



**DIAKON  
AND CONTROLLED AFFILIATES**

Consolidated Financial Statements and Schedules

December 31, 2010 and 2009

(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, 2010 and 2009, 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, 2010 and 2009, 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 2010 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 2010 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 22, 2011

**DIAKON  
AND CONTROLLED AFFILIATES**

Consolidated Balance Sheets

December 31, 2010 and 2009

<b>Assets</b>	<b>2010</b>	<b>2009</b>
	<hr/>	<hr/>
Current assets:		
Cash and cash equivalents	\$ 7,950,530	5,244,753
Investments	55,141,901	51,982,229
Assets limited as to use	1,511,655	8,893,930
Accounts receivable (net of allowance for doubtful accounts of \$1,110,000 and \$876,000 in 2010 and 2009, respectively):		
Patients and residents	9,528,107	9,045,043
Statewide Adoption and Permanency Network	9,546,771	2,022,805
Other client services	3,662,379	3,628,956
Estimated third-party payor settlements	1,396,187	1,487,164
Prepaid expenses and other assets	4,521,981	2,210,255
Total current assets	<hr/> 93,259,511	<hr/> 84,515,135
Assets limited as to use, net of current portion:		
Statutory Minimum Liquid Reserves	8,099,013	5,032,633
Other	128,667,220	125,404,132
Investments in joint ventures	719,558	647,540
Land, buildings and equipment, net	198,314,967	197,445,937
Other assets:		
Deferred debt issuance costs, net	3,134,576	3,134,548
Receivables from charitable gift annuities	830,289	838,452
Funds held in trust by others and beneficial interest in trust	33,943,820	28,993,042
Other assets	5,848,412	5,737,068
Total assets	<hr/> <hr/> \$ 472,817,366	<hr/> <hr/> 451,748,487

**DIAKON  
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Consolidated Balance Sheets

December 31, 2010 and 2009

<b>Liabilities and Net Assets</b>	<b>2010</b>	<b>2009</b>
Current liabilities:		
Accounts payable – trade	\$ 4,260,811	3,348,644
Accounts payable – Statewide Adoption and Permanency Network	6,091,981	487,511
Accrued expenses (note 2)	28,942,791	23,797,825
Deposits – patients and residents	946,084	1,130,078
Deferred revenue	364,111	676,746
Estimated third-party payor settlements	1,179,871	1,361,537
Current maturities of long-term debt	8,491,029	12,619,884
Total current liabilities	50,276,678	43,422,225
Pension liability	18,465,811	16,489,616
Swap agreement	7,975,424	6,591,468
Deferred revenue – entrance agreements	60,933,988	58,114,534
Deferred gain on sale of assets	665,102	960,703
Other long-term liabilities	1,895,693	1,950,472
Long-term debt, less current maturities	225,081,601	222,347,793
Total liabilities	365,294,297	349,876,811
Net assets (note 2):		
Unrestricted	56,748,688	59,100,446
Temporarily restricted	8,695,846	5,487,299
Permanently restricted	42,078,535	37,283,931
Total net assets	107,523,069	101,871,676
Total liabilities and net assets	\$ 472,817,366	451,748,487

See accompanying notes to consolidated financial statements.

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

Years ended December 31, 2010 and 2009

	<b>2010</b>	<b>2009</b>
Operating revenues, gains and other support:		
Patient and resident service revenue, net of contractual allowances (note 2)	\$ 131,633,673	129,628,389
Patient and resident service revenue – nursing home assessment	2,689,708	2,543,112
Amortization of entrance fees	8,339,306	8,476,701
Contract revenue	12,833,266	13,410,502
Other fees and services	12,423,026	12,041,998
Statewide Adoption and Permanency Network revenue	40,582,151	31,950,262
Investment income, net of expenses	15,168,134	5,826,736
Income from trusts	1,225,944	1,313,094
Contributions and bequests	745,992	1,280,549
Net assets released from restrictions – operations	1,694,115	1,621,785
Gain on disposal of assets	252,877	283,257
Gain on joint venture	—	1,537,086
	<b>227,588,192</b>	<b>209,913,471</b>
Expenses:		
Salaries and wages	69,222,993	69,663,860
Employee benefits	19,579,582	19,867,492
Other expenses (note 2)	68,472,013	64,570,844
Other expenses – Statewide Adoption and Permanency Network	39,418,086	30,837,297
Nursing home assessment	1,714,543	1,769,129
Interest	11,193,710	9,576,263
Depreciation and amortization	13,853,571	13,425,365
	<b>223,454,498</b>	<b>209,710,250</b>
Operating income (note 2)	4,133,694	203,221
(Decrease) increase in fair value of swap agreement	(1,383,956)	8,210,755
Equity in gains of joint ventures	72,018	—
	<b>2,821,756</b>	<b>8,413,976</b>
Other changes:		
Pension-related changes other than net periodic pension costs	(1,084,765)	3,410,003
Unrealized (losses) gains on investments	(4,195,645)	19,355,687
Increase in fair value of swap agreement	—	596,481
Net assets released from restrictions – capital	106,896	122,821
	<b>(5,173,514)</b>	<b>23,484,992</b>
(Decrease) increase in unrestricted net assets (note 2)	<b>(2,351,758)</b>	<b>31,898,968</b>

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

Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Temporarily restricted net assets:		
Contributions and bequests	\$ 1,859,326	1,275,076
Investment losses, net of expenses	(12,960)	(845,586)
Unrealized gains on investments	2,419,469	2,635,187
Net assets released from restrictions – operations	(1,694,115)	(1,621,785)
Net assets released from restrictions – capital	(106,896)	(122,821)
Change in beneficial interest in trust	743,723	152,640
Increase in temporarily restricted net assets	<u>3,208,547</u>	<u>1,472,711</u>
Permanently restricted net assets:		
Contributions and bequests	240,677	654,594
Increase in fair value of funds held in trust by others	4,553,927	3,717,555
Increase in permanently restricted net assets	<u>4,794,604</u>	<u>4,372,149</u>
Increase in net assets (note 2)	5,651,393	37,743,828
Net assets, beginning of year (note 2)	<u>101,871,676</u>	<u>64,127,848</u>
Net assets, end of year (note 2)	<u>\$ 107,523,069</u>	<u>101,871,676</u>

See accompanying notes to consolidated financial statements.

