

Children's Health Council, Inc.

Financial Statements

June 30, 2011

(With Comparative Totals for 2010)

Audit Committee and Board of Directors
Children's Health Council, Inc.
Palo Alto, California

Certified
Public
Accountants

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statement of financial position of Children's Health Council, Inc. (the Council) as of June 30, 2011, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Council's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Council's June 30, 2010 financial statements and, in our report dated November 2, 2010, we expressed an unqualified opinion on those financial statements.

New York
Palo Alto
San Francisco
San Jose
St. Helena

We conducted our audit 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. We believe that our audit provides 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 Children's Health Council, Inc. as of June 30, 2011, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Frank, Rimerman + Co., LLP

December 23, 2011

Children's Health Council, Inc.
Statement of Financial Position
June 30, 2011 (with Comparative Totals at June 30, 2010)

| | Unrestricted | Temporarily Restricted | Permanently Restricted (Endowment) | June 30, 2011 Total | June 30, 2010 Total |
|---|----------------------|---------------------------|--|------------------------|------------------------|
| ASSETS | | | | | |
| Cash and Cash Equivalents | \$ 78,111 | \$ 353,326 | \$ 54,039 | \$ 485,476 | \$ 1,836,320 |
| Accounts Receivable, net of allowance for doubtful accounts of \$1,384,202 (\$1,330,190 in 2010) | 2,783,148 | - | - | 2,783,148 | 2,495,825 |
| Receivable from Sale of Investments | - | - | 787,780 | 787,780 | 782,394 |
| Pledges Receivable, net | 442,334 | - | 119,975 | 562,309 | 565,705 |
| Prepaid Expenses and Other Assets | 94,768 | - | - | 94,768 | 145,296 |
| Investments | 3,216,327 | 390,617 | 17,819,297 | 21,426,241 | 18,797,102 |
| Property and Equipment, net | 7,197,049 | - | - | 7,197,049 | 6,677,025 |
| Total assets | <u>\$ 13,811,737</u> | <u>\$ 743,943</u> | <u>\$ 18,781,091</u> | <u>\$ 33,336,771</u> | <u>\$ 31,299,667</u> |
| LIABILITIES AND NET ASSETS | | | | | |
| Liabilities | | | | | |
| Accounts payable | \$ 272,768 | \$ - | \$ - | \$ 272,768 | \$ 306,959 |
| Accrued expenses and other liabilities | 1,128,188 | - | - | 1,128,188 | 1,082,161 |
| Deferred revenue | 202,207 | - | - | 202,207 | 223,713 |
| Total liabilities | 1,603,163 | - | - | 1,603,163 | 1,612,833 |
| Commitments and Contingencies (Notes 4, 8 and 9) | | | | | |
| Net Assets | | | | | |
| Unrestricted: | | | | | |
| Undesignated | 12,208,574 | - | - | 12,208,574 | 9,879,944 |
| Board designated | - | - | - | - | 824,000 |
| Temporarily restricted | - | 743,943 | - | 743,943 | 211,425 |
| Permanently restricted | - | - | 18,781,091 | 18,781,091 | 18,771,465 |
| Total net assets | <u>12,208,574</u> | <u>743,943</u> | <u>18,781,091</u> | <u>31,733,608</u> | <u>29,686,834</u> |
| Total liabilities and net assets | <u>\$ 13,811,737</u> | <u>\$ 743,943</u> | <u>\$ 18,781,091</u> | <u>\$ 33,336,771</u> | <u>\$ 31,299,667</u> |

See Notes to Financial Statements

Children's Health Council, Inc.

Statement of Activities

Year Ended June 30, 2011 (with Comparative Totals for the Year Ended June 30, 2010)

