



**DIAKON
AND CONTROLLED AFFILIATES**

Consolidated Financial Statements and Schedules

December 31, 2009 and 2008

(With Independent Auditors' Report Thereon)

**DIAKON
AND CONTROLLED AFFILIATES**

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Independent Auditors' Report

The Board of Directors
Diakon:

We have audited the accompanying consolidated balance sheets of Diakon and controlled affiliates (collectively, the Corporation), as of December 31, 2009 and 2008, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Diakon and controlled affiliates as of December 31, 2009 and 2008, and the results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The 2009 consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations and changes in net assets (deficit) of the individual entities. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

April 8, 2010

**DIAKON
AND CONTROLLED AFFILIATES**

Consolidated Balance Sheets

December 31, 2009 and 2008

Assets	2009	2008
	<hr/>	<hr/>
Current assets:		
Cash and cash equivalents	\$ 5,244,753	7,251,883
Investments	51,982,229	41,437,516
Assets limited as to use	13,926,563	15,172,937
Accounts receivable (net of allowance for doubtful accounts of \$876,000 and \$839,000 in 2009 and 2008, respectively):		
Patients and residents	9,045,043	11,770,789
Other client services	5,651,761	4,994,456
Estimated third-party payor settlements	1,487,164	1,290,915
Prepaid expenses and other assets	2,210,255	1,707,105
	<hr/>	<hr/>
Total current assets	89,547,768	83,625,601
Assets limited as to use, net of current portion	125,404,132	99,177,008
Investments in joint ventures	647,540	647,540
Land, buildings and equipment, net	197,445,937	188,231,335
Other assets:		
Deferred debt issuance costs, net	3,134,548	1,185,687
Receivables from charitable gift annuities	838,452	961,720
Funds held in trust by others and beneficial interest in trust	28,993,042	25,122,847
Other assets	5,737,068	5,878,301
	<hr/>	<hr/>
Total assets	\$ 451,748,487	404,830,039
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**DIAKON
AND CONTROLLED AFFILIATES**

Consolidated Balance Sheets

December 31, 2009 and 2008

Liabilities and Net Assets	2009	2008
Current liabilities:		
Lines of credit	\$ —	5,570,918
Accounts payable – trade	3,836,155	4,265,353
Accrued expenses	15,397,825	17,417,331
Deposits – patients and residents	1,130,078	1,039,633
Deferred revenue	676,746	559,311
Estimated third-party payor settlements	1,361,537	1,097,778
Current maturities of long-term debt	12,619,884	39,323,678
Total current liabilities	35,022,225	69,274,002
Pension liability	16,489,616	18,603,108
Swap agreements	6,591,468	20,172,008
Deferred revenue – entrance agreements	58,114,534	60,039,033
Deferred gain on sale of assets	960,703	1,256,304
Other long-term liabilities	1,950,472	1,488,358
Long-term debt, less current maturities	222,347,793	163,569,378
Total liabilities	341,476,811	334,402,191
Net assets:		
Unrestricted	67,500,446	33,501,478
Temporarily restricted	5,487,299	4,014,588
Permanently restricted	37,283,931	32,911,782
Total net assets	110,271,676	70,427,848
Total liabilities and net assets	\$ 451,748,487	404,830,039

See accompanying notes to consolidated financial statements.

**DIAKON
AND CONTROLLED AFFILIATES**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2009 and 2008

	2009	2008
Operating revenues, gains and other support:		
Patient and resident service revenue, net of contractual allowances	\$ 131,028,389	127,296,604
Patient and resident service revenue – nursing home assessment (note 3)	2,543,112	2,759,103
Amortization of entrance fees	8,476,701	8,087,312
Contract revenue	13,410,502	13,855,545
Other fees and services	12,041,998	10,476,844
Statewide Adoption and Permanency Network revenue	31,950,262	20,470,336
Investment income, net of expenses	5,826,736	6,205,387
Income from trusts	1,313,094	1,497,976
Contributions and bequests	1,280,549	1,554,364
Net assets released from restrictions – operations	1,621,785	1,657,896
Gain on disposal of assets	283,257	338,413
Gain on joint venture	1,537,086	—
	211,313,471	194,199,780
Expenses:		
Salaries and wages	69,663,860	71,401,941
Employee benefits	19,867,492	16,459,276
Other expenses	63,870,844	64,608,350
Other expenses – Statewide Adoption and Permanency Network	30,837,297	19,598,075
Nursing home assessment (note 3)	1,769,129	1,784,389
Interest	9,576,263	10,794,812
Depreciation and amortization	13,425,365	12,485,683
Realignment costs	—	1,585,500
	209,010,250	198,718,026
Operating income (loss)	2,303,221	(4,518,246)
Increase (decrease) in fair value of swap agreements	8,210,755	(12,677,842)
Equity in losses of joint ventures	—	(2,757,866)
Unrealized loss on other-than-temporary impairment of investments	—	(47,715,878)
Loss from early extinguishment of debt	—	(7,179,013)
	10,513,976	(74,848,845)
Other changes:		
Pension-related changes other than net periodic pension costs	3,410,003	(10,235,855)
Equity in losses of joint ventures	—	(2,251,951)
Unrealized gains (losses) on investments	19,355,687	(2,151,393)
Increase in fair value of swap agreements	596,481	538,085
Net assets released from restrictions – capital	122,821	231,745
	23,484,992	(13,869,369)
Increase (decrease) in unrestricted net assets	33,998,968	(88,718,214)

**DIAKON
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Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Temporarily restricted net assets:		
Contributions and bequests	\$ 1,275,076	1,496,765
Investment (losses) income, net of expenses	(845,586)	287,536
Unrealized gains (losses) on investments	2,635,187	(4,120,422)
Net assets released from restrictions – operations	(1,621,785)	(1,657,896)
Net assets released from restrictions – capital	(122,821)	(231,745)
Change in beneficial interest in trust	152,640	(186,191)
	<u>1,472,711</u>	<u>(4,411,953)</u>
Permanently restricted net assets:		
Contributions and bequests	654,594	286,326
Increase (decrease) in fair value of funds held in trust by others	3,717,555	(9,755,127)
	<u>4,372,149</u>	<u>(9,468,801)</u>
Increase (decrease) in net assets	39,843,828	(102,598,968)
Net assets, beginning of year	<u>70,427,848</u>	<u>173,026,816</u>
Net assets, end of year	<u>\$ 110,271,676</u>	<u>70,427,848</u>

See accompanying notes to consolidated financial statements.

**DIAKON
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Consolidated Statements of Cash Flows
Years ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 39,843,828	(102,598,968)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Net realized (gains) losses on investments	(1,030,834)	442,090
Net unrealized (gains) losses on investments	(21,990,874)	6,271,815
Unrealized loss on other-than-temporary impairment of investments	—	47,715,878
Depreciation and amortization	13,425,365	12,485,683
(Decrease) increase in pension liability	(2,113,492)	10,235,855
Amortization of entrance fees	(8,476,701)	(8,087,312)
Proceeds from entrance fees	5,407,560	7,430,650
Amortization of deferred gain on sale of assets	(295,601)	(295,600)
Change in funds held in trust by others and beneficial interest in trust	(3,870,195)	10,007,060
(Gain) loss on swap agreements	(8,807,236)	12,139,757
Equity in losses of joint ventures	—	5,009,817
Gain on joint venture	(1,537,086)	—
Loss on early extinguishment of debt	—	7,179,013
Provision for bad debts	604,604	481,021
Restricted contributions and investment losses (income)	537,701	(412,730)
Change in assets and liabilities:		
Accounts receivable	1,343,288	(3,534,413)
Estimated third-party payor settlements	67,510	(211,421)
Prepaid expenses and other current assets	(382,601)	58,813
Contributions and charitable gift/remainder trusts	(21,358)	277,366
Other assets	(219,554)	(144,317)
Accounts payable, accrued expenses, and other liabilities	(443,757)	(2,419,314)
Deposits – patients and residents	90,445	90,924
Net cash provided by operating activities	<u>12,131,012</u>	<u>2,121,667</u>
Cash flows from investing activities:		
Purchase of investments and assets limited as to use	(115,825,685)	(27,720,708)
Proceeds from sales of investments and assets limited as to use	103,429,911	50,504,587
Purchase of property and equipment	(23,640,690)	(29,261,529)
Proceeds from joint venture	1,537,086	—
Net cash used in investing activities	<u>(34,499,378)</u>	<u>(6,477,650)</u>
Cash flows from financing activities:		
Payment of long-term debt	(90,080,143)	(1,761,580)
Proceeds from bond issuance	122,154,764	—
Payment of debt issuance costs	(2,012,750)	—
Net (payment) proceeds from lines of credit	(5,570,918)	2,228,000
Termination of swap	(4,773,304)	—
(Uses) proceeds from restricted contributions and investment (losses) income	(501,055)	396,529
Proceeds from entrance fees	3,952,788	2,935,520
Refunds of entrance fees	(2,808,146)	(2,326,823)
Net cash provided by financing activities	<u>20,361,236</u>	<u>1,471,646</u>
Net decrease in cash and cash equivalents	(2,007,130)	(2,884,337)
Cash and cash equivalents, beginning of year	<u>7,251,883</u>	<u>10,136,220</u>
Cash and cash equivalents, end of year	<u>\$ 5,244,753</u>	<u>7,251,883</u>

See accompanying notes to consolidated financial statements.

