(228,785)	(377,309)
Other	(697)	(42)	(739)
	<u>\$ 14,479</u>	<u>\$ 17,399</u>	<u>\$ 31,878</u>

## Diocese of Davenport (Debtor-in-Possession)

### Notes to Financial Statements

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#### **Note 9. Retirement Plan**

The Diocese has adopted a 401(k) retirement plan which covers substantially all of its employees. The Diocese will match 100% of employees' contributions up to 2% of employee compensation. The Diocese also has the option to make discretionary contributions to the plan. The Diocese's matching and discretionary contribution was approximately \$61,300 and \$56,100 for the years ended June 30, 2007 and 2006, respectively.

#### **Note 10. Concentrations of Credit Risk**

The Diocese has deposits exceeding the federal depository insurance limits in various major financial institutions. These financial institutions have strong credit ratings and management believes the credit risk related to these deposits is minimal.

The Diocese routinely invests their surplus operating funds in money market funds. These funds generally invest in highly liquid U.S. government and agency obligations and various investment grade corporate obligations. Investments in money market funds are not insured or guaranteed by the U.S. government or by the underlying corporation; however, management believes that credit risk related to these investments is minimal.

#### **Note 11. Lawsuit and Petition for Reorganization under Chapter 11**

On October 10, 2006, the Diocese filed a voluntary petition under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Southern District of Iowa. Under Chapter 11, certain claims against the Diocese in existence prior to the filing of the petition for relief under the federal bankruptcy laws were stayed while the Diocese continues business operations as a Debtor-in-Possession.

The Diocese has had numerous lawsuits filed against it. On November 29, 2007, the Diocese entered into a settlement agreement with the Official Committee of Unsecured Creditors and an insurance company; however, this agreement is still subject to approval by the Bankruptcy Court. The tentative settlement requires the Diocese to pay approximately \$13,600,000 in cash, plus the deed to the St. Vincent Center property, which is classified as assets waiting disposition as of June 30, 2007. The Diocese has recorded this liability on its books. The tentative agreement also includes \$19,500,000 to be paid by the insurance company.

# McGladrey & Pullen

Certified Public Accountants

April 4, 2008

To the Board of Directors  
Diocese of Davenport  
Davenport, Iowa

This letter is intended to inform the Board of Directors about significant matters related to the conduct of the annual audit so it can appropriately discharge its oversight responsibility and that we comply with our professional responsibilities to the Board of Directors.

The following summarizes various matters which must be communicated to you under auditing standards generally accepted in the United States of America.

## **The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America**

Our audit of the financial statements of the Diocese of Davenport for the year ended June 30, 2007 was conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. 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. However, due to the magnitude of the potential effects on the financial statements related to the bankruptcy and lawsuits, if any, as might have been required had the outcome of the uncertainties been known, we do not express an opinion on the financial statements as of and for the year ended June 30, 2007.

## **Management's Judgments and Accounting Estimates**

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us they used all the relevant facts available to them at the time to make the best judgments about accounting estimates and we considered this information in the scope of our audit. The Board of Directors may wish to monitor throughout the year the process used to compute and record these accounting estimates.

Following is management's description of the process utilized in forming particularly sensitive accounting estimates.

- Self-insurance reserves and expenses – based on the Diocese's actual loss experience, an evaluation for current claims, estimates for incurred, but not reported claims, and other relevant data.
- Lawsuit settlement costs – based on current status of claims.

### **Audit Adjustment**

The Diocese recorded an entry for the estimate of the liability for the lawsuit.

### **Accounting Policies and Alternative Treatments**

Management has the ultimate responsibility for the appropriateness of the accounting policies used by the Organization. The Organization did not adopt any significant new accounting policies nor have there been any changes in existing significant accounting policies during the current period which should be brought to your attention for approval.

### **Other Information in Documents Containing Audited Financial Statements**

We are not aware of any other documents that contain the audited basic financial statements. If such documents were to be published, we would have a responsibility to determine that such financial information was not materially inconsistent with the audited statements of the Organization.

### **Disagreements with Management**

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.

### **Consultations with Other Accountants**

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

### **Major Issues Discussed with Management Prior to Retention**

The bankruptcies and lawsuits were discussed with management prior to our retention to perform the aforementioned audit.

### **Difficulties Encountered in Performing the Audit**

We did not encounter any difficulties in dealing with management relating to the performance of the audit.

### **Material Contingencies**

Except for disclosures related to the Organization's self-insurance programs, lawsuits and the bankruptcy filing, the financial statements reflect no disclosure associated with material contingency and there are no other matters we believe should be disclosed as a material contingency.

## Closing

We will be pleased to respond to any questions you have about the foregoing. We appreciate the opportunity to continue to be of service to the Diocese of Davenport.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than the specified parties.

*McGladrey & Pullen, LLP*