**DIAKON  
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Consolidated Statements of Cash Flows  
Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Increase in net assets (note 2)	\$ 5,651,393	37,743,828
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net realized gains on investments	(11,398,748)	(1,030,834)
Net unrealized losses (gains) on investments	1,776,176	(21,990,874)
Depreciation and amortization	13,853,571	13,425,365
Increase (decrease) in pension liability	1,976,195	(2,113,492)
Amortization of entrance fees	(8,339,306)	(8,476,701)
Proceeds from entrance fees	8,304,155	5,407,560
Amortization of deferred gain on sale of assets	(295,601)	(295,601)
Change in funds held in trust by others and beneficial interest in trust	(4,750,871)	(3,870,195)
Loss (gain) on swap agreements	1,383,956	(8,807,236)
Equity in gains of joint ventures	(72,018)	—
Gain on joint venture	—	(1,537,086)
Provision for bad debts	1,042,027	604,604
Restricted contributions and investment (income) losses	(392,928)	537,701
Change in assets and liabilities:		
Accounts receivable	(9,072,509)	1,343,288
Estimated third-party payor settlements	(90,689)	67,510
Prepaid expenses and other current assets	(2,321,697)	(382,601)
Contributions and charitable gift/remainder trusts	(199,908)	(21,358)
Other assets	(191,177)	(219,554)
Accounts payable, accrued expenses, and other liabilities (note 2)	10,583,908	1,656,243
Deposits – patients and residents	(183,994)	90,445
Net cash provided by operating activities	<u>7,261,935</u>	<u>12,131,012</u>
Cash flows from investing activities:		
Purchase of investments and assets limited as to use	(160,917,877)	(115,825,685)
Proceeds from sales of investments and assets limited as to use	168,433,584	103,429,911
Purchase of property and equipment	(13,756,052)	(23,640,690)
Proceeds from joint venture	—	1,537,086
Net cash used in investing activities	<u>(6,240,345)</u>	<u>(34,499,378)</u>
Cash flows from financing activities:		
Payment of long-term debt	(1,395,047)	(90,080,143)
Proceeds from bond issuance	—	122,154,764
Payment of debt issuance costs	(176,463)	(2,012,750)
Net payment of lines of credit	—	(5,570,918)
Termination of swap	—	(4,773,304)
Proceeds (uses) from restricted contributions and investment (income) losses	401,092	(501,055)
Proceeds from entrance fees	5,901,512	3,952,788
Refunds of entrance fees	(3,046,907)	(2,808,146)
Net cash provided by financing activities	<u>1,684,187</u>	<u>20,361,236</u>
Net increase (decrease) in cash and cash equivalents	2,705,777	(2,007,130)
Cash and cash equivalents, beginning of year	<u>5,244,753</u>	<u>7,251,883</u>
Cash and cash equivalents, end of year	<u>\$ 7,950,530</u>	<u>5,244,753</u>

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2010 and 2009

**(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 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), Diakon Housing and Development, Inc. and the sole shareholder of Institute for Strategic Management, Inc. (ISM), a for-profit corporation. 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 or shareholder, appoints the board for DLF and appoints a number of directors of the boards of Diakon Housing and Development, Inc. and ISM; the remaining directors of Diakon Housing and Development, Inc. and ISM are certain identified officers and directors of Diakon.

**(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 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:

	<b>Total</b>
Nursing beds	999
Assisted living beds	625
Independent living units	948
HUD housing units	335
Total	2,907

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

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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.

ISM, a Pennsylvania for-profit corporation, began operations on January 1, 2010, and provides business management services to DLSM and other organizations.

Diakon Housing and Development, Inc. is a 501(c)(3) corporation that operated through December 31, 2010, in East Baltimore to purchase vacant buildings and rehabilitate them for use as affordable housing.

**(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.

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The Corporation has exposure to credit risk related to cash on deposit at financial institutions in excess of FDIC insured limits. As of December 31, 2010 the amount held in excess of the FDIC insured limits at financial institutions was \$6,900,000.

**(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.

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. No such losses were recognized in 2010 or 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 represent investment in 50% or less owned entities, including an information technology joint venture. A not-for-profit venture was terminated in August 2009 and DLSM 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.

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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 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 \$176,435 and \$63,889 in 2010 and 2009, respectively. Debt issuance costs incurred and subject to amortization totaled \$3,608,015 and \$3,431,552 at December 31, 2010 and 2009, respectively. Accumulated amortization as of December 31, 2010 and 2009 totaled \$473,439 and \$297,004, respectively.

Other noncurrent assets include goodwill of approximately \$5,593,000 related to the acquisition of a continuing care retirement community. Amortization expense for this asset was approximately \$266,000 in 2009 and accumulated amortization totaled approximately \$1,020,000 at December 31, 2010 and 2009. For accounting periods beginning on and after January 1, 2010, the Corporation

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ceased amortizing goodwill in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 350-20-35-1.

Goodwill is analyzed at least annually by management to assess its recoverability using a two-step method.

**(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.

**(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

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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 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 an interest rate swap 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, 2010 and 2009 under contractual refund provisions, was approximately \$43,000,000 and \$40,000,000, respectively.

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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.

**(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, 2010 or 2009.

**(u) Income Taxes**

Diakon and its controlled affiliates, with the exception of ISM, a Pennsylvania for-profit corporation, 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. Skilled nursing facilities and hospice programs derive a significant portion of their revenues from federal and state reimbursement programs. These reimbursements are subject to audit and periodic adjustment. Skilled nursing services and hospice services provided to Medicare beneficiaries are paid under terms of a prospective payment system at predetermined rates based on clinical, diagnostic, and other factors.