**DIAKON
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Notes to Consolidated Financial Statements

December 31, 2009 and 2008

(1) Summary of Significant Accounting Policies

(a) Organization

Diakon is a private, nonprofit charitable organization recognized by the Internal Revenue Service as a 501(c)(3) corporation and is exempt from federal income taxation under the group exemption of the Evangelical Lutheran Church in America (ELCA). Diakon is the sole member of Diakon Lutheran Social Ministries and Controlled Entities (DLSM), Diakon Lutheran Fund (DLF), and Diakon Housing and Development, Inc. Diakon is affiliated with ELCA through Lutheran Services in America (LSA), the membership alliance of Lutheran social ministry organizations and church bodies. Diakon has a relationship with the following participating synods: Delaware-Maryland, Lower Susquehanna, Northeastern Pennsylvania, Southeastern Pennsylvania, and Upper Susquehanna. Through a cooperative agreement, it also serves in the Allegheny Synod (collectively, the Synods). In accordance with Diakon’s bylaws, the bishops of the Synods elect the majority of the Diakon’s board of directors. The bishops of the Synods also elect the majority of DLSM’s board of directors. The board of Diakon, in its role as sole member, appoints the boards for DLF and Diakon Housing and Development, Inc.

(b) Description of Controlled Affiliates

DLSM, the operating entity for the retirement living and family and community ministries of Diakon, is a Pennsylvania nonprofit corporation recognized as a charitable organization under Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxation under the group exemption of ELCA. DLSM provides both senior living and health services and family and community ministry services in Pennsylvania, Maryland, and Delaware. DLSM is also the prime contractor for the Pennsylvania Statewide Adoption and Permanency Network under a contract with the Pennsylvania Department of Public Welfare (the SWAN Contract).

The following table details the number of beds/units operated by DLSM:

	Total
Nursing beds	999
Assisted living beds	625
Independent living units	943
HUD housing units	335
Total	2,902

DLF, a 501(c)(3) corporation, is authorized by its charter to provide management of DLSM’s investments and solicit contributions only for services to children, youth, and family programs. In the absence of donor restrictions, DLF has discretionary control over the amounts, timing, and use of its distributions to children and family programs, and may not distribute funds for any other programs. DLF is a supporting organization to DLSM’s children, youth, and family services programs.

Diakon Housing and Development, Inc. is a 501(c)(3) corporation that operates in East Baltimore to purchase vacant buildings and rehabilitate them for use as affordable housing.

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Notes to Consolidated Financial Statements

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(c) Basis of Consolidation

The accompanying consolidated financial statements have been prepared to focus on Diakon and all controlled affiliated organizations (collectively, the Corporation) as a whole. All material intercompany transactions have been eliminated in consolidation.

(d) Basis of Accounting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting and present balances and transactions according to the existence or absence of donor-imposed restrictions.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has lapsed) are reported as net assets released from restrictions in the consolidated statements of operations and changes in net assets.

There are three classes of net assets – permanently restricted, temporarily restricted, and unrestricted.

Permanently restricted net assets are net assets subject to donor-imposed stipulations that are required to be maintained permanently by the Corporation. Generally, the donors of these assets permit the institution to use all or part of the income earned on related investments for general or specific purposes. Permanently restricted net assets consist principally of funds held in trust by others.

Temporarily restricted net assets are net assets subject to donor-imposed stipulations that may or will be met by actions of the Corporation and/or the passage of time.

Unrestricted net assets are net assets not subject to donor-imposed stipulations.

(e) Cash and Cash Equivalents

Cash and cash equivalents include repurchase agreements and other interest-bearing instruments with an original maturity of three months or less, excluding amounts classified as assets limited as to use.

(f) Investments and Investment Income

Investments are measured at fair value in the consolidated balance sheets.

Certain investments and assets limited as to use are maintained in investment pools (pooled funds). To equitably allocate investment income, including gains and losses, each participating fund is assigned a number of units using the market value method.

Investment income and gains and losses on the sale of investments are added to or deducted from the appropriate net asset classification depending on the existence of donor-imposed restrictions.

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A decline in market value of any investment below its cost basis that is deemed to be other-than-temporary results in a reduction in carrying amount to the fair value. The impairment is recognized as a loss and a new cost basis for the investment is established. For the year ended December 31, 2008, there were \$47,715,878 of other-than-temporary declines recognized as unrealized losses on other-than-temporary impairment of investments. No such losses were recognized in 2009.

(g) *Assets Limited as to Use*

Assets limited as to use include assets set aside by the board of directors for future capital improvements and other designated purposes, over which the board retains control and may, at its discretion, subsequently use for other purposes; assets held by trustees under mortgage agreements with agencies of the U.S. government; assets held by trustees under bond indentures; and donor and other restricted funds. Investment income and gains and losses on assets limited as to use are included in investment income.

(h) *Investments in Joint Ventures*

The Corporation accounts for the equity interest it has in not-for-profit and for-profit joint ventures where it has joint control and economic interest with another organization by reflecting a pro rata share of the venture as an investment under the equity method of accounting. Changes in the venture's equity have been reflected in the consolidated statements of operations and changes in net assets as equity in gains (losses) of joint ventures and classified consistent with the characteristics of the joint venture's activities.

Investments in joint ventures represents investment in 50% or less owned entities, including an information technology joint venture and a continuing care retirement community. The not-for-profit venture was terminated in August 2009 and DLSSM received a distribution in excess of the carrying value of the investment of approximately \$1,537,000.

(i) *Land, Buildings, and Equipment*

Land, buildings, and equipment are recorded at cost. The cost of maintenance and repairs is expensed as incurred, whereas significant renewals and betterments are capitalized. Depreciation is calculated on the straight-line method over the estimated useful lives of the depreciable assets.

Depreciable lives are determined as follows:

Land improvements	10 to 25 years
Buildings	10 to 40 years
Furniture and equipment	3 to 20 years
Vehicles	4 to 7 years
Leasehold improvements	7 to 15 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived

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

Interest cost incurred on borrowed funds less interest income earned on these funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(j) *Impairment of Long-Lived Assets*

Long-lived assets, such as property and equipment and purchased intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and would no longer be depreciated. The assets and liabilities of a disposal group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheets.

(k) *Deferred Debt Issuance Costs and Other Assets*

Debt issuance costs are amortized over the period the obligation is outstanding. Amortization expense was \$63,889 and \$102,983 in 2009 and 2008, respectively. Debt issuance costs incurred and subject to amortization totaled \$3,431,552 and \$1,418,802 at December 31, 2009 and 2008, respectively. Accumulated amortization as of December 31, 2009 and 2008 totaled \$297,004 and \$233,115, respectively.

The Corporation remarketed the Series B 2007 bonds and Series D 2003 bonds on February 14, 2008 and February 29, 2008, respectively. As a result of these transactions, losses from early extinguishment of debt of \$7,179,013 were recognized in 2008, primarily related to the write-off of unamortized deferred debt issuance costs.

Other assets include goodwill of approximately \$5,593,000 related to the acquisition of a continuing care retirement community, which is being amortized over a period of 21 years. Amortization expense for this asset was approximately \$266,000 in 2009 and 2008 and accumulated amortization totaled approximately \$1,020,000 at December 31, 2009 and \$754,000 at December 31, 2008. For accounting periods beginning on and after January 1, 2010, the Corporation will cease amortizing goodwill in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 350-20-35-1.

(l) *Receivables from Charitable Gift Annuities*

Independent trustees maintain charitable gift annuities for which the Corporation has been named beneficiary of the corpus and will receive these funds upon the death of the annuitant.

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(m) Funds Held in Trust by Others and Beneficial Interest in Trust

DLSM, or its predecessor entities, and DLF (the beneficiaries) have been named as the beneficiaries of a number of trusts that are administered and controlled by independent trustees. The trusts are recorded as contribution revenue when the beneficiaries are notified of the trust's existence. The beneficiaries receive the earnings from these trusts whose principal is to be held in perpetuity. The earnings from the trusts are recorded as investment income.

Funds held in trust by others and the beneficial interest in trust are valued at the fair value of the underlying investments. The change in the fair value of funds held in trust by others is reported as a change in permanently restricted net assets and the change in the fair value of the beneficial interest in trust is reported as a change in temporarily restricted net assets. Lifecare residents of Twining Village requiring financial assistance have been named as the beneficiaries of a trust administered and controlled by independent trustees.

(n) Self Insurance

Accrued expenses and other long-term liabilities include a provision for estimated self-insured workers' compensation claims for both reported claims not yet paid and claims incurred but not reported.

(o) Deposits – Patients and Residents

Deposits – patients and residents represents security deposits paid in advance to cover possible costs when patients and residents vacate their apartments or personal care units. These deposits are taken into income only if earned upon the termination of a residency agreement. Deposits – patients and residents also includes nursing home patients' funds held in safekeeping by the Corporation for the patients' personal use.

(p) Pension Benefits

The Corporation has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits are based on years of service and the employee's compensation.

The Corporation records annual amounts relating to its pension plan based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, and turnover rates. The Corporation reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded as an other change in unrestricted net assets and amortized to net periodic cost over future periods using the corridor method. The Corporation believes that the assumptions utilized in recording its obligations under its plan are reasonable based on its experience and market conditions.

The net periodic costs are recognized as employees render the services necessary to earn the pension benefits. The funded status of the plan is reported in the pension liability caption in the consolidated balance sheet. The Corporation is required to recognize the funded status of defined benefit pension

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and other postretirement plans as a net asset or liability and to recognize changes in that funded status in the year in which the changes occur through other changes in unrestricted net assets to the extent those changes are not included in the net periodic cost.

(q) *Derivative Instruments*

Derivative financial instruments are used to limit interest rate exposure on variable rate debt. The Corporation has entered into interest rate swaps to limit its exposure to interest rate changes on its variable rate revenue bonds. Hedge accounting has not been elected; therefore, variations in fair value are marked-to-market and reported outside of the Corporation's intermediate measure of operating performance and within its performance indicator in the consolidated statements of operations and changes in net assets except as noted below.

As the performance indicator reported by not-for-profit healthcare organizations is analogous to income from continuing operations of a for-profit enterprise, the only derivative activity reported outside the performance indicator is the activity associated with effective cash flow hedges and gains that represent a recovery of losses recognized outside the performance indicator prior to January 1 2003.

