

**SAINT MARY'S COLLEGE
OF CALIFORNIA**

Financial Statements
Including Independent Auditors' Report

June 30, 2008 and 2007

SAINT MARY'S COLLEGE OF CALIFORNIA

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SAINT MARY'S COLLEGE
of California

Vice President For Finance

September 16, 2008

Members of the Board of Trustees
Saint Mary's College of California
1928 St. Mary's Road
Moraga, Ca 94556

Dear Ladies and Gentlemen:

I am pleased to provide a report on the financial position of Saint Mary's College of California as of June 30, 2008, the end of fiscal year 2007-2008. For the first time in many years, the College did not experience a growth in its net assets. Macroeconomic factors negatively impacted operating margins as well as the change in net assets. Macroeconomic factors impacting fiscal year 2007-2008 included a decline in the market value of almost all investment asset classes, tightening credit markets and the collapse of the market for auction rate securities.

The combination of these macroeconomic factors resulted in a decline in net assets of \$18.5 million or 8.2%, from \$223.9 million on June 30, 2007 to \$205.4 million on June 30, 2008. The decline in net assets was most noticeable in the decreased market value of endowment assets. The market value of endowment assets decreased by \$14.5 million or 8.8%, from \$164.4 million on June 30, 2007 to \$149.9 million on June 30, 2008. The decline in net assets was also noticeable in the unrealized loss on the market value of the College's interest rate exchange (swap) agreement. This unrealized loss totaled \$3.6 million as of June 30, 2008.

Fiscal year 2007-2008 also represented a time of investment in campus facilities. The new Filippi Academic Hall, home of the Kalmanovitz School of Education, was dedicated in January 2008. The \$23.4 million project budget for this new facility was completely funded from donor contributions and included a \$2.7 million endowment fund for operating and maintenance costs. In addition, the College's long-term debt was restructured in August 2007 and increased by \$25.1 without a projected increase in total annual debt service. The funds provided by the increase in long-term debt are being utilized to renovate existing food service and residence hall facilities on campus.

In addition to an investment in facilities, the College invested in its employees and retirees during fiscal year 2007-2008. The College joined Emeriti Retirement Health Solutions (Emeriti Program) effective July 2007. The Emeriti Program is a consortium of colleges and universities organized to provide access to affordable retiree health care benefits. The Emeriti Program also administers a tax preferred savings vehicle through a Voluntary Employees Benefit Association (VEBA). The VEBA structure allows the College and its employees to pre-fund retiree healthcare costs, which reduces the College's liability for postretirement health care benefits over time.

The audited financial statements of the College, along with related notes, are provided on the following pages. Also provided is the Independent Auditors' Report from Virchow, Krause & Company, LLP that provides an opinion, without qualification, on the fair presentation of the College's financial statements.

An explanation of the financial statements and notes is provided on the following pages along with some highlights of significant changes reflected in the statements.

Balance Sheet

The balance sheet (also known as the statement of financial position) details the status of the College's assets, liabilities, and net assets (or equity) as of June 30, 2008, the end of the fiscal year.

Significant changes in the balance sheet from the prior year include:

- *Assets* total \$307.8 million and increased by \$14.7 million or 5.0% from the prior year. This increase is primarily attributed to an increase in value of property, plant and equipment related to the completion of Filippi Academic Hall.
- *Liabilities* total \$102.4 million and increased by \$33.2 million or 47.9%. This increase is primarily attributed to an increase in the College's long-term debt, which will be used to renovate existing food service and residence hall facilities on campus. The increase is also attributed to the unrealized loss in the market value of the College's swap agreement.
- *Net assets* total \$205.4 million and decreased by \$18.5 million or 8.2%. This decrease can be primarily attributed to the decline in market value of endowment investments as well as the decline in the market value of the College's swap agreement.

Statement of Activities

The statement of activities (also known as the income statement) presents financial activity during the fiscal year. In doing so, it reconciles the beginning and end-of-year net asset positions (or equity).