Skilled nursing and hospice 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.

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**(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.

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.

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The following is a summary of the value of the Corporation's support of these programs during the years ended December 31, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
Medical assistance cost in excess of contractual reimbursement	\$ 7,318,699	7,777,305
Charity care in support of those in need	2,528,502	2,705,876
FCM programs supported by DLSM (charity care):		
Children's services	2,151,246	1,951,602
Behavioral health	732,617	834,669
Family life and congregation	298,748	358,087
Community services	1,038,560	878,034
Home services for seniors	149,041	69,947
Total FCM programs supported by DLSM	4,370,212	4,092,339
Donation of property to other not-for-profit organizations	265,929	—
Scholarships	64,577	—
Total	\$ 14,547,919	14,575,520

(y) ***Operating Income***

The consolidated statements of operations and changes in net assets include an intermediate measure of operations labeled "operating income." Changes in the performance indicator that are excluded from this measure include joint venture equity changes reported within the joint venture's performance indicator and changes in the fair value of swap agreement.

(z) ***Performance Indicator***

The consolidated statements of operations and changes in net assets include a performance indicator of operations labeled "excess 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, 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

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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.

**(2) Correction of an Error**

During 2010, the Corporation recognized a provision for an estimated repayment of certain overpayments of Medicare receipts related to services rendered in 2010 and prior years. The accompanying financial statements for 2009 reflect the following related adjustments; Patient and resident service revenue, and Total operating revenues, gains and other support decreased by \$1.4 million. Other expenses increased by \$700,000. Operating income, Excess of operating revenues, gains and other support over expenses, Increase in unrestricted net assets and Increase in net assets decreased by \$2.1 million. In addition, Net assets, beginning of year decreased by \$6.3 million, Accrued expenses increased by \$8.4 million and net assets, end of year decreased by \$8.4 million.

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**(3) 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>2010</u>	<u>2009</u>
Under bond indentures for debt service reserve fund:		
Cash and short-term investments	\$ 4,558,945	14,999,692
U.S. government obligations and corporate bonds	14,033,456	5,984,816
Under bond indentures for construction projects:		
Cash and short-term investments	30,694,642	47,674,427
U.S. government obligations and corporate bonds	11,840,377	—
Endowment funds:		
Cash and short-term investments	31,800	256,262
Fixed income securities	2,264,210	2,086,362
Equity securities	7,316,017	7,053,398
Donor and other restricted funds:		
Cash and short-term investments	634,088	384,361
Equity securities	3,600,547	2,421,427
Fixed income securities	1,348,595	886,731
By board for designated purposes:		
Funded depreciation:		
Cash and short-term investments	6,409	54,285
Equity securities	1,753,204	1,554,474
Fixed income securities	1,376,407	1,011,838
Entrance fees and other designated purposes:		
Cash and short-term investments	1,096,560	2,690,683
Equity securities	27,646,705	28,385,064
Fixed income securities	21,976,913	18,854,242
Statutory Minimum Liquid Reserves:		
Equity securities	4,507,645	3,023,989
Fixed income securities	3,591,368	2,008,644
Total assets limited as to use	<u>138,277,888</u>	<u>139,330,695</u>
Less assets limited as to use – required for current liabilities:		
Other	<u>1,511,655</u>	<u>8,893,930</u>
Assets limited as to use, net of current portion	<u>\$ 136,766,233</u>	<u>130,436,765</u>

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A summary of investments at December 31 is as follows:

	<u>2010</u>	<u>2009</u>
Cash and short-term investments	\$ 1,019,544	1,253,456
Equity securities	35,926,922	35,015,180
Fixed income securities	18,195,435	15,713,593
	<u>\$ 55,141,901</u>	<u>51,982,229</u>

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

	<u>2010</u>		<u>2009</u>	
Cash and short-term investments	\$ 38,041,988	19.7%	\$ 67,313,166	35.2%
U.S. government obligations and corporate bonds	25,873,833	13.4	5,984,816	3.1
Equity securities	80,751,040	41.7	77,453,532	40.5
Fixed income securities	48,752,928	25.2	40,561,410	21.2
	<u>\$ 193,419,789</u>	<u>100.0%</u>	<u>\$ 191,312,924</u>	<u>100.0%</u>

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

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Total 2010</u>	<u>Total 2009</u>
Excess of operating revenues, gains and other support over expenses:				
Interest and dividends, net of expenses	\$ 3,515,065	241,361	3,756,426	3,950,316
Net realized gains (losses) on investments	<u>11,653,069</u>	<u>(254,321)</u>	<u>11,398,748</u>	<u>1,030,834</u>
Investment income (losses)	15,168,134	(12,960)	15,155,174	4,981,150
Other changes in net assets:				
Unrealized gains (losses) on investments	(4,195,645)	—	(4,195,645)	19,355,687
Changes in unrealized gains (losses) on temporarily and permanently restricted net assets	<u>—</u>	<u>2,419,469</u>	<u>2,419,469</u>	<u>2,635,187</u>
Total investment return (loss)	<u>\$ 10,972,489</u>	<u>2,406,509</u>	<u>13,378,998</u>	<u>26,972,024</u>

A summary of unrestricted investments with fair values below cost as of December 31, 2010 is as follows:

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Description of securities:						
Fixed income securities	\$ 24,987,196	427,709	—	—	24,987,196	427,709
Total temporarily impaired securities	<u>\$ 24,987,196</u>	<u>427,709</u>	<u>—</u>	<u>—</u>	<u>24,987,196</u>	<u>427,709</u>

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

**(4) Third-Party Reimbursement**

The Corporation's nursing care facilities, hospice and other programs 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 and as a result, the industry is sensitive to related legislative changes and is affected by reductions in governmental spending for these programs. Additionally, laws and regulations governing the Medicare and Medicaid

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programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

Revenues from Medicare and Medicaid represent approximately 42% and 40% of patient and resident service revenue, net of contractual allowances, for the years ended December 31, 2010 and 2009, respectively. Medicare and Medicaid receivables represent approximately 50% and 49% of patient and resident accounts receivable at December 31, 2010 and 2009, respectively.