| | Unrestricted | Temporarily Restricted | Permanently Restricted (Endowment) | Year Ended June 30, 2011 Total | Year Ended June 30, 2010 Total |
|---|----------------------|------------------------|------------------------------------|--------------------------------|--------------------------------|
| Public Support | | | | | |
| Donations | \$ 833,048 | \$ - | \$ 9,626 | \$ 842,674 | \$ 1,053,816 |
| Auxiliary and special events, net | 333,924 | - | - | 333,924 | 485,041 |
| Foundation and trust grants | - | 542,757 | - | 542,757 | 556,178 |
| | <u>1,166,972</u> | <u>542,757</u> | <u>9,626</u> | <u>1,719,355</u> | <u>2,095,035</u> |
| Revenue | | | | | |
| Patient fees and insurance payments | 2,378,119 | - | - | 2,378,119 | 2,291,362 |
| School district funding | 2,958,342 | - | - | 2,958,342 | 2,861,335 |
| Government contracts | 2,845,794 | - | - | 2,845,794 | 1,763,799 |
| Government contract billings for excess services in current and prior years | 212,004 | - | - | 212,004 | 503,158 |
| Other income | 491,416 | - | - | 491,416 | 707,963 |
| | <u>8,885,675</u> | <u>-</u> | <u>-</u> | <u>8,885,675</u> | <u>8,127,617</u> |
| Net Assets Released from Restrictions | <u>260,239</u> | <u>(260,239)</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Total public support and revenue | 10,312,886 | 282,518 | 9,626 | 10,605,030 | 10,222,652 |
| Expenses | | | | | |
| Program services: | | | | | |
| Outpatient clinical services | 5,639,588 | - | - | 5,639,588 | 5,383,016 |
| School services | 3,493,707 | - | - | 3,493,707 | 2,860,276 |
| | <u>9,133,295</u> | <u>-</u> | <u>-</u> | <u>9,133,295</u> | <u>8,243,292</u> |
| Supporting services: | | | | | |
| Administration, management and general | 2,670,596 | - | - | 2,670,596 | 2,532,735 |
| Fundraising | 406,637 | - | - | 406,637 | 422,680 |
| | <u>3,077,233</u> | <u>-</u> | <u>-</u> | <u>3,077,233</u> | <u>2,955,415</u> |
| Total expenses | <u>12,210,528</u> | <u>-</u> | <u>-</u> | <u>12,210,528</u> | <u>11,198,707</u> |
| Increase (decrease) in net assets from operations | (1,897,642) | 282,518 | 9,626 | (1,605,498) | (976,055) |
| Investment Income | | | | | |
| Interest and dividends, net | 227,041 | - | - | 227,041 | 168,151 |
| Net realized and unrealized income | 3,175,231 | 250,000 | - | 3,425,231 | 2,326,891 |
| | <u>3,402,272</u> | <u>250,000</u> | <u>-</u> | <u>3,652,272</u> | <u>2,495,042</u> |
| Change in Net Assets | 1,504,630 | 532,518 | 9,626 | 2,046,774 | 1,518,987 |
| Net Assets, beginning of year | <u>10,703,944</u> | <u>211,425</u> | <u>18,771,465</u> | <u>29,686,834</u> | <u>28,167,847</u> |
| Net Assets, end of year | <u>\$ 12,208,574</u> | <u>\$ 743,943</u> | <u>\$ 18,781,091</u> | <u>\$ 31,733,608</u> | <u>\$ 29,686,834</u> |

See Notes to Financial Statements

Children's Health Council, Inc.
Statement of Functional Expenses
Year Ended June 30, 2011

| | Outpatient Clinical Services | School Services | Total Program Services | Administration, Management and General | Fundraising | Total Supporting Services | Total |
|---|------------------------------------|---------------------|------------------------------|--|-------------------|---------------------------------|----------------------|
| Salaries, Benefits, Contract Staff and Payroll Taxes | \$ 4,949,022 | \$ 2,376,960 | \$ 7,325,982 | \$ 1,669,985 | \$ 331,573 | \$ 2,001,558 | \$ 9,327,540 |
| Operating Expenses | 386,536 | 777,854 | 1,164,390 | 793,595 | 50,379 | 843,974 | 2,008,364 |
| Utilities and Maintenance | 170,479 | 188,594 | 359,073 | 110,594 | 13,421 | 124,015 | 483,088 |
| Insurance | 37,059 | 36,779 | 73,838 | 31,148 | 2,749 | 33,897 | 107,735 |
| Total Expenses before Depreciation | 5,543,096 | 3,380,187 | 8,923,283 | 2,605,322 | 398,122 | 3,003,444 | 11,926,727 |
| Depreciation | 96,492 | 113,520 | 210,012 | 65,274 | 8,515 | 73,789 | 283,801 |
| Total expenses | <u>\$ 5,639,588</u> | <u>\$ 3,493,707</u> | <u>\$ 9,133,295</u> | <u>\$ 2,670,596</u> | <u>\$ 406,637</u> | <u>\$ 3,077,233</u> | <u>\$ 12,210,528</u> |
| Percentage of Total Expenses | <u>46%</u> | <u>29%</u> | <u>75%</u> | <u>22%</u> | <u>3%</u> | <u>25%</u> | <u>100%</u> |

See Notes to Financial Statements

Children's Health Council, Inc.
Statement of Functional Expenses
Year Ended June 30, 2010

| | Outpatient Clinical Services | School Services | Total Program Services | Administration, Management and General | Fundraising | Total Supporting Services | Total |
|---|------------------------------------|---------------------|------------------------------|--|-------------------|---------------------------------|----------------------|
| Salaries, Benefits, Contract Staff and Payroll Taxes | \$ 4,630,296 | \$ 2,090,715 | \$ 6,721,011 | \$ 1,732,725 | \$ 315,208 | \$ 2,047,933 | \$ 8,768,944 |
| Operating Expenses | 470,956 | 457,818 | 928,774 | 608,559 | 84,780 | 693,339 | 1,622,113 |
| Utilities and Maintenance | 152,479 | 167,035 | 319,514 | 97,405 | 11,847 | 109,252 | 428,766 |
| Insurance | 40,170 | 39,866 | 80,036 | 33,763 | 2,980 | 36,743 | 116,779 |
| Total Expenses before Depreciation | 5,293,901 | 2,755,434 | 8,049,335 | 2,472,452 | 414,815 | 2,887,267 | 10,936,602 |
| Depreciation | 89,115 | 104,842 | 193,957 | 60,283 | 7,865 | 68,148 | 262,105 |
| Total expenses | <u>\$ 5,383,016</u> | <u>\$ 2,860,276</u> | <u>\$ 8,243,292</u> | <u>\$ 2,532,735</u> | <u>\$ 422,680</u> | <u>\$ 2,955,415</u> | <u>\$ 11,198,707</u> |
| Percentage of Total Expenses | <u>48%</u> | <u>26%</u> | <u>74%</u> | <u>23%</u> | <u>4%</u> | <u>26%</u> | <u>100%</u> |

