

**Children's Health Council, Inc.**

**Financial Statements**

**June 30, 2012**

**(With Comparative Totals for 2011)**

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, 2012, 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 comparative information has been derived from the Council's June 30, 2011 financial statements and, in our report dated December 23, 2011, we expressed an unqualified opinion on those financial statements.

Palo Alto  
San Francisco  
San Jose  
St. Helena  
New York

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, 2012, 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.



January 23, 2013

**Children's Health Council, Inc.**  
**Statement of Financial Position**  
**June 30, 2012 (with Summarized Comparative Totals 2011)**

	Unrestricted	Temporarily Restricted	Permanently Restricted (Endowment)	June 30, 2012 Total	June 30, 2011 Total
<b>ASSETS</b>					
Cash and Cash Equivalents	\$ 595,294	\$ 424,477	\$ 116,213	\$ 1,135,984	\$ 485,476
Accounts Receivable, net of allowance for doubtful accounts of \$500,307 (\$1,384,202 in 2011)	1,506,350	-	-	1,506,350	2,783,148
Pledges Receivable, net	428,101	-	117,918	546,019	562,309
Prepaid Expenses and Other Assets	102,106	-	-	102,106	94,768
Investments	2,138,765	-	18,548,032	20,686,797	21,426,241
Property and Equipment, net	7,206,229	-	-	7,206,229	7,197,049
Receivable from Sale of Investments	-	-	-	-	787,780
Total assets	<u>\$ 11,976,845</u>	<u>\$ 424,477</u>	<u>\$ 18,782,163</u>	<u>\$ 31,183,485</u>	<u>\$ 33,336,771</u>
<b>LIABILITIES AND NET ASSETS</b>					
<b>Liabilities</b>					
Accounts payable	\$ 234,857	\$ -	\$ -	\$ 234,857	\$ 272,768
Accrued expenses and other liabilities	1,142,681	-	-	1,142,681	1,128,188
Deferred revenue	393,277	-	-	393,277	202,207
Total liabilities	1,770,815	-	-	1,770,815	1,603,163
<b>Commitments and Contingencies (Notes 5 and 9)</b>					
<b>Net Assets</b>					
Unrestricted	10,206,030	-	-	10,206,030	12,208,574
Temporarily restricted	-	424,477	-	424,477	743,943
Permanently restricted (endowments)	-	-	18,782,163	18,782,163	18,781,091
Total net assets	<u>10,206,030</u>	<u>424,477</u>	<u>18,782,163</u>	<u>29,412,670</u>	<u>31,733,608</u>
Total liabilities and net assets	<u>\$ 11,976,845</u>	<u>\$ 424,477</u>	<u>\$ 18,782,163</u>	<u>\$ 31,183,485</u>	<u>\$ 33,336,771</u>

See Notes to Financial Statements

**Children's Health Council, Inc.**  
**Statement of Activities**  
**Year Ended June 30, 2012 (with Summarized Comparative Totals for 2011)**