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 \$2,689,708 and \$1,714,543 for 2010, respectively, and \$2,543,112 and \$1,769,129 for 2009, respectively.

**(5) Land, Buildings and Equipment**

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

	<u>2010</u>	<u>2009</u>
Land	\$ 22,050,909	22,050,909
Land improvements	22,669,380	20,296,815
Buildings	245,228,844	234,571,771
Furniture and equipment	48,115,226	46,483,312
Vehicles	491,995	494,639
	<u>338,556,354</u>	<u>323,897,446</u>
Accumulated depreciation	<u>(155,779,196)</u>	<u>(142,321,248)</u>
	182,777,158	181,576,198
Construction in progress	<u>15,537,809</u>	<u>15,869,739</u>
	<u>\$ 198,314,967</u>	<u>197,445,937</u>

Depreciation expense for the years ended December 31, 2010 and 2009 was \$13,597,303 and \$13,000,690, respectively.

Construction in progress as of December 31, 2010 and 2009 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 agreement with the purchasers of the property to lease the office building for a term of eleven (11) years.

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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 2010 and 2009, 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.

**(6) 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 (see note 18) 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.

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

	<b>2010</b>	<b>2009</b>
<p>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%.</p>	\$ 123,210,000	123,210,000
<p>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%.</p>	61,955,000	61,955,000
<p>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 0.43% and 0.32% at December 31, 2010 and 2009, respectively. The bonds are collateralized by a letter of credit provided by Wells Fargo Bank, N.A. expiring on September 30, 2011. See note 18.</p>	4,915,000	5,030,000
<p>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 0.33% and 0.22% at December 31, 2010 and 2009, respectively. The bonds are collateralized by a letter of credit provided by Wells Fargo Bank, N.A. expiring on September 30, 2011. See note 18.</p>	9,455,000	9,905,000

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	<b>2010</b>	<b>2009</b>
<p>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 0.32% and 0.21% at December 31, 2010 and 2009, respectively. The bonds are collateralized by a letter of credit provided by Wells Fargo Bank, N.A. expiring on September 30, 2011. See note 18.</p>	\$ 19,420,000	19,780,000
<p>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. See note 18.</p>	8,896,089	9,251,966
<p>Mortgage note payable, Artesia Mortgage Capital Corporation, \$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.</p>	5,233,840	5,314,360
	233,084,929	234,446,326
<p>Less current maturities of bonds and mortgages payable</p>	(8,491,029)	(12,619,884)
<p>Unamortized premium</p>	1,537,462	1,576,588
<p>Unamortized discount</p>	(1,049,761)	(1,055,237)
	\$ 225,081,601	222,347,793

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

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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.

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.

Under the terms of certain regulatory agreements related to DLSSM's affordable housing property mortgages, DLSSM 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 \$331,360 and \$331,481 at December 31, 2010 and 2009, 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, 2010 and 2009 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>
2011	\$ 8,491,029	8,491,029
2012	3,666,297	15,722,547
2013	3,693,485	19,073,485
2014	3,909,018	7,187,768
2015	4,158,216	3,398,216
Thereafter	<u>209,166,884</u>	<u>179,211,884</u>
	<u>\$ 233,084,929</u>	<u>233,084,929</u>

The amount of cash paid for interest (including the net cost of the interest rate swap agreement and letter of credit support fees) was \$8,429,904 and \$10,587,723 for the years ended December 31, 2010 and 2009, respectively. These amounts are net of capitalized interest of approximately \$2,218,407 and \$471,000 for the respective years.

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

	<u>2010</u>	<u>2009</u>
DLSM Obligated Group	4.66%	4.41%
Obligations outside of the Obligated Group	8.06	8.07
Combined	4.87	4.67

**(7) Lines of Credit**

DLSM has a line of credit with Wells Fargo Bank, N.A. 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, 2010 and 2009) and expires on March 31, 2011 (see note 18). Amounts ranging from \$0 to \$5,290,000 and from \$0 to \$8,723,000 were outstanding for various periods during 2010 and 2009, respectively. No borrowings were outstanding at December 31, 2010 and 2009. In addition to the line of credit, DLSM had unused outstanding letters of credit issued by the same bank in the amount of \$8,002,519 and \$10,402,519 at December 31, 2010 and 2009, respectively. The bank line of credit is secured on a parity basis with the Obligated Group's outstanding bonds.

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**(8) Fair Value**

**(a) Financial Instruments**

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, prepaid expenses and 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.

*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 the underlying securities held by the trusts multiplied by the Corporation's percentage interest in the trusts.

*Swap Agreement* – The carrying amount for the swap agreement 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. The fair value estimates are derived from proprietary models based upon financial principles and reasonable estimates about relevant future market conditions.

*Long-term debt (including mortgages and bonds 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. 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 \$205,265,426 and \$209,134,546, at December 31, 2010 and 2009, respectively.

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**(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 to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Corporation has the ability to access.

Level 2     Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

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

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, 2010 and 2009:

	Fair value measurement at reporting date using			December 31, 2010 total
	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant inputs unobservable inputs Level 3	
Assets:				
Investments and assets limited as to use:				
Cash and short term	\$ 38,041,988	—	—	38,041,988
Fixed income	48,752,928	—	—	48,752,928
Equity securities	80,751,040	—	—	80,751,040
U.S. government obligations and corporate bonds	25,873,833	—	—	25,873,833
Funds held in trust by others and beneficial interest in trust	—	33,943,820	—	33,943,820
Total	<u>\$ 193,419,789</u>	<u>33,943,820</u>	<u>—</u>	<u>227,363,609</u>
Liabilities:				
Interest rate swap agreement	\$ —	7,975,424	—	7,975,424
Total	<u>\$ —</u>	<u>7,975,424</u>	<u>—</u>	<u>7,975,424</u>

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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 Level 3	December 31, 2009 total
Assets:				
Investments and assets limited as to use:				
Cash and short term	\$ 67,313,164	—	—	67,313,164
Fixed income	40,561,410	—	—	40,561,410
Equity securities	77,453,534	—	—	77,453,534
U.S. government obligations and corporate bonds	5,984,816	—	—	5,984,816
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

**(9) 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 with Wells Fargo Bank, N.A. 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, 2010) 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, 2010 is a liability of \$7,975,424.