(r) *Entrance Agreement Contracts*

Entrance fees paid by residents of the Corporation's independent living units, including certain cottages and apartments, are recorded as deferred revenue. A resident, upon termination of occupancy, is entitled to receive a refund of a portion of the entrance fee pursuant to the terms of the contract, which is required to be paid only upon the subsequent receipt of an entrance fee from a new resident for that independent living unit. These entrance fee agreements guarantee occupancy rights to residents for life; for three facilities, there are lifetime healthcare services provided under the provisions of certain agreements.

The nonrefundable portion of entrance fees as stated in each contract is deferred and amortized to revenue over the estimated life expectancy of each resident; whereas the portion of entrance fees refundable only upon reoccupancy is amortized to revenue on a straight-line basis over the remaining estimated useful life of the facility.

The amount of entrance fees, which is refundable to residents at December 31, 2009 and 2008 under contractual refund provisions, was approximately \$40,000,000 and \$43,000,000, respectively. Proceeds and refunds of refundable entrance fees are classified as financing activities in the consolidated statements of cash flows.

(s) *Conditional Asset Retirements*

The Corporation has evaluated its facilities to determine if it has a liability for the fair value of a conditional asset retirement obligation. The types of asset retirement obligations evaluated are those for which an entity has a legal obligation to perform an asset retirement activity; however, the timing and (or) method of settling the obligation is conditional on a future event that may or may not be within the control of the entity. No material conditional asset retirement obligations have been identified by the Corporation.

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(t) *Obligation to Provide Future Services to Continuing Care Residents*

The Corporation annually calculates the present value of the net cost of future services using a discount rate of 6% and compares that amount with the balance of deferred revenue from advance fees. If the present value of the net cost of future services and the use of facilities exceeds the deferred revenue from acquisition fees, a liability would be recorded (obligation to provide future services and use of facilities) with the corresponding charge to income. As a result of the calculation, the present value of the net cost of future services did not exceed deferred revenue; accordingly, no obligation was recorded at December 31, 2009 or 2008.

(u) *Income Taxes*

Diakon and its controlled affiliates are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes.

The Corporation uses a threshold of more likely than not for recognition and derecognition of tax positions taken or expected to be taken in a tax return. The Corporation does not believe that there are any unrecognized tax benefits or liabilities that should be recorded.

(v) *Patient and Resident Service Revenue*

Patient and resident service revenue is reported at the estimated net realizable amount to be received from patients, residents, and others including Medicare, Medicaid, and other third-party payors for services rendered. The Corporation derives a significant portion of its revenues from federal and state reimbursement programs. These reimbursements are subject to audit. All of the skilled nursing facilities operated by the Corporation are certified to receive benefits under Medicare and Medicaid, with the exception of Twining Manor, which is not certified to receive benefits under Medicaid.

Skilled nursing services provided to Medicare beneficiaries are paid under terms of a prospective payment system at predetermined rates based on clinical, diagnostic, and other factors.

Nursing services provided to Medicaid beneficiaries are paid at prospectively determined rates per day. These rates vary according to a resident classification system that is based on clinical diagnostic and other factors, and the reimbursement methodology is subject to various limitations and adjustments. The Corporation's current concentration of skilled nursing facilities in Pennsylvania exposes it to the risk of changes in Medicaid reimbursement in this state.

Revenues from Medicare and Medicaid represent approximately 41% of patient and resident service revenue, net of contractual allowances, for the years ended December 31, 2009 and 2008. Medicare and Medicaid receivables represent approximately 49% and 67% of patient and resident accounts receivable at December 31, 2009 and 2008, respectively.

(w) *Contributions and Donor Restrictions*

Contributions received with donor-imposed restrictions that are met in the same year as received are reported as increases in temporarily restricted net assets, and reclassified to unrestricted net assets as net assets released from restrictions.

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Contributions, including unconditional promises to give, if any, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value as of the date of contributions. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history, type of contributions, and nature of fund-raising activity.

(x) Charity Care and Support of Those in Need

The Corporation provides charity care and other support of those in need to many of the programs and individuals that it serves. In addition, DLF provides support of children's and family programs.

The Corporation maintains records to identify and monitor the amount of charity care it provides. These records include charges foregone, based on established rates, for services and supplies furnished under its charity care policy, and the estimated cost of those services and supplies.

Support of those in need includes services provided to persons who cannot afford healthcare because of inadequate resources and/or who are uninsured or underinsured.

A number of programs operated by the Corporation's Family and Community Ministries (FCM) do not receive sufficient funding from the sponsoring organizations or from program fees to meet the needs of the people they serve. The Corporation has elected to underwrite the operating deficits of certain programs in order to serve as many of the identified needs as possible.

The following is a summary of the value of the Corporation's support of these programs during the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Medical assistance cost in excess of contractual reimbursement	\$ 7,777,305	6,592,271
Charity care in support of those in need	2,705,876	1,839,006
FCM programs supported by DLSM (charity care):		
Children's services	1,951,602	2,460,515
Behavioral health	834,669	1,234,969
Family life and congregation	358,087	515,558
Community services	878,034	426,125
Home services for seniors	69,947	206,064
	<u>4,092,339</u>	<u>4,843,231</u>
Total	\$ <u>14,575,520</u>	<u>13,274,508</u>

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(y) *Operating Income*

The consolidated statements of operations and changes in net assets include an intermediate measure of operations labeled “operating income (loss).” Changes in the performance indicator that are excluded from this measure include joint venture equity changes reported within the joint venture’s performance indicator, changes in the fair value of swap agreements, unrealized losses on other-than-temporary impairment of investments and losses on the early extinguishment of debt.

During 2008, the Corporation realigned certain support and operating department management and staffing. As a result, nonrecurring costs related to severance payments, outplacement assistance, extended benefit eligibility, other benefits and lease and property costs were incurred. Such costs have been recognized in a line item entitled “realignment costs” within the consolidated statements of operations and changes in net assets for the year ended December 31, 2008.

(z) *Performance Indicator*

The consolidated statements of operations and changes in net assets include a performance indicator of operations labeled “excess (deficit) of operating revenues, gains, and other support over expenses.” Changes in unrestricted net assets that are excluded from this measure include unrealized gains (losses) on investments, pension-related changes other than net periodic pension costs, joint venture equity changes reported outside the venture’s performance indicator, derivative gains that represent a recovery of accumulated losses previously recognized outside the performance indicator and net assets released from restrictions for capital purposes.

(aa) *Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

(bb) *Statutory Reserve Requirement*

The Pennsylvania Continuing Care Provider Registration and Disclosure Act requires a statutory reserve equivalent to the greater of the total of debt service payments due during the next 12 months on account of any loan or 10% of the projected annual operating expenses of the facilities exclusive of depreciation, computed only on the proportional share of financing or operating expenses that is applicable to residents under entrance agreement contracts. This statutory reserve requirement is considered to be fulfilled from board-designated funds included within assets limited as to use and unrestricted cash and investments.

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(2) Assets Limited as to Use and Investments

The composition of assets limited as to use at December 31 is set forth in the following table:

	<u>2009</u>	<u>2008</u>
Under bond indentures for debt service reserve fund:		
Cash and short-term investments	\$ 14,999,692	7,351,465
U.S. government obligations and corporate bonds	5,984,816	12,921,319
Under bond indentures for construction projects:		
Cash and short-term investments	47,674,427	35,032,441
Endowment funds:		
Cash and short-term investments	256,262	252,451
Fixed income securities	2,086,362	2,091,429
Equity securities	7,053,398	5,856,417
Donor and other restricted funds:		
Cash and short-term investments	1,211,029	970,580
Equity securities	2,421,427	720,170
Fixed income securities	1,304,840	858,421
By board for designated purposes:		
Funded depreciation:		
Cash and short-term investments	54,285	115,355
Equity securities	1,554,474	1,198,205
Fixed income securities	1,011,838	755,005
Entrance fees and other designated purposes:		
Cash and short-term investments	1,864,015	4,786,587
U.S. government obligations and corporate bonds	—	434,306
Equity securities	31,409,053	25,155,171
Fixed income securities	20,444,777	15,850,623
Total assets limited as to use	<u>139,330,695</u>	<u>114,349,945</u>
Less assets limited as to use – required for current liabilities	<u>13,926,563</u>	<u>15,172,937</u>
Assets limited as to use, net of current portion	<u>\$ 125,404,132</u>	<u>99,177,008</u>

A summary of investments at December 31 is as follows:

	<u>2009</u>	<u>2008</u>
Cash and short-term investments	\$ 1,253,456	2,094,424
Equity securities	35,015,180	26,084,146
Fixed income securities	<u>15,713,593</u>	<u>13,258,946</u>
	<u>\$ 51,982,229</u>	<u>41,437,516</u>

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The combined composition of assets limited as to use and investments at December 31 is as follows:

	<u>2009</u>		<u>2008</u>	
Cash and short-term investments	\$ 67,313,166	35.2%	\$ 50,603,303	32.5%
U.S. government obligations and corporate bonds	5,984,816	3.1	13,355,625	8.6
Equity securities	77,453,532	40.5	59,014,109	37.9
Fixed income securities	40,561,410	21.2	32,814,424	21.0
	<u>\$ 191,312,924</u>	<u>100.0%</u>	<u>\$ 155,787,461</u>	<u>100.0%</u>

Total investment income (losses) for the years ended December 31 consists of the following:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Total 2009</u>	<u>Total 2008</u>
Income (deficit) of operating revenues, gains and other support over expenses:				
Interest and dividends, net of expenses	\$ 3,719,018	231,298	3,950,316	\$ 6,935,013
Net realized gains (losses) on investments	<u>2,107,718</u>	<u>(1,076,884)</u>	<u>1,030,834</u>	<u>(442,090)</u>
Investment income (losses)	5,826,736	(845,586)	4,981,150	6,492,923
Unrealized loss on other-than-temporary impairment of investments	—	—	—	(47,715,878)
Other changes in net assets:				
Unrealized gains (losses) on investments	19,355,687	—	19,355,687	(2,151,393)
Changes in unrealized gains (losses) on temporarily and permanently restricted net assets	<u>—</u>	<u>2,635,187</u>	<u>2,635,187</u>	<u>(4,120,422)</u>
Total investment return (loss)	<u>\$ 25,182,423</u>	<u>1,789,601</u>	<u>26,972,024</u>	<u>\$ (47,494,770)</u>

There were no unrestricted investments with fair values below adjusted cost basis at December 31, 2009.