	Unrestricted	Temporarily Restricted	Permanently Restricted (Endowment)	Year Ended June 30, 2012 Total	Year Ended June 30, 2011 Total
<b>Public Support</b>					
Donations	\$ 1,221,478	\$ -	\$ 1,072	\$ 1,222,550	\$ 842,674
Auxiliary and special events, net	401,015	-	-	401,015	333,924
Foundation and trust grants	-	331,933	-	331,933	542,757
	<u>1,622,493</u>	<u>331,933</u>	<u>1,072</u>	<u>1,955,498</u>	<u>1,719,355</u>
<b>Revenue</b>					
Patient fees and insurance payments	2,045,990	-	-	2,045,990	2,378,119
School district funding	3,194,173	-	-	3,194,173	2,878,534
Government contracts	1,873,840	-	-	1,873,840	3,057,798
Tuition	499,990	-	-	499,990	79,808
Other income	207,118	-	-	207,118	491,416
	<u>7,821,111</u>	<u>-</u>	<u>-</u>	<u>7,821,111</u>	<u>8,885,675</u>
Net Assets Released from Restrictions	<u>401,399</u>	<u>(401,399)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total public support and revenue	<u>9,845,003</u>	<u>(69,466)</u>	<u>1,072</u>	<u>9,776,609</u>	<u>10,605,030</u>
<b>Expenses</b>					
Program services:					
Outpatient clinical services	4,729,239	-	-	4,729,239	5,639,588
School services	4,045,405	-	-	4,045,405	3,493,707
	<u>8,774,644</u>	<u>-</u>	<u>-</u>	<u>8,774,644</u>	<u>9,133,295</u>
Supporting services:					
Administration, management and general	2,168,949	-	-	2,168,949	2,670,596
Fundraising	501,695	-	-	501,695	406,637
	<u>2,670,644</u>	<u>-</u>	<u>-</u>	<u>2,670,644</u>	<u>3,077,233</u>
Total expenses	<u>11,445,288</u>	<u>-</u>	<u>-</u>	<u>11,445,288</u>	<u>12,210,528</u>
Increase (decrease) in net assets from operations	<u>(1,600,285)</u>	<u>(69,466)</u>	<u>1,072</u>	<u>(1,668,679)</u>	<u>(1,605,498)</u>
<b>Investment Income (Loss)</b>					
Interest, dividends and earnings, net	341,111	-	-	341,111	272,022
Net realized and unrealized gain (loss)	<u>(743,370)</u>	<u>(250,000)</u>	<u>-</u>	<u>(993,370)</u>	<u>3,380,250</u>
Net investment income (loss)	<u>(402,259)</u>	<u>(250,000)</u>	<u>-</u>	<u>(652,259)</u>	<u>3,652,272</u>
Change in Net Assets	<u>(2,002,544)</u>	<u>(319,466)</u>	<u>1,072</u>	<u>(2,320,938)</u>	<u>2,046,774</u>
Net Assets, beginning 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>
Net Assets, end of year	<u>\$ 10,206,030</u>	<u>\$ 424,477</u>	<u>\$ 18,782,163</u>	<u>\$ 29,412,670</u>	<u>\$ 31,733,608</u>

See Notes to Financial Statements

**Children's Health Council, Inc.**  
**Statement of Functional Expenses**  
**Year Ended June 30, 2012**

	Outpatient Clinical Services	School Services	Total Program Services	Administration, Management and General	Fundraising	Total Supporting Services	Total
Salaries, Benefits, Contract Staff and Payroll Taxes	\$ 4,237,353	\$ 2,803,987	\$ 7,041,340	\$ 1,472,502	\$ 388,783	\$ 1,861,285	\$ 8,902,625
Operating Expenses	161,877	869,223	1,031,100	449,525	85,730	535,255	1,566,355
Utilities and Maintenance	163,156	183,221	346,377	105,457	13,009	118,466	464,843
Insurance	38,478	37,945	76,423	31,818	2,846	34,664	111,087
Total Expenses before Depreciation	4,600,864	3,894,376	8,495,240	2,059,302	490,368	2,549,670	11,044,910
Depreciation	128,375	151,029	279,404	109,647	11,327	120,974	400,378
Total expenses	<u>\$ 4,729,239</u>	<u>\$ 4,045,405</u>	<u>\$ 8,774,644</u>	<u>\$ 2,168,949</u>	<u>\$ 501,695</u>	<u>\$ 2,670,644</u>	<u>\$ 11,445,288</u>
Percentage of Total Expenses	<u>41%</u>	<u>36%</u>	<u>77%</u>	<u>19%</u>	<u>4%</u>	<u>23%</u>	<u>100%</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.**  
**Statements of Cash Flows (with Comparative Totals for 2011)**