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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, 2010 and 2009:

	<u>Within performance indicator</u>	<u>Outside performance indicator</u>	<u>Total</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	<u>(6,591,468)</u>	<u>—</u>	<u>(6,591,468)</u>
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			\$ 4,773,304
Accumulated swap liability, December 31, 2009			\$ <u>(6,591,468)</u>
2009 Swap	<u>\$ (1,383,956)</u>	<u>—</u>	<u>(1,383,956)</u>
2010 change in fair value	<u>\$ (1,383,956)</u>	<u>—</u>	<u>(1,383,956)</u>
Accumulated swap liability, December 31, 2010			\$ <u>(7,975,424)</u>

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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**(10) 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.

The following table sets forth the pension benefit obligation, fair value of plan assets, and funded status at December 31, 2010 and 2009:

	<b>Pension benefits</b>	
	<b>2010</b>	<b>2009</b>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 66,412,921	62,699,938
Service cost	2,931,041	2,792,326
Interest cost	3,989,889	3,709,474
Change in Assumptions	3,134,897	101,248
Actuarial loss (gain)	872,384	(457,128)
Benefit payments	(2,731,843)	(2,432,937)
Benefit obligation at end of year	<u>74,609,289</u>	<u>66,412,921</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	49,923,305	44,096,830
Actual return on plan assets, net of expenses	5,952,016	5,259,412
Employer contribution	3,000,000	3,000,000
Benefit payments	(2,731,843)	(2,432,937)
Fair value of plan assets at end of year	<u>56,143,478</u>	<u>49,923,305</u>
Funded status	<u>\$ (18,465,811)</u>	<u>(16,489,616)</u>

Amounts recognized in the consolidated balance sheet at December 31 consist of:

	<b>2010</b>	<b>2009</b>
Noncurrent liabilities	\$ (18,465,811)	(16,489,616)
Unrestricted net assets	<u>19,165,147</u>	<u>17,784,172</u>
Net amount recognized	<u>\$ 699,336</u>	<u>1,294,556</u>

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Amounts recognized in unrestricted net assets but not yet included in net periodic benefit costs consist of:

	<u>2010</u>	<u>2009</u>
Net actuarial loss	\$ (19,165,147)	(17,782,582)
Prior service costs	—	(1,590)
	<u>\$ (19,165,147)</u>	<u>(17,784,172)</u>

The accumulated benefit obligation for the pension plan was \$69,331,944 and \$61,853,841 at December 31, 2010 and 2009, respectively.

Other changes in plan assets and benefit obligations recognized in unrestricted net assets for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Net (loss) gain	\$ (1,086,355)	3,408,415
Prior service cost	1,590	1,588
Total recognized in unrestricted net assets	<u>\$ (1,084,765)</u>	<u>3,410,003</u>
Total recognized in net periodic benefit cost and unrestricted net assets	\$ (4,987,706)	(886,508)

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 \$1,463,027.

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

	<u>2010</u>	<u>2009</u>
Service cost	\$ 2,931,041	2,792,326
Interest cost	3,989,889	3,709,474
Expected return on plan assets	(4,348,158)	(3,853,245)
Amortization of prior service costs	1,590	1,588
Amortization of net loss	1,328,579	1,646,368
Net periodic benefit cost	<u>\$ 3,902,941</u>	<u>4,296,511</u>

	<u>2010</u>	<u>2009</u>
Benefit cost	\$ 3,902,941	4,296,511
Benefits paid	2,731,843	2,432,937

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Weighted average assumptions used to determine benefit obligations at December 31, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
Discount rate	5.75%	6.10%
Rate of compensation increase	3.25	3.25

Weighted average assumptions used to determine net benefit cost for the years ended December 31, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
Discount rate	6.10%	6.10%
Expected long-term rate of return on plan assets	8.70	8.70
Rate of compensation increase	3.25	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 Corporation has invested fifteen percent of the pension plan assets into a hedge fund of funds. The Corporation's risk management policies permit investments in mutual funds. The Corporation addresses diversification by the use of private mutual fund investments whose underlying investments are in domestic and international fixed income securities and domestic and international equity securities. These mutual funds are only available to institutional investors and are not traded on a public exchange, however they can be sold to fund benefit payment obligations as they become payable without restriction.

The Corporation determines the fair value of the hedge fund based on the net asset value provided by the fund manager, without adjustment, as permitted under ASU 2009-12, *Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*. The Corporation determines the fair value of the mutual funds is based on quoted prices from the fund managers at December 31. While these funds are not traded in active markets, there are no lock-ups or restrictions on redemptions. Therefore, the December 31 unit values reported by the fund managers represent the exit price of the security.