See Notes to Financial Statements

Children's Health Council, Inc.
Statements of Cash Flows

| | Years Ended June 30, | |
|--|----------------------|--------------|
| | 2011 | 2010 |
| Cash Flows from Operating Activities | | |
| Change in net assets | \$ 2,046,774 | \$ 1,518,987 |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Depreciation | 283,801 | 262,105 |
| Amortization of discount on pledges receivable | (6,189) | 8,418 |
| Net realized and unrealized gains on investments | (3,380,250) | (2,326,891) |
| Allowance for doubtful accounts | 54,012 | 415,548 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (341,335) | (263,307) |
| Pledges receivable | (40,415) | (39,066) |
| Prepaid expenses and other assets | 50,528 | 9,713 |
| Accounts payable | (34,191) | (46,420) |
| Accrued expenses, other liabilities and deferred revenue | 24,521 | (203,210) |
| Net cash used in operating activities | (1,342,744) | (664,123) |
| Cash Flows from Investing Activities | | |
| Proceeds from sale of investments | 4,735,340 | 4,571,305 |
| Purchase of investments | (4,714,177) | (3,768,267) |
| Reinvested investment income | (57,832) | (24,261) |
| Proceeds from receivable from sale of investments | 782,394 | - |
| Purchase of property and equipment | (803,825) | (71,654) |
| Net cash provided (used) by investing activities | (58,100) | 707,123 |
| Cash Flows from Financing Activities | | |
| Proceeds from contributions receivable restricted for endowment | 50,000 | 3,700 |
| Net cash provided by financing activities | 50,000 | 3,700 |
| Net Increase (Decrease) in Cash and Cash Equivalents | (1,350,844) | 46,700 |
| Cash and Cash Equivalents, June 30, 2010 | 1,836,320 | 1,789,620 |
| Cash and Cash Equivalents, June 30, 2011 | \$ 485,476 | \$ 1,836,320 |
| Supplemental Schedule of Noncash Investing Activities | | |
| Receivable from sale of investments | \$ 787,780 | \$ 782,394 |

See Notes to Financial Statements

Children's Health Council, Inc.
Notes to Financial Statements

1. Organization

Children's Health Council, Inc. (the Council) is a private, not-for-profit, tax-exempt corporation dedicated to helping children, teens and families find the best ways to learn, develop and thrive. The Council is organized into three major service divisions:

The Clinical Services Division (the Clinic) provides assessment and treatment services for children who face emotional, developmental, behavioral and educational issues. The Clinic functions by finding common goals and values that are shared by families, children, and clinical professionals who work together to improve the lives of clients.

The Esther B. Clark School (EBC School), a non-public school with a campus located at the Council, serves students in fourth through tenth grade who have emotional, behavioral and/or learning challenges, which make it difficult for them to succeed in public school classrooms. EBC School employs a combination of therapeutic, academic and enrichment opportunities to create an individualized comprehensive plan for each student. EBC School's goal is to have students ready to transition back to their classrooms or less restrictive settings within one to two years.

Sand Hill School, which opened in February 2011, is an independent school with a campus located at Children's Health Council, Inc. Sand Hill School offers a personalized learning environment for children in grades K-3 who are bright, but struggling in a conventional classroom setting. Specializing in early support for children with learning issues, Sand Hill School teachers collaborate with the Council's specialists to create the path for each child's successful transition to a more 'mainstream' classroom.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies

Financial Statement Presentation:

The Council prepares its financial statements on the accrual basis of accounting. The Council segregates its assets and liabilities, operations and cash flows into three categories: unrestricted, temporarily restricted and permanently restricted. Unrestricted assets are those available for use in the general activities of the Council, without restrictions by donors. Temporarily restricted assets are those whose use is restricted by the donor, based on time or purpose. Generally, these funds will be expended for a specified purpose or over a period of time and are not currently available for general use. Permanently restricted assets are those assets restricted by the donor in perpetuity. For the Council, these assets are endowments consisting of cash equivalents, investments, amounts receivable from sale of investments, and pledges receivable.

There are no permanent donor restrictions on investment income earned on permanently restricted assets. The Council's Board of Directors has a policy of withdrawing up to 5% of investment income from permanently restricted assets annually to support operations and up to 6% in the aggregate to support operations and to finance capital improvements. Because the withdrawal rate is determined by the Board's internal policy rather than by donor restriction, the investment earnings in excess of the annual draw are added to the Council's board designated endowment funds, which is recorded as either unrestricted or temporarily restricted net assets.