	Years Ended June 30,	
	2012	2011
Cash Flows from Operating Activities		
Change in net assets	\$ (2,320,938)	\$ 2,046,774
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	400,378	283,801
Amortization of discount on pledges receivable	(943)	(6,189)
Net realized and unrealized (gain) loss on investments	993,370	(3,380,250)
Allowance for doubtful accounts	(883,895)	54,012
Changes in operating assets and liabilities:		
Accounts receivable	2,160,693	(341,335)
Pledges receivable	14,233	(40,415)
Prepaid expenses and other assets	(7,338)	50,528
Accounts payable and other current liabilities	(23,418)	11,836
Deferred revenue	191,070	(21,506)
Net cash provided by (used in) operating activities	523,212	(1,342,744)
Cash Flows from Investing Activities		
Proceeds from sale of investments	7,147,466	4,735,340
Purchase of investments	(6,566,373)	(4,714,177)
Reinvested investment income	(47,239)	(57,832)
Purchase of property and equipment	(409,558)	(803,825)
Proceeds from receivable from sale of investments	-	782,394
Net cash provided by (used in) investing activities	124,296	(58,100)
Cash Flows from Financing Activities		
Proceeds from contributions receivable restricted for endowment	3,000	50,000
Net cash provided by financing activities	3,000	50,000
Net Increase (Decrease) in Cash and Cash Equivalents	650,508	(1,350,844)
Cash and Cash Equivalents, beginning of year	485,476	1,836,320
Cash and Cash Equivalents, end of year	\$ 1,135,984	\$ 485,476
Supplemental Schedule of Noncash Investing Activities		
Receivable from sale of investments	\$ -	\$ 787,780

See Notes to Financial Statements

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

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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 four distinct service divisions:

The Community Clinic provides assessment and treatment services for children who face a full range of mental health, developmental and behavioral issues and who are primarily funded by Santa Clara County Medi-Cal, Healthy Families, and First 5 Santa Clara County.

The Center provides integrated assessment and treatment services, and innovative programs for children and families who face social-emotional, developmental, behavioral and learning challenges to life and school success.

The Esther B. Clark School (EBC School), a nonpublic therapeutic school with a campus located at the Council, serves students between the ages of seven and sixteen who have anxiety, depression and/or ADHD and may also have accompanying learning disabilities or speech-language disorders. EBC School employs a combination of therapeutic, academic and enrichment opportunities to create an individualized comprehensive plan for each student. When a student is equipped emotionally and educationally to return to local public school, he or she is gradually transitioned to ensure successful reintegration, generally within one to two years.

Sand Hill School, which opened in February 2011, is a private school with a campus located at Children's Health Council, Inc. Sand Hill School offers a personalized learning environment for young, bright children with learning and attention challenges for grades K-4. The school's goal is to restore confidence in children by helping them acquire the skills and resiliency to thrive in traditional classroom settings.



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

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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 endowment assets restricted by the donor in perpetuity and consist of cash equivalents, 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. 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**

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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 direct costs and expenses. Revenues and expenses associated with the Bargain Box and special events are as follows for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Summer Symphony	\$ 750,295	\$ 816,971
Bargain Box	295,833	270,985
Concert Series	178,772	-
Other Events	<u>15,400</u>	<u>14,000</u>
Total revenues	1,240,300	1,101,956
Summer Symphony Cash Expenditures	452,949	482,145
Summer Symphony In-Kind Goods and Services	48,532	131,694
Bargain Box	158,262	154,193
Concert Series	<u>179,542</u>	<u>-</u>
Total expenses	<u>839,285</u>	<u>768,032</u>
Auxiliary and special events, net	<u>\$ 401,015</u>	<u>\$ 333,924</u>

The fiscal 2012 Summer Symphony event was held in September 2012. As a result, fiscal 2012 operations do not include revenue and expenses related to the 2012 event. The 2011 Summer Symphony event was held in September 2011; therefore, revenues, net of expenses, are included in 2012 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**

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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, 2012. 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 \$13,583,000 at June 30, 2012 (\$13,432,000 at June 30, 2011), respectively. Non-marketable securities of \$7,520,000 at June 30, 2012 (\$7,901,000 at June 30, 2011) 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 buildings.