Due to the level of unrealized declines in fair value over an extended period of time and ongoing uncertainty created by current market conditions, management deemed the value of all unrestricted

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investment securities with fair values below cost basis to be other-than-temporarily impaired at December 31, 2008 and reduced the carrying value to equal the fair value at that date.

(3) Third-Party Reimbursement

The Corporation's nursing care facilities primarily derive their revenues from private-pay, Medicare, and Medicaid patients. Private-pay rates are established on the basis of the cost of delivering services and competitive considerations and, as such, are essentially market driven. In contrast, Medicare and Medicaid payment rates are regulated by the federal and state governments. As a result, the industry is sensitive to related legislative changes and is affected by reductions in governmental spending for these programs.

The Centers for Medicare and Medicaid Services (CMS) have approved a Pennsylvania State Plan implementing a Nursing Home Assessment (the Assessment). The Assessment requires all Pennsylvania nursing homes, except for county homes, to pay a fee to the Department of Public Welfare (DPW) based upon all non-Medicare days. DPW makes supplemental payments back to nursing home facilities based upon a standard rate per Medicaid day claimed. Total nursing home assessment revenues and expenses were \$2,543,112 and \$1,769,129 for 2009, respectively, and \$2,759,103 and \$1,784,389 for 2008, respectively.

(4) Land, Buildings and Equipment

Land, buildings and equipment and accumulated depreciation at December 31 are as follows:

	<u>2009</u>	<u>2008</u>
Land	\$ 22,050,909	22,050,909
Land improvements	20,296,815	19,677,309
Buildings	234,571,771	214,362,987
Furniture and equipment	46,483,312	49,296,460
Vehicles	494,639	1,050,587
	<u>323,897,446</u>	<u>306,438,252</u>
Accumulated depreciation	<u>(142,321,248)</u>	<u>(136,275,397)</u>
	181,576,198	170,162,855
Construction in progress	<u>15,869,739</u>	<u>18,068,480</u>
	<u>\$ 197,445,937</u>	<u>188,231,335</u>

Depreciation expense for the years ended December 31, 2009 and 2008 was \$13,000,690 and \$11,986,340, respectively.

Construction in progress as of December 31, 2009 and 2008 is principally capitalized costs related to the repositioning of the Corporation's Senior Living Service (SLS) campuses.

In 2002, the Corporation completed a sale/leaseback transaction related to an office building and land with an unrelated third party. The gross sales price was \$4,800,000, and the Corporation deferred a gain on the sale of approximately \$3,240,000. At the time of the sale, the Corporation entered into an operating lease

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agreement with the purchasers of the property to lease the office building for a term of eleven (11) years. The initial annual lease payment was \$492,782, payable monthly. Subsequent annual payments increase two and one-half percent each year throughout the term of the lease. During 2009 and 2008, approximately \$295,600 of the gain was amortized and recognized within gain on disposal of assets in the consolidated statements of operations and changes in net assets.

(5) Long-Term Debt

The Corporation has established an obligated group (the Obligated Group) comprised of the assets/liabilities and activities of the DLSSM corporate entity, excluding the following assets/liabilities and activities: Frostburg Heights affordable housing community, Lutherwood affordable housing community and the Medical Arts Building in Allentown, Pennsylvania. The Obligated Group excludes the following affiliated entities: Diakon, Diakon Lutheran Fund, Diakon Housing and Development, Inc. and the Institute for Strategic Management, Inc.

Long-term debt of the Corporation consisted of the following at December 31:

	2009	2008
Cumberland County Municipal Authority Bonds Series 2009, \$123,210,000 of tax exempt fixed interest rate bonds with principal payable in annual installments ranging from \$660,000 to \$14,720,000 from 2011 to 2039. Interest rates range from 3.0% to 6.5% and the bonds were issued at an aggregate discount of \$1,055,000, which is being amortized ratably over the life of the issue, to yield an effective interest rate of 6.26%.	\$ 123,210,000	—
Cumberland County Municipal Authority Bonds Series A 2007, \$61,955,000 of tax exempt fixed interest rate bonds with principal payable in annual installments ranging from \$1,880,000 to \$11,905,000 from 2025 to 2036. The bonds bear interest at a stated rate of 5% and were issued at an aggregate premium of approximately \$1,681,000, which is being amortized ratably over the life of the issue, to yield an effective interest rate of 4.81%.	61,955,000	61,955,000
Cumberland County Municipal Authority Bonds Series B 2007, \$47,400,000 of tax-exempt variable interest rate bonds. The rate adjusted weekly and was 1.25% at December 31, 2008. The bonds were insured by Radian Asset Assurance, Inc. and collateralized by a letter of credit provided by Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010). The bonds were fully refunded in December 2009.	—	46,350,000

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	<u>2009</u>	<u>2008</u>
Cumberland County Municipal Authority Bonds Series A 2003, \$5,555,000 of tax-exempt variable interest rate bonds with principal payable in annual installments ranging from \$115,000 to \$295,000 through 2033. The rate adjusts weekly and was 0.32% and 1.30% at December 31, 2009 and 2008, respectively. The bonds are collateralized by a letter of credit provided by Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010) expiring on September 30, 2011.	\$ 5,030,000	5,140,000
Cumberland County Municipal Authority Bonds Series C 2003, \$10,605,000 of tax-exempt variable interest rate bonds with principal payable in annual installments ranging from \$275,000 to \$870,000 through 2033. The rate adjusts weekly and was 0.22% and 1.28% at December 31, 2009 and 2008, respectively. The bonds are collateralized by a letter of credit provided by Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010) expiring on September 30, 2011.	9,905,000	10,365,000
Cumberland County Municipal Authority Bonds Series D 2003, \$43,000,000 of tax-exempt variable interest rate bonds. The rate adjusted weekly and was 1.25% at December 31, 2008. The bonds were insured by Radian Asset Assurance, Inc. and collateralized by a letter of credit provided by Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010). The bonds were fully refunded in December 2009.	—	42,355,000
Washington County, Maryland Bonds Series E 2003 \$20,465,000 of tax-exempt variable rate bonds with principal payable in annual installments ranging from \$90,000 to \$3,130,000 through 2033. The rate adjusts weekly and was 0.21% and 1.26% at December 31, 2009 and 2008, respectively. The bonds are collateralized by a letter of credit provided by Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010) expiring on September 30, 2011.	19,780,000	20,145,000

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	2009	2008
Mortgage notes payable, U.S. Department of Housing and Urban Development (HUD), four individual notes collateralized by the property and equipment of DLSSM's affordable housing properties. These notes, related properties and operations are excluded from the Obligated Group. The mortgages bear interest at fixed rates ranging from 6.79% to 9.25% and monthly payments, including interest, total \$96,569.	\$ 9,251,966	9,579,099
Mortgage note payable, Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010), \$5,600,000 nonrecourse mortgage note payable collateralized solely by the property and rental proceeds of DLSSM's Medical Arts Building. The note, related property and operations of the of the Medical Arts Building are excluded from the Obligated Group. The note bears interest at a fixed rate of 6.13% and monthly payments are \$34,044 until September 2011, when the remaining balance of \$5,170,302 is payable.	5,314,360	5,390,040
	234,446,326	201,279,139
Less current maturities of bonds and mortgages payable	(12,619,884)	(39,323,678)
Unamortized premium	1,576,588	1,613,917
Unamortized discount	(1,055,237)	—
	\$ 222,347,793	163,569,378

All of the outstanding bonds described herein are obligations of the Obligated Group. In 2009, the Cumberland County (PA) Municipal Authority issued \$123,210,000 of Series 2009 bonds on behalf of the Obligated Group. The Series 2009 bonds were issued in order to fully refund the previously outstanding Series B 2007 and Series D 2003 bonds, to finance the costs of various capital projects, to provide capital to terminate a previously existing interest rate swap agreement and to pay for issuance costs.

The Series 2009 and Series A 2007 Bonds have been issued pursuant to the terms of a 1998 Master Trust Indenture, as amended and supplemented over time. The effect of these amendments was to consolidate the entities comprising the Obligated Group and to grant to the 2009 and 2007 bondholders and credit providers equal standing and security with the 2003 bondholders and credit providers. The master trust indenture contains certain provisions that require the Obligated Group to maintain certain cash deposits with a trustee as well as meet certain financial covenants on an annual basis. The master trust indenture also places various restrictions on the Obligated Group's ability to incur additional indebtedness. The cash deposits held with the trustee are included in assets whose use is limited in the consolidated financial statements.

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The Obligated Group is also subject to certain financial and other restrictive covenants through a Loan and Agency Agreement with the conduit issuers of the outstanding bonds as well as an Amended and Restated Reimbursement Credit and Security Agreement with the Obligated Group's letter of credit provider. These agreements also require the Obligated Group to meet certain financial covenants on a periodic basis.

To secure the required loan payments for the 2009 and 2007 bonds, the Obligated Group has granted the Cumberland Authority and the County Commissioners of Washington County, MD (the Washington issuer) (issuer of the 2003 Series E bonds) a parity security interest in their gross receipts and a parity first lien mortgage on substantially all of the Obligated Group's property and equipment.

Through February 13, 2008, the interest rate on the Series B 2007 and Series D 2003 was a tax-exempt auction rate established under certain dutch auction procedures described in the trust indenture. On February 14, 2008, the remaining outstanding balance of both the Series B 2007 issue and the Series D 2003 issue were remarketed as tax-exempt variable rate demand bonds secured by a letter of credit issued by Wachovia Bank, National Association. As a result of the remarketing, an early extinguishment of debt was recognized in 2008.