Revenue Recognition:

The Council recognizes contributions, including promises to give (pledges), in the period the donor makes a promise to give that is, in substance, unconditional. Contributions restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the revenue is recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction as to time or use expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Pledges are stated at their net present value based on the expected date of receipt using a discount rate. The Council records an allowance against a pledge receivable when collectability is uncertain.

Patient fees, tuition and insurance payments, school district funding and government contract revenue are recognized in the period in which the services are provided. Amounts received for these services not yet provided are classified as deferred revenue.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Auxiliary and Special Events:

The Council has an auxiliary that raises money through the operation of a thrift store, the Bargain Box, and from special events. Revenues from the auxiliary and special events are reported net of related costs and expenses. Revenues and expenses associated with the Bargain Box and special events are as follows for the years ended June 30:

| | <u>2011</u> | <u>2010</u> |
|--|-------------------|-------------------|
| Summer Symphony | \$ 816,971 | \$ 1,014,308 |
| Bargain Box | 270,985 | 272,492 |
| Auxiliary | - | 12,000 |
| Other Events | <u>14,000</u> | <u>15,698</u> |
| Total revenues | 1,101,956 | 1,314,498 |
| Summer Symphony Cash Expenditures | 482,145 | 544,857 |
| Summer Symphony In-Kind Goods and Services | 131,694 | 134,649 |
| Bargain Box | <u>154,193</u> | <u>149,951</u> |
| Total expenses | <u>768,032</u> | <u>829,457</u> |
| Auxiliary and special events, net | <u>\$ 333,924</u> | <u>\$ 485,041</u> |

The 2011 Summer Symphony event was held in September 2011. As a result, fiscal 2011 operations do not include revenue and expenses related to the 2011 event. The 2010 Summer Symphony event was held in August 2010 and revenues, net of expenses, were included in 2011 revenue as detailed above.

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. Significant estimates include the estimated fair values of the Council's non-marketable investments and the collectability of accounts and pledges receivable.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Concentration of Credit Risk:

Financial instruments that potentially subject the Council to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable and pledges receivable. The Council maintains its cash and cash equivalents with one major U.S. financial institution and two major brokerage firms. The Council's cash balances in the one major U.S. financial institution may, at times, exceed the amount insured by the Federal Deposit Insurance Corporation; however, cash balances did not exceed the insurable limit at June 30, 2011. The Council's cash and investment balances held with the two major brokerage firms exceeded the amount insured by the Securities Investor Protection Corporation by \$307,000 and \$13,125,000 at June 30, 2011, respectively. Non-marketable securities are not insured.

Property and Equipment:

Purchased assets are recorded at cost. Donated assets are recorded at estimated fair value at the date of contribution. Acquisitions of property and equipment with a cost or donated value in excess of \$1,000 are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of three to five years for equipment and automobiles; seven years for furniture and fixtures; and forty years for the building.

Investments:

Investments in marketable securities are presented at fair value based on prices quoted on established securities exchanges. Non-marketable investments in private equity funds and partnerships are presented at fair value as determined by the fund managers or general partners of the entities.

The Council's investment portfolio of marketable and non-marketable securities is managed by an independent investment advisor. The Council's investment committee reviews the investment accounts periodically to ensure compliance with the Council's established investment policies.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Income Taxes:

The Council has been determined to be exempt from federal and California income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code, respectively. As a result, no provision for federal or state income taxes has been made in the accompanying financial statements.

Although the Council is recognized as tax exempt, it is still liable for tax on its unrelated business taxable income (UBTI). The Council does not believe it has UBTI that should have been reported for tax purposes.

The Council applies the provisions set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 740 to account for uncertainty in income taxes. The Council assessed all income tax positions taken where the statute of limitations remained open. Examples of these tax positions include the Council's tax-exempt status and potential sources of UBTI. The Council believes that its tax filing position will be sustained upon tax examinations; therefore, no liability for unrecognized income tax benefits has been recorded at June 30, 2011.

The Council's federal exempt organization business income tax return (Form 990) is subject to examination, generally for three years after it is filed with the Internal Revenue Service. The Council's California exempt organization business income tax return is subject to examination, generally for four years after it is filed with the Franchise Tax Board.

Statement of Functional Expenses:

The costs of providing the Council's various programs and services have been summarized on a functional basis in the Statement of Functional Expenses. Direct expenses are allocated to the related program or service benefited. Indirect expenses are generally allocated based on the direct salaries incurred or square footage used by each program or service benefited.

Cash and Cash Equivalents:

For purposes of the Statement of Cash Flows, the Council considers all highly liquid debt instruments purchased with a remaining maturity of three months or less to be cash equivalents.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Land Lease:

The Council leases the land on which its primary facility is located from Leland Stanford Junior University. The lease, which provides for a nominal annual rent, expires in 2046. The Council determined at the inception of the lease that the present value of the bargain rent to be received over the lease term was not material to its financial position.

Comparative Financial Information:

The financial statements include certain prior year summarized comparative information. 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 Council's financial statements for the year ended June 30, 2010, from which the summarized information was derived.