*Investments:*

Investments in marketable securities are presented at fair value based on prices quoted on established securities exchanges. Non-marketable investments in limited partnerships and private equity funds are reported at fair value based on quoted market prices, to the extent these funds are invested in publicly traded investments. The remaining investments are carried at estimated fair values as determined by the general partners and investment managers of these funds after giving consideration to operating results, financial condition, recent sales prices of issuers' securities and other pertinent information. These investments are valued at the Council's percentage interest owned in these funds. Because of the inherent uncertainty of valuations, however, the estimated fair values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

The Council's investment portfolio of marketable and non-marketable securities is managed by an independent investment advisor. The Council's investment committee establishes investment policy, measures and evaluates investment performance, oversees the investment advisors and reviews the investment accounts periodically to ensure compliance with the Council's established investment policies.

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

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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 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 positions will be sustained upon tax examinations; therefore, no liability for unrecognized income tax benefits has been recorded at June 30, 2012 or 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 Statements 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 Statements 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**

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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, 2011, from which the summarized information was derived.

*Reclassifications:*

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

*Recent Accounting Pronouncements:*

In May 2011, the Financial Accounting Standards Board (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.

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

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3. Pledges Receivable

Pledges receivable consist of the following at June 30:

	<u>2012</u>	<u>2011</u>
Endowment Campaign	\$ 175,000	\$ 178,000
Programs and Other	<u>446,505</u>	<u>460,738</u>
	621,505	638,738
Less discount to net present value	<u>(75,486)</u>	<u>(76,429)</u>
Net Contributions Receivable	<u>\$ 546,019</u>	<u>\$ 562,309</u>
Amounts receivable in:		
Less than one year	\$ -	\$ 3,000
One to five years	<u>621,505</u>	<u>635,738</u>
	<u>\$ 621,505</u>	<u>\$ 638,738</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.

Pledges receivable include receivables from four irrevocable survivor trusts (five in 2011) 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 \$544,000 at June 30, 2012 (\$553,000 at June 30, 2011), based on the current estimated fair value of the trust assets and estimated payments to be made to the lifetime beneficiaries.

4. Investments

Fair value, cost and cumulative unrealized appreciation of the Council's investments are as follows at June 30, 2012:

	<u>Fair Value</u>	<u>Cost</u>	<u>Cumulative Unrealized Appreciation</u>
Investments:			
Mutual funds	\$ 13,166,642	\$ 11,962,128	\$ 1,204,514
Limited partnerships and private equity funds	<u>7,520,155</u>	<u>6,964,043</u>	<u>556,112</u>
Total	<u>\$ 20,686,797</u>	<u>\$ 18,926,171</u>	<u>\$ 1,760,626</u>

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

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4. Investments (continued)

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 was presented as a permanently restricted receivable at June 30, 2011.

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

	<u>Fair Value</u>	<u>Cost</u>	<u>Cumulative Unrealized Appreciation</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>

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 and earnings from limited partnerships and private equity funds, 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.

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

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4. Investments (continued)

Net investment loss consists of the following for the year ended June 30, 2012:

	Interest, Dividends and Earnings	Net Realized/ Unrealized Loss	Investment Management Expenses	Total
Mutual funds	\$ 429,380	\$ (931,005)	\$ (106,733)	\$ (608,358)
Limited partnerships and private equity funds	<u>18,464</u>	<u>(62,365)</u>	<u>-</u>	<u>(43,901)</u>
	<u>\$ 447,844</u>	<u>\$ (993,370)</u>	<u>\$ (106,733)</u>	<u>\$ (652,259)</u>

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

	Interest, Dividends and Earnings	Net Realized/ Unrealized Gain	Investment Management Expenses	Total
Mutual funds	\$ 336,124	\$ 2,336,787	\$ (109,083)	\$ 2,563,828
Limited partnerships and private equity funds	<u>44,477</u>	<u>1,043,967</u>	<u>-</u>	<u>1,088,444</u>
	<u>\$ 380,601</u>	<u>\$ 3,380,754</u>	<u>\$ (109,083)</u>	<u>\$ 3,652,272</u>

5. Fair Value Measurements

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.