Under the terms of certain regulatory agreements related to DLSP's affordable housing property mortgages, DLSP is required to deposit residual revenue, as defined, into residual receipts accounts on an annual basis. Disbursements from these accounts must be approved by the United States Department of Housing and Urban Development (HUD). The balance in the residual receipts accounts was \$331,481 and \$331,606 at December 31, 2009 and 2008, respectively. These residual receipts accounts are classified as assets limited as to use in the accompanying consolidated financial statements.

Should the Corporation be required to access the letter of credit liquidity facilities securing the Obligated Group's variable rate bonds due to an inability to remarket the bonds, the Corporation would be required to repay such draws over periods that are shorter than the stated maturity terms of the bonds. The amounts classified as current maturities of long-term debt in the accompanying consolidated balance sheets at December 31, 2009 and 2008 are those payments that would be due within one year of the consolidated balance sheet dates assuming the Corporation's inability to remarket the outstanding variable rate demand bonds.

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The following is a summary of scheduled annual maturities of long-term debt and annual maturities of long-term debt assuming that liquidity facilities have been accessed due to the inability to remarket variable rate bonds:

	<u>Scheduled maturity</u>	<u>Assumes liquidity facility accessed</u>
2010	\$ 1,356,552	12,619,884
2011	8,495,841	30,102,509
2012	3,666,297	2,946,297
2013	3,693,485	2,998,485
2014	3,909,018	3,169,018
Thereafter	<u>213,325,133</u>	<u>182,610,133</u>
	<u>\$ 234,446,326</u>	<u>234,446,326</u>

The amount of cash paid for interest (including the net cost of interest rate swap agreements and letter of credit support fees) was \$10,587,723 and \$10,678,289 for the years ended December 31, 2009 and 2008, respectively. These amounts are net of capitalized interest of approximately \$471,000 and \$387,000 for the respective years.

The effective interest rates paid for the years ended December 31 are as follows:

	<u>2009</u>	<u>2008</u>
DLSM Obligated Group	4.41%	5.00%
Obligations outside of the Obligated Group	8.07	7.90
Combined	4.67	5.21

(6) Lines of Credit

DLSM has a line of credit with Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010) with maximum allowable borrowings of \$10,500,000. The line of credit bears interest at the bank's prime rate (3.25% at December 31, 2009 and 2008) and expires on September 30, 2010. Amounts ranging from \$0 to \$8,723,000 and from \$1,249,000 to \$9,500,000 were outstanding for various periods during 2009 and 2008, respectively. No borrowings were outstanding at December 31, 2009 while \$5,057,000 was outstanding at December 31, 2008. In addition to the line of credit, DLSM had unused outstanding letters of credit issued by the same bank in the amount of \$10,402,519 and \$8,524,223 at December 31, 2009 and 2008, respectively. The bank line of credit is secured on a parity basis with the Obligated Group's outstanding bonds.

In 2009, DLSM terminated a previously existing revolving line of credit arrangement with Wachovia Bank, N.A. with maximum allowable borrowings of \$30,000,000. In 2008, the line of credit had been modified to reduce maximum borrowings from \$60,000,000 to \$30,000,000. Interest on the line was at the

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bank's prime rate. No draws under the line were made during the years ended December 31, 2009 and 2008.

(7) Fair Value

(a) Financial Instruments

On January 1, 2008, the Corporation adopted the provisions of FASB Statement No. 157, *Fair Value Measurements* (Statement 157), included in ASC Topic 820, *Fair Value Measurements and Disclosures*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC Topic 820 (Statement 157) also established a framework for measuring fair value and expanded disclosures about fair value measurements .

On January 1, 2009, the Corporation adopted the provisions of ASC Topic 820 (Statement 157) to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

The fair value of a financial instrument is the amount 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. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Corporation's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Corporation based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and cash equivalents, accounts receivable, estimated third-party payor settlements, other assets, accounts payable, accrued expenses, deposits, and lines of credit – The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Investments and assets limited as to use –These assets are carried at fair value, which is based primarily on quoted market prices at the reporting date.

Charitable remainder trusts, funds held in trust by others, and beneficial interest in trust – These assets are carried at fair value, which is based on quoted market prices for securities held by the trusts.

Swap Agreements – The carrying amount for swap agreements is a fair value estimate based on the anticipated discounted cash flows using indicative mid-market levels, adjusted to reflect counterparty nonperformance risk of both the Corporation and the counterparty for all swaps except those with Lehman Brothers Special Financing, Inc. (LBSFI). The fair value estimates are derived from proprietary models based upon financial principles and reasonable estimates about relevant future market conditions.

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Due to the uncertain conditions identified in note 7, *Derivative Instruments*, the fair value of the LBSFI swap agreement at December 31, 2008 was a fair value estimate based on the anticipated discounted cash flows using indicative mid-market levels without adjustment to reflect counterparty nonperformance risk.

Mortgages payable – The fair value of mortgages payable is measured using quoted market prices when such market prices are available. If quoted market prices are not available, the fair value is determined by discounting future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Corporation’s credit standing.

Bonds payable – The fair value of variable rate bonds payable is based on current interest rates for bonds of similar nature and maturities. The carrying amounts included in long-term debt in the consolidated balance sheets for bonds payable approximate fair value. The fair value of fixed rate bonds is determined by discounting future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Corporation’s credit standing.

The fair value of the Corporation’s long-term debt approximated \$209,134,546 and \$176,191,917, at December 31, 2009 and 2008, respectively.

(b) Fair Value Hierarchy

The Corporation determines fair value measurements using the fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

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The following table presents assets and liabilities that are measured at fair value on a recurring basis at December 31, 2009 and 2008:

	Fair value measurement at reporting date using			
	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant inputs unobservable inputs Level 3	December 31, 2009 total
Assets:				
Investments and assets limited as to use	\$ 191,312,924	—	—	191,312,924
Funds held in trust by others and beneficial interest in trust	—	28,993,042	—	28,993,042
Total	\$ 191,312,924	28,993,042	—	220,305,966
Liabilities:				
Interest rate swap agreements	\$ —	6,591,468	—	6,591,468
Total	\$ —	6,591,468	—	6,591,468

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	Fair value measurement at reporting date using			
	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant inputs unobservable inputs Level 3	December 31, 2008 total
Assets:				
Investments and assets limited as to use	\$ 155,787,461	—	—	155,787,461
Funds held in trust by others and beneficial interest in trust	—	25,122,847	—	25,122,847
Total	\$ 155,787,461	25,122,847	—	180,910,308
Liabilities:				
Interest rate swap agreements	\$ —	20,172,008	—	20,172,008
Total	\$ —	20,172,008	—	20,172,008

(8) Derivative Instruments

The Obligated Group has entered into several interest rate swap agreements over time in order to manage interest rate risk associated with its variable rate bonds. In 2009, the Obligated Group amended two previously existing interest rate swap agreements (the 1998 Swap and the 1993 Swap, see below) with Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010) by entering a revised interest rate swap agreement (the Amended Swap). The Amended Swap has a notional value equal to the aggregate outstanding principal balance of the Series A, C, and E 2003 Bonds (\$34,715,000 at December 31, 2009) and its notional value will decline in conjunction with the aggregate principal amortization of those bonds. The Obligated Group will pay a fixed rate of interest equal to 5.202% and will receive a variable rate of interest equal to 67% of 30-day LIBOR until the agreement ends in 2028. No cash or collateral requirements exist under the agreement. The Amended Swap's fair value as of December 31, 2009 is a liability of \$6,591,468.

Prior to executing the Amended Swap, the Obligated Group had two interest rate swap agreements with Wachovia Bank, N.A. (Wells Fargo Bank, N.A. as of March 20, 2010). The 1998 Swap had a notional value that correlated with the outstanding principal amount of a previously refunded bond issue (\$37,445,000 notional value at amendment). The 1998 Swap required the Obligated Group to pay a fixed rate of interest of 4.06% and provided for the receipt of a variable rate of interest equal to 67% of 30-day LIBOR. The 1993 Swap also had a notional value that correlated with the outstanding principal amount of a previously refunded bond issue (\$12,580,000 notional value at amendment). The 1993 Swap required the Obligated Group to pay a fixed rate of interest of 6.875% and provided for the receipt of a variable rate of

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interest equal to the SIFMA Municipal Swap Index plus 0.1%. No cash or collateral requirements existed related to the 1998 Swap or the 1993 Swap. As of the date of amendment in 2009, the aggregate fair value of the 1998 Swap and the 1993 Swap was a liability of \$10,157,084, which was reflected in the fixed interest rate of the Amended Swap in lieu of a cash payment upon termination. The aggregate fair value of the 1998 Swap and the 1993 Swap as of December 31, 2008 was a liability of \$10,749,869.

In 2009, the Obligated Group terminated its interest rate swap agreement (the 2003 Swap) with LBSFI in conjunction with the Obligated Group's issuance of the Series 2009 Bonds. In connection with the termination of the interest rate swap agreement, the Obligated Group paid LBSFI \$4,773,304. At December 31, 2008, the fair value of the 2003 Swap was a liability of \$9,422,139. The notional value of the 2003 Swap correlated with the outstanding principal amount of the Series D 2003 bonds. Prior to the termination of the swap, the agreement required the Obligated Group to pay a fixed rate of interest to LBSFI of 3.685% and provided for the receipt of a variable rate of interest equal to 71% of 30-day LIBOR. LBSFI filed for bankruptcy in 2008 and defaulted on its payment obligations under the agreement while the Obligated Group continued to make its payments of fixed interest through the termination date.