Recent Accounting Pronouncements:

In January 2010, FASB issued Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06) to add new disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances and settlements relating to Level 3 measurements. The Council adopted ASU 2010-06, effective July 1, 2010 with no material impact on the Council's financial statements and disclosures.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20), which requires reporting entities to make new disclosures about the nature of credit risk inherent in the entity's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. ASU 2010-20 will be effective for annual reporting periods ending on or after December 15, 2011. The Council does not expect the adoption of the pronouncement will have a material impact on its financial statements and disclosures.

Children's Health Council, Inc.
Notes to Financial Statements

2. Significant Accounting Policies (continued)

Recent Accounting Pronouncements: (continued)

In May 2011, the FASB issued Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS)* (ASU 2011-04), which results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements, and is not intended to result in a change in the application of fair value measurement reporting requirements. ASU 2011-04 will be effective for annual reporting periods beginning after December 15, 2011. The Council does not expect the adoption of the pronouncement will have a material impact on its financial statements and disclosures.

Reclassifications:

Certain prior year balances have been reclassified to conform with current year presentation.

3. Pledges Receivable

Pledges receivable consist of the following at June 30:

| | <u>2011</u> | <u>2010</u> |
|------------------------------------|-------------------|-------------------|
| Endowment Campaign | \$ 178,000 | \$ 228,000 |
| Programs and Other | <u>460,738</u> | <u>420,323</u> |
| | 638,738 | 648,323 |
| Less discount to net present value | <u>(76,429)</u> | <u>(82,618)</u> |
| Net Contributions Receivable | <u>\$ 562,309</u> | <u>\$ 565,705</u> |
| Amounts receivable in: | | |
| Less than one year | 3,000 | 3,000 |
| One to five years | <u>635,738</u> | <u>645,323</u> |
| | <u>\$ 638,738</u> | <u>\$ 648,323</u> |

Contributions to be received after one year from the financial statement date are reflected at the net present value of estimated future cash flows using a risk-adjusted discount rate of 5%. Uncollectible promises are expected to be insignificant.

Children's Health Council, Inc.
Notes to Financial Statements

3. Pledges Receivable (continued)

Pledges receivable include receivables from five irrevocable survivor trusts where the Council has been named as a remainder beneficiary. Management has recorded the estimated net present value of the Council's interest in the trusts at \$553,000 at June 30, 2011 (\$559,000 at June 30, 2010), based on the current estimated fair value of the trust assets and estimated payments to be made to the lifetime beneficiaries.

4. Investments and Fair Value Measurements

Fair value, cost and cumulative unrealized appreciation (depreciation) of the Council's investments are as follows at June 30, 2011:

| | <u>Fair Value</u> | <u>Cost</u> | <u>Cumulative Unrealized Appreciation (Depreciation)</u> |
|--|-----------------------|----------------------|--|
| Investments: | | | |
| Mutual funds | \$ 13,524,926 | \$ 11,182,194 | \$ 2,342,732 |
| Limited partnerships and private equity funds | <u>7,901,315</u> | <u>7,182,043</u> | <u>719,272</u> |
| Total | <u>\$ 21,426,241</u> | <u>\$ 18,364,237</u> | <u>\$ 3,062,004</u> |

In fiscal 2011, the Council redeemed \$788,000 of permanently restricted (endowment) investments in two private partnerships. The amount was yet to be received at June 30, 2011, and is presented as a permanently restricted receivable at June 30, 2011 (\$782,000 redeemed and yet to be received at June 30, 2010).

Fair value, cost and cumulative unrealized appreciation (depreciation) of the Council's investments are as follows at June 30, 2010:

| | <u>Fair Value</u> | <u>Cost</u> | <u>Cumulative Unrealized Appreciation (Depreciation)</u> |
|--|-----------------------|----------------------|--|
| Investments: | | | |
| Mutual funds | \$ 10,977,337 | \$ 10,402,541 | \$ 574,796 |
| Limited partnerships and private equity funds | <u>7,819,765</u> | <u>8,128,439</u> | <u>(308,674)</u> |
| Total | <u>\$ 18,797,102</u> | <u>\$ 18,530,980</u> | <u>\$ 266,122</u> |

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments and Fair Value Measurements (continued)

Investments are exposed to various risks, such as changes in interest rate, market, and credit risks. Economic concerns continue to challenge the global financial markets; hence, it is at least reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the Council's financial statements.

Investment income represents interest and dividends earned, net of investment management expenses. Realized gains and losses on investments are calculated as the difference between proceeds received and the original cost of the investment. Unrealized gains and losses represent the difference between the current fair value of the investments and their cost basis if purchased during the year or their fair value at the beginning of the year.