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

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5. Fair Value Measurements (continued)

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

	<u>2012</u>	<u>2011</u>
Mutual Funds:		
Equity funds:		
Domestic	\$ 5,042,567	\$ 5,118,508
International	2,560,931	2,550,534
Income funds:		
Domestic	2,193,871	2,555,298
International	423,615	-
Emerging market funds	1,538,144	1,851,433
Natural resources and commodities funds	704,935	764,319
Absolute return funds	<u>702,579</u>	<u>684,834</u>
Total	<u>\$ 13,166,642</u>	<u>\$ 13,524,926</u>

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

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5. 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>2012</u>	<u>2011</u>
Limited partnerships and private equity funds	<u>\$ 7,520,155</u>	<u>\$ 7,901,315</u>

Level 3 investments include twelve limited partnerships and private equity funds that invest in domestic and foreign companies. The limited partnerships and private equity funds 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, 2012, 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 years 2015 through 2030.

The tables below include a roll-forward of the amounts in the Statements of Financial Position for the years ended June 30, 2012 and 2011 (including the change in fair value) for non-marketable securities classified by the Council within Level 3 of the fair value hierarchy. 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 tables below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

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

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5. Fair Value Measurements (continued)

Investment activity in in the Council's non-marketable securities consists of the following for the year ended June 30, 2012:

	June 30, 2011	Contributions	Realized and Unrealized Gain (Loss)	Investment Income	Distributions	June 30, 2012
Fortress Partners Offshore Fund L.P.	\$ 2,728,625	\$ -	\$ (201,180)	\$ -	\$ -	\$ 2,527,445
HCP Absolute Return Fund Offshore Feeder, L.P.	1,870,743	-	(25,883)	-	-	1,844,860
GT Offshore Fund, Ltd. Class A	840,953	-	-	-	(829,284)	11,669
GT Offshore Fund, Ltd. Class B	582,632	700,000	(5,453)	-	(367,000)	910,179
Common Sense Long-Biased Offshore, Ltd.	507,957	-	6,171	-	-	514,128
Palladian Partners VI, LP	338,626	117,000	49,873	-	-	505,499
Penn Square Global Real Estate Fund I, L.P.	321,215	-	11,141	-	-	332,356
Hudson Realty Capital Fund IV Co-Investment Vehicle, LP	197,227	-	438	2,459	(5,328)	194,796
Metropolitan Real Estate Partners VI, L.P.	157,541	30,000	39,839	4,832	(25,707)	206,505
Metropolitan Real Estate Partners 2008 Distressed Co-Investment Vehicle, LP	150,816	56,250	27,293	10,545	(37,360)	207,544
Rosemont Solebury Co-Investment Fund (Offshore), L.P.	137,590	52,156	24,236	628	(4,841)	209,769
RCH Energy MLP Fund, L.P.	67,390	2,495	5,297	-	(19,777)	55,405
Total	<u>\$ 7,901,315</u>	<u>\$ 957,901</u>	<u>\$ (68,228)</u>	<u>\$ 18,464</u>	<u>\$ (1,289,297)</u>	<u>\$ 7,520,155</u>

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

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5. Fair Value Measurements (continued)

Investment activity in in the Council's non-marketable securities consists of the following for the year ended June 30, 2011:

	June 30, 2010	Contributions	Realized and Unrealized Gain	Investment Income	Distributions	June 30, 2011
Fortress Partners Offshore Fund L.P.	\$ 2,469,577	\$ -	\$ 259,048	\$ -	\$ -	\$ 2,728,625
HCP Absolute Return Fund Offshore Feeder, L.P.	1,697,423	-	173,320	-	-	1,870,743
RCH Energy MLP Fund, L.P.	782,966	67,390	259,715	29,369	(1,072,050)	67,390
GT Offshore Fund, Ltd. Class A	742,416	-	98,537	-	-	840,953
Thirteen Partners Offshore, LTD	719,141	718,955	-	-	(1,438,096)	-
GT Offshore Fund, Ltd. Class B	595,078	-	72,054	-	(84,500)	582,632
Penn Square Global Real Estate Fund I, L.P.	222,122	50,000	49,093	-	-	321,215
Hudson Realty Capital Fund IV Co-Investment Vehicle, LP	189,692	-	7,535	2,049	(2,049)	197,227
Palladian Partners VI, LP	179,051	84,500	75,075	-	-	338,626
Metropolitan Real Estate Partners 2008 Distressed Co-Investment Vehicle, LP	89,573	60,625	5,672	7,071	(12,125)	150,816
Metropolitan Real Estate Partners VI, L.P.	81,169	71,250	10,897	1,725	(7,500)	157,541
Rosemont Solebury Co-Investment Fund (Offshore), L.P.	51,557	83,331	25,064	4,263	(26,625)	137,590
Common Sense Long-Biased Offshore, Ltd.	-	500,000	7,957	-	-	507,957
Total	<u>\$ 7,819,765</u>	<u>\$ 1,636,051</u>	<u>\$ 1,043,967</u>	<u>\$ 44,477</u>	<u>\$ (2,642,945)</u>	<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 general partners and fund managers of these limited partnerships and private equity funds based on a variety of factors deemed relevant by the general partner and fund manager.

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

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5. Fair Value Measurements (continued)

While the general partners and fund managers 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.

The Council has commitments to invest additional capital to fund certain of its non-marketable securities. At June 30, 2012, the Council had future capital call commitments of \$542,000, which are payable when required by the general partners or fund managers.

6. Property and Equipment

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

	<u>2012</u>	<u>2011</u>
Building	\$ 9,696,291	\$ 9,535,522
Equipment	1,247,697	1,197,512
Computer software	790,139	592,631
Furniture and fixtures	655,349	654,258
Automobiles	<u>104,176</u>	<u>104,176</u>
	12,493,652	12,084,099
Less accumulated depreciation	<u>(5,287,423)</u>	<u>(4,887,050)</u>
	<u>\$ 7,206,229</u>	<u>\$ 7,197,049</u>

7. Temporarily Restricted Net Assets

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

	<u>2012</u>	<u>2011</u>
School Programs	\$ 215,775	\$ 290,211
Outpatient Clinical Programs	69,548	81,850
Unappropriated Endowment Income	-	250,000
Other	<u>139,154</u>	<u>121,882</u>
	<u>\$ 424,477</u>	<u>\$ 743,943</u>

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

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7. Temporarily Restricted Net Assets (continued)

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>2012</u>	<u>2011</u>
Time and Purpose Restrictions Accomplished Based on Stipulations of the Donor:		
School programs	\$ 249,078	\$ 146,489
Outpatient clinical programs	77,194	46,614
Other	<u>75,127</u>	<u>67,136</u>
	<u>\$ 401,399</u>	<u>\$ 260,239</u>

8. 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.

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.

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

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8. Endowment (continued)

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 limited partnerships, that is intended to result in a consistent rate of return that has sufficient liquidity to make an annual distribution of 5%, while growing the funds, if possible. The long-term targeted asset allocation is: 40% cash, cash equivalents and fixed income securities; 36% equity securities (50% domestic equity securities, 50% international equity securities); and 24% limited partnerships and private equity funds. 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**

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8. Endowment (continued)

The Council's investment committee 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 Total Return Index
- b) International equity: MSCI ACWI ex-US Total Return Index
- c) Fixed income: Barclays Capital Aggregate Bond Index and Citigroup World Government Bond Index
- d) Limited partnerships and private equity funds: Cambridge Associates LLC US Private Equity Index

In addition, the Council's investment advisor will strive to outperform the following benchmarks by 1% or more:

- a) Barclays U.S. Aggregate Bond Index
- b) S&P 500 Total Return Index

The Council has a policy of appropriating for distribution each year 5% 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 considers 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.