The Obligated Group is subject to credit risk and market risk as a result of using derivative products to manage exposures to changes in interest rates. Credit risk is the failure of the counterparty on the derivative instrument to perform under the terms of the derivative instrument. Depending on interest rate movements, one party will owe the other party a payment under the applicable derivative contract. The Obligated Group attempts to manage the credit or repayment risk in derivative instruments by entering into transactions with high-quality counterparties rated "A" or better by Moody's Investor Service. The swap payments and termination payments under the derivative agreements are secured by master note agreements on parity with the outstanding debt obligations in the amounts provided in such corresponding master note obligations.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with derivative contracts is managed by establishing and monitoring internal parameters and reviews that limit the types and degree of market risk that may be undertaken. Neither the Obligated Group nor the counterparties to these agreements are required to deposit collateral dependent on the market valuation of the derivatives contract.

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The following table summarizes the changes in fair values for each of the derivative instruments reported in the consolidated statements of operations and changes in net assets for the years ended December 31, 2009 and 2008:

	<u>Within performance indicator</u>	<u>Outside performance indicator</u>	<u>Total</u>
Accumulated swap liability, December 31, 2007			\$ (8,032,251)
1993 Swap	\$ (971,026)	538,085	(432,941)
1998 Swap	(3,692,361)	—	(3,692,361)
2003 Swap	(8,014,455)	—	(8,014,455)
2008 change in fair value	<u>\$ (12,677,842)</u>	<u>538,085</u>	<u>(12,139,757)</u>
Accumulated swap liability, December 31, 2008			\$ (20,172,008)
1993 Swap (prior to combination into Amended Swap)	3,262,994	596,481	3,859,475
1998 Swap (prior to combination into Amended Swap)	6,890,395	—	6,890,395
2003 Swap	4,648,834	—	4,648,834
Amended Swap	(6,591,468)	—	(6,591,468)
2009 change in fair value	<u>\$ 8,210,755</u>	<u>596,481</u>	<u>8,807,236</u>
2009 termination payment related to the 2003 Swap			<u>4,773,304</u>
Accumulated swap liability, December 31, 2009			\$ (6,591,468)

(9) Pension Benefits

The Corporation has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits are based on years of service and the employee's compensation. Contributions provide for benefits earned to date as well as benefits expected to be earned in the future. The measurement date used for the defined benefit plan is December 31.

Actuarial gains and losses are generally amortized subject to the corridor, over the average remaining service life of the Corporation's active employees.

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The following table sets forth the pension benefit obligation, fair value of plan assets, and funded status at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Benefit obligation at December 31	\$ 66,412,921	62,699,938
Fair value of plan assets at December 31	<u>49,923,305</u>	<u>44,096,830</u>
Funded status at end of year	<u>\$ (16,489,616)</u>	<u>(18,603,108)</u>
Amounts recognized in the consolidated balance sheet:		
Noncurrent liabilities	\$ (16,489,616)	(18,603,108)
Unrestricted net assets	<u>17,784,172</u>	<u>21,501,896</u>
Net amount recognized	<u>\$ 1,294,556</u>	<u>2,898,788</u>

Amounts recognized in unrestricted net assets consist of:

	<u>2009</u>	<u>2008</u>
Net actuarial loss	\$ (17,782,582)	(21,498,718)
Prior service costs	<u>(1,590)</u>	<u>(3,178)</u>
	<u>\$ (17,784,172)</u>	<u>(21,501,896)</u>

The accumulated benefit obligation for the pension plan was \$61,853,841 and \$57,526,991 at December 31, 2009 and 2008, respectively.

Other changes in plan assets and benefit obligations recognized in unrestricted net assets for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Net gain (loss)	\$ 3,408,415	(10,237,443)
Prior service cost	<u>1,588</u>	<u>1,588</u>
Total recognized in unrestricted net assets	<u>\$ 3,410,003</u>	<u>(10,235,855)</u>
Total recognized in net periodic benefit cost and unrestricted net assets	\$ (886,508)	(12,386,569)

The net loss for the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year is \$1,241,340.

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The following table summarizes the components of net periodic benefit costs recognized for the years ended December 31:

	<u>2009</u>	<u>2008</u>
Service cost	\$ 2,792,326	2,568,752
Interest cost	3,709,474	3,538,713
Expected return on plan assets	(3,853,245)	(4,328,461)
Amortization of prior service costs	1,588	1,588
Amortization of net loss	<u>1,646,368</u>	<u>370,122</u>
Net periodic benefit cost	<u>\$ 4,296,511</u>	<u>2,150,714</u>

The following summarizes the benefit cost, employer contribution, and benefits paid by the pension plan for the years ended December 31:

	<u>2009</u>	<u>2008</u>
Benefit cost	\$ 4,296,511	2,150,714
Employer contribution	3,000,000	2,150,714
Benefits paid	2,432,937	2,470,503

Weighted average assumptions used to determine benefit obligations at December 31, 2009 and 2008 were as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.10%	6.10%
Rate of compensation increase	3.25	3.50

Weighted average assumptions used to determine net benefit cost for the years ended December 31, 2009 and 2008 were as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.10%	6.50%
Expected long-term rate of return on plan assets	8.70	8.70
Rate of compensation increase	3.50	3.50

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The Corporation's investment policies and strategies for the pension benefit plan use target allocations for the individual asset categories. The Corporation's investment goals are to generate returns that are sufficient to meet the plan's obligations while preserving capital. As part of this investment strategy the

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Corporation has invested fifteen percent of the pension plan assets into a hedge fund of funds. Its risk management policies permit investments in mutual funds. The Corporation addresses diversification by the use of mutual fund investments whose underlying investments are in domestic and international fixed income securities and domestic and international equity securities. These mutual funds are readily marketable and can be sold to fund benefit payment obligations as they become payable.

The asset allocations of the Company's pension benefits as of December 31, 2009 and 2008 were as follows:

Fair value measurements at December 31, 2009				
pension benefits – plan assets				
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Asset category:				
Equity mutual funds	\$ 21,478,663	—	21,478,663	—
Fixed income mutual funds	22,087,687	—	22,087,687	—
Hedge fund	6,356,955	—	—	6,356,955
Total	<u>\$ 49,923,305</u>	<u>—</u>	<u>43,566,350</u>	<u>6,356,955</u>
			Plan assets 2009	Plan assets 2008
Asset category:				
Equity mutual funds			43%	44%
Fixed income mutual funds			44	46
Hedge fund of funds			13	10
Total			<u>100%</u>	<u>100%</u>

The following table represents a reconciliation for all Level 3 plan asset measured at fair value on a recurring basis for the year ended December 31, 2009:

Beginning balance January 1, 2009	\$ 4,140,438
Total gains and losses included in changes in net assets:	
Net realized and unrealized gains	216,517
Purchases	<u>2,000,000</u>
Ending balance December 31, 2009	<u>\$ 6,356,955</u>

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The Corporation expects to contribute \$3,000,000 to its pension plan in 2010.

The estimated benefit payments, which reflect expected future service, as appropriate, are as follows:

2010	\$	2,833,363
2011		3,087,606
2012		3,345,528
2013		3,603,936
2014		3,868,886
2015 – 2019		23,931,658

The Corporation also has a defined contribution plan for certain employees. Contributions recognized as expense for this plan were approximately \$634,000 and \$687,000 for the years ended December 31, 2009 and 2008, respectively.

The Corporation established a Supplemental Executive Retirement Plan (SERP), which is a nonqualified defined benefit plan under which the Corporation will pay supplemental retirement benefits to key executives in addition to amounts received under the Corporation's pension plan. The annual cost for this plan was \$267,996 and \$592,802 for the years ended December 31, 2009 and 2008, respectively. These amounts are not included in the determination of net periodic pension cost shown above. The SERP is not funded, and the liability for this plan was \$258,000 and \$209,000 as of December 31, 2009 and 2008, respectively. The liability is included in the Corporation's other long-term liabilities at December 31, 2009 and in accrued expenses at December 31, 2008.

(10) Temporarily Restricted Net Assets

Temporarily restricted net assets at December 31 carry the following time or purpose restrictions:

	2009	2008
Beneficial interest in charitable remainder trusts and beneficial interest in trust	\$ 1,329,932	1,177,293
Charitable gift annuities – ELCA	784,716	961,720
Capital additions	80,177	71,181
DLF – Educational and Children's Programs	1,635,043	1,369,383
Accumulated gains on endowment and other specific purposes	1,657,431	430,011
Total	\$ 5,487,299	4,009,588

Temporarily restricted net assets are released from donor restrictions by incurring expenses that satisfy the restrictions specified by donors related principally to specific programs or by the passage of time.

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(11) Permanently Restricted Net Assets

Permanently restricted net assets at December 31 are held in perpetuity, the income from which is expendable for the following purposes:

	2009	2008
Funds held in trust by others – income restricted for:		
Support of programs at designated facilities	\$ 20,144,089	17,372,748
Staff and resident programs	156,808	129,610
DLF – Educational and Children’s Programs	7,362,213	6,443,197
Program operations in Maryland	—	60,000
Endowment and other purposes	9,325,788	8,700,586
Charitable gift annuities-ELCA	53,736	—
DLF – Educational and Children’s Programs	241,297	205,641
	\$ 37,283,931	32,911,782

The Corporation’s endowment consists of approximately 25 individual funds established for a variety of purposes and consists of only donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Corporation has interpreted the laws of the Commonwealth of Pennsylvania as requiring the preservation of the 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 Corporation classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment and the original value of subsequent gifts to the permanent endowment. 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 organization in a manner consistent with the laws of the Commonwealth of Pennsylvania. In accordance with the laws of the Commonwealth of Pennsylvania, the Corporation 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 organization 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 organization
- (7) The investment policies of the organization

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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 the laws of the Commonwealth of Pennsylvania require the Corporation to retain as a fund of perpetual duration. No such deficiencies of this nature are reported in unrestricted net assets at December 31, 2009. Deficiencies of this nature that were reported in unrestricted net assets were \$367,219 at December 31, 2008. These deficiencies resulted from unfavorable market fluctuations that occurred during 2008.