Investment income consists of the following for the year ended June 30, 2011:

| | <u>Interest and Dividends</u> | <u>Net Realized/ Unrealized Gain</u> | <u>Investment Management Expenses</u> | <u>Total</u> |
|--|-----------------------------------|--|---|---------------------|
| Mutual funds | \$ 336,124 | \$ 2,281,971 | \$ (109,083) | \$ 2,509,012 |
| Limited partnerships and private equity funds | - | 1,143,260 | - | 1,143,260 |
| | <u>\$ 336,124</u> | <u>\$ 3,425,231</u> | <u>\$ (109,083)</u> | <u>\$ 3,652,272</u> |

Investment income consists of the following for the year ended June 30, 2010:

| | <u>Interest and Dividends</u> | <u>Net Realized/ Unrealized Gain</u> | <u>Investment Management Expenses</u> | <u>Total</u> |
|--|-----------------------------------|--|---|---------------------|
| Mutual funds | \$ 269,904 | \$ 1,055,325 | \$ (101,753) | \$ 1,223,476 |
| Limited partnerships and private equity funds | - | 1,271,566 | - | 1,271,566 |
| | <u>\$ 269,904</u> | <u>\$ 2,326,891</u> | <u>\$ (101,753)</u> | <u>\$ 2,495,042</u> |

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments and Fair Value Measurements (continued)

The Council categorizes its investments in the financial statements into a three-level hierarchy for fair value measurements based on the nature of inputs used in the valuation of an asset or liability as of the measurement date. The Council defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The three-level hierarchy for fair value measurements is defined as follows:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

An investment's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried at fair value as of June 30, 2011 and 2010, by the three-level valuation hierarchy.

The Council's investments classified as Level 1 within the fair value hierarchy are summarized as follows at June 30:

| | <u>2011</u> | <u>2010</u> |
|---|----------------------|----------------------|
| Mutual funds: | | |
| Income funds | \$ 2,555,298 | \$ 2,741,969 |
| Domestic equity funds | 5,118,508 | 3,815,246 |
| International equity funds | 2,550,534 | 2,103,595 |
| Emerging market equity funds | 1,851,433 | 1,393,268 |
| Absolute return funds | 684,834 | 511,428 |
| Natural resources and commodities funds | <u>764,319</u> | <u>411,831</u> |
| Total Level 1 investments at fair value | <u>\$ 13,524,926</u> | <u>\$ 10,977,337</u> |

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments and Fair Value Measurements (continued)

The Council's investments classified as Level 3 within the fair value hierarchy are summarized as follows at June 30:

| | <u>2011</u> | <u>2010</u> |
|---------------------------------------|---------------------|---------------------|
| Private equity funds and partnerships | <u>\$ 7,901,315</u> | <u>\$ 7,819,765</u> |

The table below includes a summary of activity for investments classified by the Council within Level 3 of the fair value hierarchy, including the change in fair value, for the years ended June 30, 2011 and 2010. When a determination is made to classify an investment within Level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. However, Level 3 investments typically include, in addition to the unobservable Level 3 inputs, observable components (that is, components that are actively quoted or can be validated to market-based sources). The gains and losses in the table below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

| | |
|---|---------------------|
| Fair Value, June 30, 2009 | \$ 8,348,200 |
| Contributions | 253,900 |
| Distributions | (2,053,901) |
| Net realized gain included in the Statement of Activities | 226,632 |
| Net unrealized gain included in the Statement of Activities | <u>1,044,934</u> |
| Fair Value, June 30, 2010 | 7,819,765 |
| Contributions | 2,361,342 |
| Distributions | (3,422,299) |
| Net realized gain included in the Statement of Activities | 259,715 |
| Net unrealized gain included in the Statement of Activities | <u>882,792</u> |
| Fair Value, June 30, 2011 | <u>\$ 7,901,315</u> |

The Council uses the net asset value method to determine the fair value of all the underlying Level 3 investments, which do not have a readily determinable fair value and prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. Significant portions of the assets comprising the value of the Council's Level 3 investments are investments that are not readily marketable. As a result, the fair values of these portfolio investments recorded in the financial statements have been estimated by the fund managers and general partners of these private equity funds and partnerships based on a variety of factors deemed relevant by the fund manager or general partner.

Children's Health Council, Inc.
Notes to Financial Statements

4. Investments and Fair Value Measurements (continued)

While the fund managers or general partners believe their valuation methods are appropriate and consistent with those used by other market participants, the use of different methodologies or assumptions to determine the fair value of the non-marketable investments could result in a different estimate of fair value at the reporting date. Estimated fair values may differ significantly from the values that would have been used had a readily available market for such investments existed, or had such investments been liquidated, and these differences could be material to the financial statements.

Level 3 investments include twelve private equity funds and partnerships that invest in domestic and foreign companies. The private equity funds and partnerships have varying investment strategies and vintage years. Distributions from the private equity funds and partnerships are received through the liquidation of its underlying assets. At June 30, 2011, the Council's Level 3 investments have varying redemption options to provide the Council with liquidity, ranging from quarterly, annual, and tri-annual redemption opportunities for investments that will not be redeemable until the calendar year 2015 through 2030.