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The asset allocations of the Company's pension benefits as of December 31, 2010 and 2009 were as follows:

<b>Fair value measurements at December 31, 2010</b>				
<b>pension benefits – plan assets</b>				
		<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
	<b>Total</b>			
<b>Asset category:</b>				
Cash and cash equivalents	\$ 3,000,263	3,000,263	—	—
Equity securities	20,465,505	—	20,465,505	—
Fixed income securities	23,208,166	—	23,208,166	—
Hedge funds	9,469,544	—	—	9,469,544
<b>Total</b>	<b>\$ 56,143,478</b>	<b>3,000,263</b>	<b>43,673,671</b>	<b>9,469,544</b>
<b>Fair value measurements at December 31, 2009</b>				
<b>pension benefits – plan assets</b>				
		<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
	<b>Total</b>			
<b>Asset category:</b>				
Equity securities	\$ 21,478,663	—	21,478,663	—
Fixed income securities	22,087,687	—	22,087,687	—
Hedge fund	6,356,955	—	—	6,356,955
<b>Total</b>	<b>\$ 49,923,305</b>	<b>—</b>	<b>43,566,350</b>	<b>6,356,955</b>
<b>Plan assets</b>				
<b>2010</b>				
<b>2009</b>				
<b>Asset category:</b>				
Cash		5%	—%	
Equity securities		37	43	
Fixed income securities		41	44	
Hedge funds		17	13	
<b>Total</b>		<b>100%</b>	<b>100%</b>	

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The following table represents a reconciliation for all Level 3 plan assets measured at fair value on a recurring basis for the year ended December 31, 2010:

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		2,000,000
Ending balance December 31, 2009		6,356,955
Total gains and losses included in changes in net assets:		
Net realized and unrealized gains		112,589
Purchases		3,000,000
Ending balance December 31, 2010	\$	9,469,544

The Corporation expects to contribute \$3,000,000 to its pension plan in 2011.

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

2011	\$	3,145,859
2012		3,395,002
2013		3,642,985
2014		3,931,041
2015		4,241,700
2016 – 2020		25,992,814

The Corporation also has a defined contribution plan for certain employees. Contributions recognized as expense for this plan were approximately \$320,000 and \$634,000 for the years ended December 31, 2010 and 2009, 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 \$205,200 and \$267,996 for the years ended December 31, 2010 and 2009, 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 \$463,000 and \$258,000 as of December 31, 2010 and 2009, respectively. The liability is included in the Corporation's other long-term liabilities.

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**(11) Temporarily Restricted Net Assets**

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

	<u>2010</u>	<u>2009</u>
Beneficial interest in charitable remainder trusts and beneficial interest in trust	\$ 1,735,124	1,329,932
Charitable gift annuities – ELCA	761,372	784,716
Capital additions	109,284	80,177
DLF – Educational and Children’s Programs	1,970,726	1,635,043
Accumulated gains on endowment and other specific purposes	<u>4,119,340</u>	<u>1,657,431</u>
Total	<u>\$ 8,695,846</u>	<u>5,487,299</u>

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.

**(12) 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:

	<u>2010</u>	<u>2009</u>
Funds held in trust by others – income restricted for:		
Support of programs at designated facilities	\$ 23,743,316	20,144,089
Staff and resident programs	172,730	156,808
DLF – Educational and Children’s Programs	8,292,650	7,362,213
Endowment and other purposes	9,510,165	9,325,788
Charitable gift annuities-ELCA	68,917	53,736
DLF – Educational and Children’s Programs	<u>290,757</u>	<u>241,297</u>
	<u>\$ 42,078,535</u>	<u>37,283,931</u>

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.

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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

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, 2010 or 2009. 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.

**(13) 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 or reserves for all asserted claims and unasserted claims.

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**(14) 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 \$2,106,000 and \$2,133,000 as of December 31, 2010 and 2009, respectively. In addition, the Corporation maintains a \$2,900,000 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 \$1,762,000 and \$2,153,000 at December 31, 2010 and 2009, respectively, and are reported within the accrued expenses caption of the consolidated balance sheets.

**(15) Functional Expenses**

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

	<u>2010</u>	<u>2009</u>
Senior Living Services	\$ 130,339,114	126,901,779
Family and Community Ministries	30,546,244	28,802,949
Statewide Adoption and Permanency Network	40,582,151	31,950,262
Ministry Support Services and management	21,986,989	22,055,260
	<u>\$ 223,454,498</u>	<u>209,710,250</u>

Ministry Support and management costs include fundraising expenses of \$1,839,956 and \$1,749,666 for the years ended December 31, 2010 and 2009, respectively.

**(16) Commitments and Contingencies**

The Corporation has entered into various construction contracts related to SLS campus repositioning activities. Contractual commitments at December 31, 2010 total approximately \$652,000.

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, 2010, which have initial or remaining terms of more than one year, are as follows:

2011	\$	1,974,328
2012		1,208,348
2013		442,949
2014		171,334
2015		77,800
		<hr/>
	\$	<u>3,874,759</u>

Total rental expenses approximated \$2,522,000 and \$2,566,000 in 2010 and 2009, respectively.

**(18) Subsequent Events**

The Corporation has evaluated subsequent events through April 22, 2011, the date the consolidated financial statements were issued.

On February 28, 2011, Lutherwood, which previously operated as a division of DLSSM, was transferred to Diakon Lutherwood Senior Housing, LLC (DLSH) from Diakon Lutheran Social Ministries (DLSSM), DLSH's sole member, in conjunction with a refinancing of the Project's HUD Section 202 mortgage loan. The refinancing was executed through HUD's Section 223(f) regulations, under which DLSH borrowed \$6,754,800 from Wells Fargo Bank N.A., and HUD has agreed to provide mortgage insurance on the entire loan amount. The mortgage loan bears interest at an annual rate of 4.09%, payable in equal monthly amounts over a thirty-five year period ending March 1, 2046. Proceeds of the refinancing are to be used primarily to pay off the Project's previously existing mortgage loan, fund future repairs and renovations, pay real estate transfer taxes related to the ownership transfer, and pay closing costs related to the financing.

On March 31, 2011, the Corporation entered into a line of credit agreement with Manufacturers and Traders Trust Company (M&T) and terminated the previously existing line of credit with Wells Fargo Bank, N.A. (Wells Fargo). The line of credit with M&T provides for maximum allowable borrowings of \$10,500,000, bears interest at 30-day LIBOR plus 2.75%. The balance under the line is payable on demand. The line of credit is secured on a parity basis with the Obligated Group's outstanding bonds.