The Corporation has adopted investment and spending policies 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 in relation to inflation trends. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the endowment assets are invested in a manner that is intended to produce results that approximate the price and yield results of the S&P 500 index while assuming a moderate level of investment risk.

To satisfy its long-term rate-of-return objectives, the Corporation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Corporation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

(12) Medical Malpractice Claims Coverage

The Corporation maintains professional liability and umbrella liability coverage on a combined basis. The Corporation believes it has adequate insurance coverage for all asserted claims, and it has no knowledge of unasserted claims that would exceed its insurance coverage. Effective January 1, 2003, the Corporation switched from an occurrence to a claims-made policy for medical malpractice.

(13) Self-Insurance

The Corporation participates in a self-insured program for its workers' compensation insurance. In the case of catastrophes or other events that would cause excessive workers' compensation claims, the Corporation is reinsured for losses in excess of \$350,000 per occurrence. Workers' compensation costs are accrued based upon an estimated liability for reported claims and an estimated liability for claims incurred but not reported and approximated \$2,133,000 and \$1,933,000 as of December 31, 2009 and 2008, respectively. In addition, the Corporation maintains a \$5,300,000 irrevocable standby letter of credit to secure future obligations under the terms of this self-insured program.

The Corporation's health insurance benefits program is a fully insured retrospectively rated cost plan whereby the Corporation's liability is subject to a range of potential exposure with an annual individual claim limitation. Total health benefit accrued expenses approximated \$2,153,000 and \$1,375,000 at December 31, 2009 and 2008, respectively, and are reported within the accrued expenses caption of the consolidated balance sheets.

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(14) Functional Expenses

Expenses by functional classification for the years ended December 31 are as follows:

	<u>2009</u>	<u>2008</u>
Senior Living Services	\$ 126,901,779	124,291,153
Family and Community Ministries	28,102,949	28,152,034
Statewide Adoption and Permanency Network	31,950,262	20,470,336
Ministry Support Services and management	22,055,260	25,804,503
	<u>\$ 209,010,250</u>	<u>198,718,026</u>

Ministry Support and management costs include fund-raising expenses of \$1,749,666 and \$2,055,114 for the years ended December 31, 2009 and 2008, respectively.

(15) Operating Results by Line of Service

Services provided are broken down into the following lines of service:

Senior Living Services (SLS) includes retirement communities offering various levels of care including skilled nursing, assisted living, and independent living communities.

Family and Community Ministries (FCM) offers a wide range of services to children, seniors, families, and other members of the community. Children's services include foster care, adoption, a day-care center and wilderness programs for adjudicated juveniles. Other services include: congregational-based support and counseling for families, senior centers, a parish nurse program, employee assistance programs, hospice and other services.

Affordable Housing includes independent living programs, financed with HUD mortgages, as well as costs associated with planning and development of other affordable housing programs.

Ministry Support Services revenues consist of interest income and unrestricted contributions, and expenses consist of nonprogram costs, depreciation, and costs of pursuing program support, after the allocation of program-specific support and administrative costs.

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The following table details operating results by line of service for the year ended December 31, 2009:

	<u>SLS</u>	<u>FCM</u>	<u>Affordable Housing</u>	<u>Ministry Support Services</u>	<u>Total</u>
Patient, contract and fee for service revenue	\$ 135,115,010	28,017,786	3,166,314	1,201,592	167,500,702
Statewide Adoption and Permanency Network revenue	—	31,950,262	—	—	31,950,262
Other income	<u>2,636,265</u>	<u>136,867</u>	<u>1,555</u>	<u>9,087,820</u>	<u>11,862,507</u>
Total revenues	<u>137,751,275</u>	<u>60,104,915</u>	<u>3,167,869</u>	<u>10,289,412</u>	<u>211,313,471</u>
Direct expenses	116,848,515	30,175,096	1,823,421	5,211,328	154,058,360
Direct expenses – Statewide Adoption and Permanency Network	—	31,950,262	—	—	31,950,262
Interest	8,193,660	—	856,887	525,716	9,576,263
Depreciation and amortization	<u>10,968,086</u>	<u>462,506</u>	<u>521,551</u>	<u>1,473,222</u>	<u>13,425,365</u>
Total expenses	<u>136,010,261</u>	<u>62,587,864</u>	<u>3,201,859</u>	<u>7,210,266</u>	<u>209,010,250</u>
Operating income (loss)	<u>\$ 1,741,014</u>	<u>(2,482,949)</u>	<u>(33,990)</u>	<u>3,079,146</u>	<u>2,303,221</u>

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The following table details operating results by line of service for the year ended December 31, 2008:

	<u>SLS</u>	<u>FCM</u>	<u>Affordable Housing</u>	<u>Ministry Support Services</u>	<u>Total</u>
Patient, contract and fee for service revenue	\$ 131,840,007	26,482,623	3,116,068	1,036,710	162,475,408
Statewide Adoption and Permanency Network revenue	—	20,470,336	—	—	20,470,336
Other income	<u>1,835,682</u>	<u>110,380</u>	<u>69,524</u>	<u>9,238,450</u>	<u>11,254,036</u>
Total revenues	<u>133,675,689</u>	<u>47,063,339</u>	<u>3,185,592</u>	<u>10,275,160</u>	<u>194,199,780</u>
Direct expenses	115,469,449	30,178,696	1,804,815	5,928,735	153,381,695
Realignment costs	—	—	250,000	1,335,500	1,585,500
Direct expenses – Statewide Adoption and Permanency Network	—	20,470,336	—	—	20,470,336
Interest	7,189,885	—	867,156	2,737,771	10,794,812
Depreciation and amortization	<u>10,077,422</u>	<u>488,746</u>	<u>511,979</u>	<u>1,407,536</u>	<u>12,485,683</u>
Total expenses	<u>132,736,756</u>	<u>51,137,778</u>	<u>3,433,950</u>	<u>11,409,542</u>	<u>198,718,026</u>
Operating income (loss)	<u>\$ 938,933</u>	<u>(4,074,439)</u>	<u>(248,358)</u>	<u>(1,134,382)</u>	<u>(4,518,246)</u>

(16) Commitments and Contingencies

The Corporation has entered into various construction contracts related to SLS campus repositioning activities. Contractual commitments at December 31, 2009 total approximately \$9,300,000.

From time to time, the Corporation is involved in claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Corporation's consolidated financial position or results of operations.

(17) Operating Leases

The Corporation has a number of leased facilities to conduct its operations, all of which are operating leases, which expire over the next five years. The Corporation also has a number of leases covering certain equipment and vehicles, which are also operating leases. Additionally, an administrative building is being leased through 2013.

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The approximate future minimum annual rentals under noncancelable operating leases in effect at December 31, 2009, which have initial or remaining terms of more than one year, are as follows:

2010	\$	1,947,022
2011		1,593,130
2012		896,182
2013		208,501
2014		7,895
		<u>4,652,730</u>
	\$	<u><u>4,652,730</u></u>

Total rental expenses approximated \$2,566,000 and \$2,581,000 in 2009 and 2008, respectively.

(18) Subsequent Events

The Corporation has evaluated subsequent events through April 8, 2010, the date the consolidated financial statements were available to be issued.

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Schedule of Consolidating Information, Balance Sheet

Legal Entity View

December 31, 2009

Assets	Diakon Lutheran Social Ministries	Diakon	Diakon Lutheran Fund	Luther Meadows Corp.	U.P. Heilman House, Inc.	Diakon Housing & Develop, Inc.	Susquehanna Housing, Inc.	Consolidating entries	Total
Current assets:									
Cash and cash equivalents	\$ 4,251,810	—	—	235,581	165,287	556,059	36,016	—	5,244,753
Investments	37,462,937	—	14,077,438	—	—	441,854	—	—	51,982,229
Assets limited as to use	13,926,563	—	—	—	—	—	—	—	13,926,563
Accounts receivable (net of allowance for doubtful accounts):									
Patients and residents	9,045,043	—	—	—	—	—	—	—	9,045,043
Other client services	5,097,950	601,273	76,210	(24,312)	(20,247)	(79,051)	(62)	—	5,651,761
Estimated third-party payor settlements	1,487,164	—	—	—	—	—	—	—	1,487,164
Prepaid expenses and other assets	2,194,209	—	4,809	—	—	11,237	—	—	2,210,255
Total current assets	<u>73,465,676</u>	<u>601,273</u>	<u>14,158,457</u>	<u>211,269</u>	<u>145,040</u>	<u>930,099</u>	<u>35,954</u>	<u>—</u>	<u>89,547,768</u>
Assets limited as to use, net of current portion	123,562,494	—	1,841,638	—	—	—	—	—	125,404,132
Investments in subsidiary	—	400,000	—	—	—	—	—	(400,000)	—
Investments in joint ventures	647,540	—	—	—	—	—	—	—	647,540
Land, buildings and equipment, net	195,533,016	—	—	501,905	1,259,710	151,306	—	—	197,445,937
Other assets:									
Deferred debt issuance costs, net	3,090,839	—	—	13,737	29,972	—	—	—	3,134,548
Receivables from charitable gift annuities	838,452	—	—	—	—	—	—	—	838,452
Funds held in trust by others and beneficial interest in trust	21,630,829	—	7,362,213	—	—	—	—	—	28,993,042
Other assets	5,737,068	—	—	—	—	—	—	—	5,737,068
Total assets	<u>\$ 424,505,914</u>	<u>1,001,273</u>	<u>23,362,308</u>	<u>726,911</u>	<u>1,434,722</u>	<u>1,081,405</u>	<u>35,954</u>	<u>(400,000)</u>	<u>451,748,487</u>

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Schedule of Consolidating Information, Balance Sheet