The Council has commitments to invest additional capital to fund certain of its non-marketable securities. At June 30, 2011, the Council had future capital call commitments of \$785,000, which are payable when required by the fund managers or general partners

5. Property and Equipment

Property and equipment, which are unrestricted, are comprised of the following at June 30:

| | <u>2011</u> | <u>2010</u> |
|-------------------------------|---------------------|---------------------|
| Building | \$ 9,535,522 | \$ 9,467,738 |
| Equipment | 1,197,512 | 1,074,365 |
| Furniture and fixtures | 654,258 | 654,258 |
| Computer software | 592,631 | - |
| Automobiles | <u>104,176</u> | <u>104,176</u> |
| | 12,084,099 | 11,300,537 |
| Less accumulated depreciation | <u>(4,887,050)</u> | <u>(4,623,512)</u> |
| | <u>\$ 7,197,049</u> | <u>\$ 6,677,025</u> |

Children's Health Council, Inc.
Notes to Financial Statements

6. Temporarily Restricted Net Assets

Temporarily restricted net assets are restricted for the following purposes at June 30:

| | <u>2011</u> | <u>2010</u> |
|---------------------------------|-------------------|-------------------|
| Outpatient Clinical Programs | \$ 81,850 | \$ 129,384 |
| School Programs | 290,211 | 79,933 |
| Unappropriated Endowment Income | 250,000 | - |
| Other | <u>121,882</u> | <u>2,108</u> |
| | <u>\$ 743,943</u> | <u>\$ 211,425</u> |

Net assets were released from donor restrictions by the passage of time or incurring expenses satisfying the restricted purposes as follows for the years ended June 30:

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| Time and Purpose Restrictions Accomplished Based on Stipulations of the Donor: | | |
| Outpatient clinical programs | \$ 46,614 | \$ 169,213 |
| School programs | 146,489 | 42,039 |
| Other | <u>67,136</u> | <u>253,365</u> |
| | <u>\$ 260,239</u> | <u>\$ 464,617</u> |

7. Endowment

The Council's endowment consists of donor restricted endowment funds, accumulated earnings on such funds, and funds designated by the Board of Directors to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

Children's Health Council, Inc.
Notes to Financial Statements

7. Endowment (continued)

The Council's Board of Directors has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Council classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) 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 in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Council in a manner consistent with the standard of prudence prescribed by SPMIFA. Once appropriated, these amounts are classified as unrestricted net assets.

In accordance with SPMIFA, the Council considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- (1) The duration and preservation of the fund;
- (2) The purposes of the Council and the donor restricted endowment fund;
- (3) General economic conditions;
- (4) The possible effect of inflation and deflation;
- (5) The expected total return from income and the appreciation of investments;
- (6) Other resources of the Council;
- (7) The Council's investment policies.

The Council has adopted investment and spending policies, approved by the Board of Directors, for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income as well as capital appreciation, which exceeds the annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes mutual funds, private equity funds and partnerships, that is intended to result in a consistent rate of return that has sufficient liquidity to make an annual distribution of 5-6%, while growing the funds if possible. The long-term targeted asset allocation is: 20% cash, cash equivalents and fixed income securities; 40% equity securities (50% domestic equity securities, 50% international equity securities); and 40% private equity funds and partnerships. Endowment assets are subject to asset class diversification and limitation guidelines in order to avoid excessive investment concentration and to protect the portfolio against unfavorable outcomes within an asset class.

Children’s Health Council, Inc.
Notes to Financial Statements

7. Endowment (continued)

The Council monitors the portfolio’s composite investment performance (net of fees) against a composite benchmark consisting of the following unmanaged market indices weighted according to the expected target asset allocations stipulated by the endowment’s investment guidelines:

- a) Domestic equity: Russell 3000 Index
- b) International equity: MSCI EAFE Index
- c) Fixed income: Barclays Capital Aggregate Bond Index and Citigroup World Government Bond Index
- d) Private equity funds and partnerships: Cambridge Associates LLC US Private Equity Index

The Council has a policy of appropriating for distribution each year 5-6% of the permanently restricted assets average fair value of the prior 12 quarters ending March 31 preceding the fiscal year in which the distribution is planned. In establishing this policy, the Council considered the long-term expected return on its investment assets and the nature and duration of the individual endowment funds and relies on a total return strategy in which investment returns are achieved through both capital appreciation, realized and unrealized, and current yield, such as interest and dividends. The Council expects the current spending policy to allow its endowment funds to grow at a nominal average rate of 3% annually, which is consistent with the Council’s objective to maintain the purchasing power of the endowment assets as well as to provide additional real growth through investment return.

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 SPMIFA requires the Council to retain as a fund of perpetual duration. Endowment investment gains in fiscal 2011 and 2010 have been classified as unrestricted net assets to capture the endowment investment losses recorded in unrestricted net assets in prior years. At June 30, 2011, the fair value of endowment investments exceeded cost by \$250,000. The cost of the endowment investments exceeded their fair value by \$2,488,000 at June 30, 2010.