Significant changes in the statement of activities include:

- *Unrestricted operating revenues* totaled \$98.2 million and increased by \$4.7 million or 5.0% from the prior year's total. This increase is primarily attributed to an increase in net tuition and fees as well as increases in income from endowment.
- *Unrestricted operating expenses* totaled \$97.8 million and increased by \$5.7 million or 6.1% over the prior year's total. This increase is primarily attributed to the planned increase in interest expenses related to the restructuring of long-term debt (the restructuring lowered principal payments with an offsetting projected increase in interest payments) that occurred in August 2007, as well as the unplanned increase in interest expenses that were incurred after the collapse of the auction rate securities market in February 2008.
- *Increase in unrestricted net assets from operations* totaled \$0.4 million. This represents a decrease from the \$1.4 million increase in unrestricted net assets from operations achieved in the prior fiscal year. The smaller increase in unrestricted net assets from operations is also primarily attributed to increased interest expenses on long-term debt noted above.

- *Decrease in total net assets from non-operating activities* totaled \$18.4 million. This represents a significant change from the prior year's \$22.5 million increase and is primarily attributed to the decline in market value of endowment investments as well as the unrealized loss on the market value of the College's swap agreement.
- *Net assets, end of year* totaled \$205.4 million. This represents a decrease from the prior year's \$223.9 million and is primarily attributed to the decline in market value of endowment investments as well as the unrealized loss on the market value of the College's swap agreement.

Statement of Cash Flows

The statement of cash flows presents cash-related activities during the fiscal year and is segmented into operating, investing, and financing activities. The statement of cash flows also reconciles the beginning and end-of-year cash and cash equivalent balances contained in the balance sheet. Finally, the statement of cash flows presents the amount of cash paid for interest expense.

Significant changes in the statement of cash flows include:

- *Change in cash and cash equivalents* reflect a decrease of \$1.4 million. This decrease can be primarily attributed to decreased cash flow from operating activities.
- *Cash paid for interest* total \$3.9 million. This reflects an increase from the prior year's \$1.8 million and is attributed to the planned increase in interest expense related to the restructuring of long-term debt and the unplanned increase in interest expense that was incurred after the collapse of the auction rate securities market.

Notes to Financial Statements

The notes to financial statements provide information about the nature of the College, the basis of the presentation of the financial statements, significant accounting policies of the College, and explanatory information about certain items in the financial statements.

Significant changes to the notes to financial statements include:

- *(2)(k) Liabilities Under Trust Agreements* provide information about the calculation of the College's liabilities under its annuity and life income contracts and agreements.
- *(8) Long-Term Debt* was modified to reflect the impact of the restructuring of long-term debt that occurred in August 2007.
- *(9) Interest Rate Swaps* was modified to reflect the new swap agreement that was executed in conjunction with the restructuring of long-term debt.
- *(10) Retirement Plan and Postretirement Benefits* was modified to reflect the College's participation in the Emeriti Program effective July 2007.

- (14) *Subsequent Events* was modified to provide details of the College's conversion of the portion of its long-term debt that was in auction rate securities to variable rate demand bonds. This conversion occurred in July 2008 and allowed the College to preserve its existing bond insurance and swap agreement. It also resulted in the execution of a direct pay letter of credit that provides both credit enhancement and a liquidity facility for the variable rate demand bonds.

Summary and Outlook

Saint Mary's College of California was negatively impacted by macroeconomic factors during the fiscal year ended June 30, 2008. Although operating margins and net assets decreased, the College began a program to improve campus facilities that includes both new debt and fund raising. The College also invested in its employees and retirees through its participation in the Emeriti Program.

As noted above, the College recently converted its auction rate securities to variable rate demand mode, which will result in significant savings in interest expense going forward. These and other strategic actions, including plans for a comprehensive fundraising campaign, should position the College well for improved financial performance in the fiscal year and years ahead.

Respectfully submitted,



Peter A. Michell
Vice President for Finance and Treasurer





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& company**

Independent Auditors' Report

The Board of Trustees
Saint Mary's College of California
Moraga, California

We have audited the accompanying balance sheet of Saint Mary's College of California as of June 30, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 Saint Mary's College of California as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Virchow Krause & Company, LLP

Minneapolis, Minnesota
September 25, 2008