Legal Entity View

December 31, 2009

Liabilities and Net Assets (Deficit)	Diakon Lutheran Social Ministries	Diakon	Diakon Lutheran Fund	Luther Meadows Corp.	U.P. Heilman House, Inc.	Diakon Housing & Develop, Inc.	Susquehanna Housing, Inc.	Consolidating entries	Total
Current liabilities:									
Accounts payable – trade	\$ 3,836,155	—	—	—	—	—	—	—	3,836,155
Accrued expenses	14,240,470	601,273	—	20,870	21,292	513,920	—	—	15,397,825
Deposits – patients and residents	1,099,940	—	—	13,611	15,559	968	—	—	1,130,078
Deferred revenue	676,746	—	—	—	—	—	—	—	676,746
Estimated third-party payor settlements	1,361,537	—	—	—	—	—	—	—	1,361,537
Current maturities of long-term debt	12,529,850	—	—	55,906	34,128	—	—	—	12,619,884
Total current liabilities	33,744,698	601,273	—	90,387	70,979	514,888	—	—	35,022,225
Pension liability	16,489,616	—	—	—	—	—	—	—	16,489,616
Swap agreements	6,591,468	—	—	—	—	—	—	—	6,591,468
Deferred revenue – entrance agreements	58,114,534	—	—	—	—	—	—	—	58,114,534
Deferred gain on sale of assets	960,703	—	—	—	—	—	—	—	960,703
Other long-term liabilities	1,949,179	—	—	663	630	—	—	—	1,950,472
Long-term debt, less current maturities	218,940,184	—	—	1,484,675	1,922,934	—	—	—	222,347,793
Total liabilities	336,790,382	601,273	—	1,575,725	1,994,543	514,888	—	—	341,476,811
Net assets (deficit):									
Unrestricted	54,182,858	400,000	14,123,752	(848,814)	(559,821)	566,517	35,954	(400,000)	67,500,446
Temporarily restricted	3,852,253	—	1,635,046	—	—	—	—	—	5,487,299
Permanently restricted	29,680,421	—	7,603,510	—	—	—	—	—	37,283,931
Total net assets (deficit)	87,715,532	400,000	23,362,308	(848,814)	(559,821)	566,517	35,954	(400,000)	110,271,676
Total liabilities and net assets (deficit)	\$ 424,505,914	1,001,273	23,362,308	726,911	1,434,722	1,081,405	35,954	(400,000)	451,748,487

See accompanying independent auditors' report.

**DIAKON
AND CONTROLLED AFFILIATES**

Schedule of Consolidating Information, Statement of Operations and Changes in Net Assets (Deficit)

Legal Entity View

Year ended December 31, 2009

	Diakon Lutheran Social Ministries	Diakon	Diakon Lutheran Fund	Luther Meadows Corp.	U.P. Heilman House, Inc.	Diakon Housing & Develop, Inc.	Susquehanna Housing, Inc.	Sub-total	Consolidating entries	Total
Operating revenues, gains and other support:										
Patient and resident service revenue, net of contractual allowances	\$ 131,028,389	—	—	—	—	—	—	131,028,389	—	131,028,389
Patient and resident service revenue, nursing home assessment	2,543,112	—	—	—	—	—	—	2,543,112	—	2,543,112
Amortization of entrance fees	8,476,701	—	—	—	—	—	—	8,476,701	—	8,476,701
Grants from Diakon Lutheran Fund	1,400,004	—	—	—	—	—	—	1,400,004	(1,400,004)	—
Contract revenue	12,810,079	—	—	298,857	301,566	—	—	13,410,502	—	13,410,502
Other fees and services	11,752,200	881,809	—	191,883	204,363	—	—	13,030,255	(988,257)	12,041,998
Statewide Adoption and Permanency Network revenue	31,950,262	—	—	—	—	—	—	31,950,262	—	31,950,262
Investment income, net of expenses	5,494,764	—	319,648	140	108	12,059	17	5,826,736	—	5,826,736
Income from trusts	1,002,148	—	310,946	—	—	—	—	1,313,094	—	1,313,094
Contributions and bequests	1,244,846	—	35,703	—	—	—	—	1,280,549	—	1,280,549
Net assets released from restrictions – operations	1,621,785	—	—	—	—	—	—	1,621,785	—	1,621,785
Gain (loss) on disposal of assets	299,257	—	—	—	—	(16,000)	—	283,257	—	283,257
Gain on joint venture	1,537,086	—	—	—	—	—	—	1,537,086	—	1,537,086
Total operating revenues, gains and other support	<u>211,160,633</u>	<u>881,809</u>	<u>666,297</u>	<u>490,880</u>	<u>506,037</u>	<u>(3,941)</u>	<u>17</u>	<u>213,701,732</u>	<u>(2,388,261)</u>	<u>211,313,471</u>
Expenses:										
Salaries and wages	69,535,984	—	—	62,878	64,998	—	—	69,663,860	—	69,663,860
Employee benefits	19,832,076	—	—	17,919	17,497	—	—	19,867,492	—	19,867,492
Other expenses	63,615,334	881,809	1,404,463	177,344	172,695	7,460	—	66,259,105	(2,388,261)	63,870,844
Other expenses – Statewide Adoption and Permanency Network	30,837,297	—	—	—	—	—	—	30,837,297	—	30,837,297
Nursing home assessment	1,769,129	—	—	—	—	—	—	1,769,129	—	1,769,129
Interest	9,228,853	—	—	145,094	177,677	24,639	—	9,576,263	—	9,576,263
Depreciation and amortization	13,299,664	—	—	50,346	75,355	—	—	13,425,365	—	13,425,365
Total expenses	<u>208,118,337</u>	<u>881,809</u>	<u>1,404,463</u>	<u>453,581</u>	<u>508,222</u>	<u>32,099</u>	<u>—</u>	<u>211,398,511</u>	<u>(2,388,261)</u>	<u>209,010,250</u>
Operating income (loss)	3,042,296	—	(738,166)	37,299	(2,185)	(36,040)	17	2,303,221	—	2,303,221
Increase in fair value of swap agreements	8,210,755	—	—	—	—	—	—	8,210,755	—	8,210,755
Excess (deficit) of operating revenues, gains and other support over expenses	<u>11,253,051</u>	<u>—</u>	<u>(738,166)</u>	<u>37,299</u>	<u>(2,185)</u>	<u>(36,040)</u>	<u>17</u>	<u>10,513,976</u>	<u>—</u>	<u>10,513,976</u>
Other changes:										
Pension-related changes other than net periodic pension costs	3,410,003	—	—	—	—	—	—	3,410,003	—	3,410,003
Equity in losses of joint ventures	—	—	—	—	—	—	—	—	—	—
Unrealized gains on investments	16,275,003	—	3,080,684	—	—	—	—	19,355,687	—	19,355,687
Increase in fair value of swap agreements	596,481	—	—	—	—	—	—	596,481	—	596,481
Net assets released from restrictions – capital	122,821	—	—	—	—	—	—	122,821	—	122,821
Total other changes	<u>20,404,308</u>	<u>—</u>	<u>3,080,684</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>23,484,992</u>	<u>—</u>	<u>23,484,992</u>
Increase in unrestricted net assets (deficit)	<u>31,657,359</u>	<u>—</u>	<u>2,342,518</u>	<u>37,299</u>	<u>(2,185)</u>	<u>(36,040)</u>	<u>17</u>	<u>33,998,968</u>	<u>—</u>	<u>33,998,968</u>

**DIAKON
AND CONTROLLED AFFILIATES**

Schedule of Consolidating Information, Statement of Operations and Changes in Net Assets (Deficit)

Legal Entity View

Year ended December 31, 2009

	Diakon Lutheran Social Ministries	Diakon	Diakon Lutheran Fund	Luther Meadows Corp.	U.P. Heilman House, Inc.	Diakon Housing & Develop, Inc.	Susquehanna Housing, Inc.	Sub-total	Consolidating entries	Total
Temporarily restricted net assets:										
Contributions and bequests	\$ 1,275,076	—	—	—	—	—	—	1,275,076	—	1,275,076
Investment losses, net of expenses	(706,074)	—	(139,512)	—	—	—	—	(845,586)	—	(845,586)
Unrealized gains on investments	2,228,280	—	406,907	—	—	—	—	2,635,187	—	2,635,187
Net assets released from restrictions – operations	(1,621,785)	—	—	—	—	—	—	(1,621,785)	—	(1,621,785)
Net assets released from restrictions – capital	(122,821)	—	—	—	—	—	—	(122,821)	—	(122,821)
Change in beneficial interest in trust	152,640	—	—	—	—	—	—	152,640	—	152,640
Equity transfer to affiliate	1,735	—	(1,735)	—	—	—	—	—	—	—
Increase in temporarily restricted net assets	<u>1,207,051</u>	<u>—</u>	<u>265,660</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,472,711</u>	<u>—</u>	<u>1,472,711</u>
Permanently restricted net assets:										
Contributions and bequests	472,633	—	181,961	—	—	—	—	654,594	—	654,594
Increase in fair value of funds held in trust by others	2,798,540	—	919,015	—	—	—	—	3,717,555	—	3,717,555
Equity transfer to affiliate	160,961	—	(160,961)	—	—	—	—	—	—	—
Increase in permanently restricted net assets	<u>3,432,134</u>	<u>—</u>	<u>940,015</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>4,372,149</u>	<u>—</u>	<u>4,372,149</u>
Increase in net assets	36,296,544	—	3,548,193	37,299	(2,185)	(36,040)	17	39,843,828	—	39,843,828
Net assets (deficit), beginning of year	51,418,988	400,000	19,814,115	(886,113)	(557,636)	602,557	35,937	70,827,848	(400,000)	70,427,848
Net assets (deficit), end of year	<u>\$ 87,715,532</u>	<u>400,000</u>	<u>23,362,308</u>	<u>(848,814)</u>	<u>(559,821)</u>	<u>566,517</u>	<u>35,954</u>	<u>110,671,676</u>	<u>(400,000)</u>	<u>110,271,676</u>

See accompanying independent auditors' report.