Endowment assets consist of the following at June 30, 2011:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|------------------------------------|---------------------|-----------------------------------|-----------------------------------|---------------|
| Unappropriated Endowment Income | \$ - | \$ 250,000 | \$ 18,781,091 | \$ 19,031,091 |

Children's Health Council, Inc.
Notes to Financial Statements

7. Endowment (continued)

Endowment assets consist of the following at June 30, 2010:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|------------------|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Donor Restricted | | | | |
| Endowment Funds | \$ - | \$ - | \$ 18,771,465 | \$ 18,771,465 |
| Board Designated | | | | |
| Endowment Funds | <u>824,000</u> | <u>-</u> | <u>-</u> | <u>824,000</u> |
| | <u>\$ 824,000</u> | <u>\$ -</u> | <u>\$ 18,771,465</u> | <u>\$ 19,595,465</u> |

Changes in endowment net assets for the year ended June 30, 2011:

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|-----------------------|---------------------|-----------------------------------|-----------------------------------|----------------------|
| Endowment Net Assets, | | | | |
| June 30, 2010 | \$ 824,000 | \$ - | \$ 18,771,465 | \$ 19,595,465 |
| Contributions | - | - | 9,626 | 9,626 |
| Appropriation of | | | | |
| Board Designated | | | | |
| Endowment Assets | | | | |
| for Expenditure | (824,000) | - | - | (824,000) |
| Unappropriated | | | | |
| Endowment Income | <u>-</u> | <u>250,000</u> | <u>-</u> | <u>250,000</u> |
| Endowment Net Assets, | | | | |
| June 30, 2011 | <u>\$ -</u> | <u>\$ 250,000</u> | <u>\$ 18,781,091</u> | <u>\$ 19,031,091</u> |

The appropriation of the Board Designated Endowment Funds was for the following purposes:

| | |
|--|-------------------|
| Purchase of new electronic health recordkeeping system | \$ 694,000 |
| Funding for Sand Hill School | <u>130,000</u> |
| | <u>\$ 824,000</u> |

Children's Health Council, Inc.
Notes to Financial Statements

8. Commitments and Contingencies

Lease:

The Council has a non-cancelable operating lease for its Bargain Box retail facility located in Palo Alto, California, which expires in August 2014. Rent expense was \$69,000 in fiscal 2011 (\$72,000 in fiscal 2010).

Future minimum rental payments under the lease are as follows for fiscal years ending June 30:

| | | |
|-------|----|----------------|
| 2012 | \$ | 69,000 |
| 2013 | | 69,000 |
| 2014 | | 69,000 |
| 2015 | | <u>11,000</u> |
| Total | \$ | <u>218,000</u> |

Government Contract Contingency:

The Council contracts with the County of Santa Clara, California (the County) to provide certain clinical and school services. The County, in turn, is reimbursed by the State of California for these payments. Historically, the Council has exceeded the service requirements on the contracts and reached the contract maximum for payments received. In fiscal 2003, the County received additional State funding for the programs provided under the contracts and passed it through to providers which had exceeded their contract service requirements. As a result, the Council received \$1,143,251 for excess services reported to the County in fiscal 1997 through 2001. The County's records and reconciliations are subject to final audit and settlement by the State Controller's office. The results of this audit will be contingent on the recordkeeping of both the County and the Council. However, management believes any adjustment that could result from a State audit will not be significant.

The Council is entitled to payment for excess services provided to the County in fiscal 2002 through 2007. Accordingly, the Council has recorded a non-current receivable of \$1,879,747 at June 30, 2011 and 2010, for excess services reported to the County after fiscal 2001. The State Controller's Office has audited the Council's excess services through fiscal 2006. The Council has reserved \$1,206,000 at June 30, 2011, (\$940,000 at June 30, 2010) against this account receivable due to the collection and audit risk associated with these excess service billings in the current economic climate. The collection of these excess service billings is dependent on future State funding becoming available in amounts sufficient for the County to reimburse the Council and the County's other service providers. The estimated reserve for uncollectible billings at June 30, 2011, is subject to change as additional information is made available to the Council by the State and County, and such change could be material to the Council's future operations.

Children's Health Council, Inc.
Notes to Financial Statements

8. Commitments and Contingencies (continued)

Litigation:

From time to time, the Council receives inquiries or is involved in legal disputes. In the opinion of management, any liabilities resulting from these claims will not have a material adverse effect on the Council's financial position or results of operations.

9. Employee Benefit Plans

The Council has a defined contribution 403(b) plan for its employees. Employees may elect to participate at any time after employment and can contribute up to a maximum of 100% of their annual salaries, not to exceed \$16,500 for employees under age 50, and \$22,000 for employees age 50 and above per year. The Council may not make contributions to the plan.

The Council had a defined contribution pension 401(a) plan for eligible employees, as defined by the plan. The Council could not make contributions to the plan. In September 2011, the 401(a) plan was terminated.

10. Related Party Transactions

A member of the Council's investment committee, who was not compensated by the Council during fiscal 2011, is the president for one of the non-marketable investments that the Council is invested in. The investment has a fair value of \$1,871,000 at June 30, 2011 (\$1,697,000 at June 30, 2010).

A member of the Council's Board of Directors, who was not compensated by the Council during fiscal 2011, donated \$301,000 in temporarily restricted funds and \$20,000 in unrestricted funds during fiscal 2011.

11. Subsequent Events

Management has reviewed subsequent events and transactions that occurred after the statement of financial position date through December 23, 2011, the date the financial statements were issued. The financial statements include all events or transactions, including estimates, required to be recognized in accordance with generally accepted accounting principles. Management has determined that there are no unrecognized subsequent events that require additional disclosure.