On April 1, 2011, the Corporation entered into a Reimbursement, Credit and Security Agreement with PNC Bank, National Association (PNC) whereby PNC has agreed to provide letters of credit as collateral for all of the Corporation's outstanding variable rate bonds. The letters of credit expire on March 15, 2014. Under the terms of the agreement, the Corporation will pay PNC an annual commitment fee which is based on the outstanding principal amount of the variable rate bonds and is subject to adjustment based on the Corporation's credit rating. The letters of credit are secured on a parity basis with the Obligated Group's outstanding bonds and require the Obligated Group to meet certain financial covenants on a periodic basis that are similar to those required under the current Amended and Restated Reimbursement, Credit and Security Agreement. In conjunction with the execution of the agreement with PNC, the previously existing letters of credit provided by Wells Fargo were terminated.

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Schedule of Consolidating Information, Balance Sheet  
Legal Entity View  
December 31, 2010

Assets	Diakon Lutheran Social Ministries	Diakon	Diakon Lutheran Fund	Diakon Lutheran Senior Housing at Luther Meadows	Diakon Lutheran Senior Housing at Heilman House	Institute for Strategic Management, Inc.	Diakon Housing & Dev., Inc.	Susquehanna Housing, Inc.	Consolidating entries	Total
Current assets:										
Cash and cash equivalents	\$ 7,557,392	—	—	220,334	112,075	24,690	—	36,039	—	7,950,530
Investments	39,874,346	468,383	14,799,172	—	—	—	—	—	—	55,141,901
Assets limited as to use	1,511,655	—	—	—	—	—	—	—	—	1,511,655
Accounts receivable (net of allowance for doubtful accounts):										
Patients and residents	9,528,107	—	—	—	—	—	—	—	—	9,528,107
Statewide Adoption and Permanency Network	9,546,771	—	—	—	—	—	—	—	—	9,546,771
Other client services	3,194,379	790,104	(148,815)	(24,905)	1,096	(149,418)	—	(62)	—	3,662,379
Estimated third-party payor settlements	1,396,187	—	—	—	—	—	—	—	—	1,396,187
Prepaid expenses and other assets	4,430,488	—	90,494	—	—	999	—	—	—	4,521,981
Total current assets	77,039,325	1,258,487	14,740,851	195,429	113,171	(123,729)	—	35,977	—	93,259,511
Assets limited as to use, net of current portion:										
Statutory minimum liquid reserves	8,099,013	—	—	—	—	—	—	—	—	8,099,013
Other	126,274,649	—	2,392,571	—	—	—	—	—	—	128,667,220
Investment in subsidiary	—	(152,242)	—	—	—	—	—	—	152,242	—
Investments in joint ventures	719,558	—	—	—	—	—	—	—	—	719,558
Land, buildings and equipment, net	196,478,227	—	—	520,974	1,249,876	65,890	—	—	—	198,314,967
Other assets:										
Deferred debt issuance costs, net	3,107,358	—	—	9,480	17,738	—	—	—	—	3,134,576
Receivables from charitable gift annuities	830,289	—	—	—	—	—	—	—	—	830,289
Funds held in trust by others and beneficial interest in trust	25,651,170	—	8,292,650	—	—	—	—	—	—	33,943,820
Other assets	5,848,412	—	—	—	—	—	—	—	—	5,848,412
Total assets	\$ 444,048,001	1,106,245	25,426,072	725,883	1,380,785	(57,839)	—	35,977	152,242	472,817,366

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Schedule of Consolidating Information, Balance Sheet  
Legal Entity View  
December 31, 2010

<b>Liabilities and Net Assets (Deficit)</b>	<b>Diakon Lutheran Social Ministries</b>	<b>Diakon</b>	<b>Diakon Lutheran Fund</b>	<b>Diakon Lutheran Senior Housing at Luther Meadows</b>	<b>Diakon Lutheran Senior Housing at Heilman House</b>	<b>Institute for Strategic Management, Inc.</b>	<b>Diakon Housing &amp; Dev., Inc.</b>	<b>Susquehanna Housing, Inc.</b>	<b>Consolidating entries</b>	<b>Total</b>
Current liabilities:										
Accounts payable – trade	\$ 4,260,811	—	—	—	—	—	—	—	4,260,811	
Accounts payable – Statewide Adoption and Permanency Network	6,091,981	—	—	—	—	—	—	—	6,091,981	
Accrued expenses	28,029,399	756,424	—	37,600	38,148	81,220	—	—	28,942,791	
Deposits – patients and residents	915,150	968	—	14,135	15,831	—	—	—	946,084	
Deferred revenue	350,928	—	—	—	—	13,183	—	—	364,111	
Estimated third-party payor settlements	1,179,871	—	—	—	—	—	—	—	1,179,871	
Current maturities of long-term debt	8,392,398	—	—	61,302	37,329	—	—	—	8,491,029	
Total current liabilities	49,220,538	757,392	—	113,037	91,308	94,403	—	—	50,276,678	
Pension liability	18,465,811	—	—	—	—	—	—	—	18,465,811	
Swap agreement	7,975,424	—	—	—	—	—	—	—	7,975,424	
Deferred revenue – entrance agreements	60,933,988	—	—	—	—	—	—	—	60,933,988	
Deferred gain on sale of assets	665,102	—	—	—	—	—	—	—	665,102	
Other long-term liabilities	1,894,399	—	—	664	630	—	—	—	1,895,693	
Long-term debt, less current maturities	221,772,624	—	—	1,423,372	1,885,605	—	—	—	225,081,601	
Total liabilities	360,927,886	757,392	—	1,537,073	1,977,543	94,403	—	—	365,294,297	
Net assets (deficit):										
Unrestricted	42,899,867	348,853	14,871,939	(811,190)	(596,758)	(152,242)	—	35,977	152,242	56,748,688
Temporarily restricted	6,725,120	—	1,970,726	—	—	—	—	—	—	8,695,846
Permanently restricted	33,495,128	—	8,583,407	—	—	—	—	—	—	42,078,535
Total net assets (deficit)	83,120,115	348,853	25,426,072	(811,190)	(596,758)	(152,242)	—	35,977	152,242	107,523,069
Total liabilities and net assets (deficit)	\$ 444,048,001	1,106,245	25,426,072	725,883	1,380,785	(57,839)	—	35,977	152,242	472,817,366

See accompanying independent auditors' report.