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. In fiscal 2012, the Council allocated the cumulative unrealized depreciation of \$279,000 that would have reduced fair value below the cost of the permanently restricted endowment investments to unrestricted investment loss in order to preserve the corpus portion of these permanently restricted investments. Endowment investment gains in fiscal 2011 were classified as unrestricted net assets to capture the endowment investment losses recorded in unrestricted net assets in prior years. The fair value of the endowment investments exceeded their cost by \$250,000 at June 30, 2011.



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

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8. Endowment (continued)

Endowment assets consist of the following at June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor Restricted Endowment Funds	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 18,782,163</u>	<u>\$ 18,782,163</u>

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	\$ -	\$ 250,000
Donor Restricted Endowment Funds	<u>-</u>	<u>-</u>	<u>18,781,091</u>	<u>18,781,091</u>
	<u>\$ -</u>	<u>\$ 250,000</u>	<u>\$ 18,781,091</u>	<u>\$ 19,031,091</u>

Changes in endowment net assets for the year ended June 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, June 30, 2011	\$ -	\$ 250,000	\$ 18,781,091	\$ 19,031,091
Contributions	-	-	1,072	1,072
Unappropriated Endowment Loss	<u>-</u>	<u>(250,000)</u>	<u>-</u>	<u>(250,000)</u>
Endowment Net Assets, June 30, 2012	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 18,782,163</u>	<u>\$ 18,782,163</u>

**Children’s Health Council, Inc.**  
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9. 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 2012 and 2011.

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

2013	\$	69,000
2014		69,000
2015		<u>11,000</u>
Total	\$	<u>149,000</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 had recorded a non-current receivable of \$1,879,747 at June 30, 2011 for excess services to the County after fiscal 2001. The State Controller’s Office has audited the Council’s excess services through fiscal 2006. The Council has fully reserved the receivable at June 30, 2012 (reserved \$1,206,000 at June 30, 2011) due to the collection risk associated with these excess service billings in the current economic climate. The collection of these excess service billings is dependent upon future State funding becoming available in amounts sufficient for the County to reimburse the Council and the County’s other service providers. Based on the current and projected economic status of the California economy, the Council has determined the collection of the receivable is not reasonably assured and has written off the receivable as of June 30, 2012. Any amounts collected from the County will be recognized as other income when received.

**Children's Health Council, Inc.**  
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9. 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.

10. 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 (the Plan) for eligible employees, as defined by the Plan. Effective November 1, 2010, the Council's Board of Directors approved the termination of the Plan. Participants remained fully vested in their accounts, with rights to benefits accrued to the benefit payment date. Plan participants had the option to transfer account balances to the Council's 403(b) plan, receive direct distributions or rollover account balances to a qualified retirement plan. The Plan continued to operate through September 6, 2011, at which date all Plan assets had been distributed and the Plan ceased to exist.

11. Related Party Transactions

A member of the Council's investment committee, who was not compensated by the Council during fiscal 2012, is the chairman and managing director for one of the non-marketable investments that the Council is invested in. The investment has a fair value of \$1,845,000 at June 30, 2012 (\$1,871,000 at June 30, 2011). During fiscal 2013, the investment committee member resigned from the committee and is no longer affiliated with the Council.

A member of the Council's Board of Directors, who was not compensated by the Council during fiscal 2012, donated \$50,000 in temporarily restricted funds and \$25,000 in unrestricted funds during fiscal 2012 (\$301,000 and \$20,000, respectively, during fiscal 2011).

**Children's Health Council, Inc.**  
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12. Subsequent Events

Management has reviewed subsequent events and transactions that occurred after the statement of financial position date through January 21, 2013, 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.