**DIAKON  
AND CONTROLLED AFFILIATES**

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

Year ended December 31, 2010

	<b>Diakon Lutheran Social Ministries</b>	<b>Diakon</b>	<b>Diakon Lutheran Fund</b>	<b>Diakon Lutheran Senior Housing at Luther Meadows</b>	<b>Diakon Lutheran Senior Housing at Heilman House</b>	<b>Institute for Strategic Management, Inc.</b>	<b>Diakon Housing &amp; Dev., Inc.</b>	<b>Susquehanna Housing, Inc.</b>	<b>Consolidating entries</b>	<b>Total</b>
Operating revenues, gains and other support:										
Patient and resident service revenue, net of contractual allowances	\$ 131,633,673	—	—	—	—	—	—	—	—	131,633,673
Patient and resident service revenue, nursing home assessment	2,689,708	—	—	—	—	—	—	—	—	2,689,708
Amortization of entrance fees	8,339,306	—	—	—	—	—	—	—	—	8,339,306
Grants from Diakon Lutheran Fund	1,100,004	—	—	—	—	—	—	—	—	1,100,004
Contract revenue	12,188,264	—	—	310,843	274,159	—	60,000	—	—	12,833,266
Other fees and services	11,905,472	583,851	—	196,900	207,424	495,815	—	—	(966,436)	12,423,026
Statewide Adoption and Permanency Network revenue	40,582,151	—	—	—	—	—	—	—	—	40,582,151
Investment income, net of expenses	13,960,470	—	1,180,972	94	46	—	26,529	23	—	15,168,134
Income from trusts	924,053	—	301,891	—	—	—	—	—	—	1,225,944
Contributions and bequests	762,195	—	(16,203)	—	—	—	—	—	—	745,992
Net assets released from restrictions – operations	1,621,857	—	72,258	—	—	—	—	—	—	1,694,115
Gain on disposal of assets	252,877	—	—	—	—	—	—	—	—	252,877
<b>Total operating revenues, gains and other support</b>	<b>225,960,030</b>	<b>583,851</b>	<b>1,538,918</b>	<b>507,837</b>	<b>481,629</b>	<b>495,815</b>	<b>86,529</b>	<b>23</b>	<b>(2,066,440)</b>	<b>227,588,192</b>
Expenses:										
Salaries and wages	69,092,465	—	—	65,500	65,028	—	—	—	—	69,222,993
Employee benefits	19,539,490	—	—	20,353	19,739	—	—	—	—	19,579,582
Other expenses	67,633,879	564,669	1,160,124	190,573	183,108	640,085	166,015	—	(2,066,440)	68,472,013
Other expenses – Statewide Adoption and Permanency Network	39,418,086	—	—	—	—	—	—	—	—	39,418,086
Nursing home assessment	1,714,543	—	—	—	—	—	—	—	—	1,714,543
Interest	10,874,982	—	—	139,349	174,261	—	5,118	—	—	11,193,710
Depreciation and amortization	13,714,731	—	—	54,438	76,430	7,972	—	—	—	13,853,571
<b>Total expenses</b>	<b>221,988,176</b>	<b>564,669</b>	<b>1,160,124</b>	<b>470,213</b>	<b>518,566</b>	<b>648,057</b>	<b>171,133</b>	<b>—</b>	<b>(2,066,440)</b>	<b>223,454,498</b>
Operating income (loss)	3,971,854	19,182	378,794	37,624	(36,937)	(152,242)	(84,604)	23	—	4,133,694
Decrease in fair value of swap agreement	(1,383,956)	—	—	—	—	—	—	—	—	(1,383,956)
Equity in gains (losses) of joint ventures and subsidiaries	72,018	(552,242)	—	—	—	—	—	—	552,242	72,018
Excess (deficit) of operating revenues, gains and other support over expenses	2,659,916	(533,060)	378,794	37,624	(36,937)	(152,242)	(84,604)	23	552,242	2,821,756
Other changes:										
Pension-related changes other than net periodic pension costs	(1,084,765)	—	—	—	—	—	—	—	—	(1,084,765)
Unrealized (losses) gains on investments	(4,565,038)	—	369,393	—	—	—	—	—	—	(4,195,645)
Net assets released from restrictions – capital	106,896	—	—	—	—	—	—	—	—	106,896
Equity transfer to affiliate	—	481,913	—	—	—	—	(481,913)	—	—	—
<b>Total other changes</b>	<b>(5,542,907)</b>	<b>481,913</b>	<b>369,393</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(481,913)</b>	<b>—</b>	<b>—</b>	<b>(5,173,514)</b>
<b>Increase in unrestricted net assets (deficit)</b>	<b>(2,882,991)</b>	<b>(51,147)</b>	<b>748,187</b>	<b>37,624</b>	<b>(36,937)</b>	<b>(152,242)</b>	<b>(566,517)</b>	<b>23</b>	<b>552,242</b>	<b>(2,351,758)</b>

**DIAKON  
AND CONTROLLED AFFILIATES**

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

Year ended December 31, 2010

	<b>Diakon Lutheran Social Ministries</b>	<b>Diakon</b>	<b>Diakon Lutheran Fund</b>	<b>Diakon Lutheran Senior Housing at Luther Meadows</b>	<b>Diakon Lutheran Senior Housing at Heilman House</b>	<b>Institute for Strategic Management, Inc.</b>	<b>Diakon Housing &amp; Dev., Inc.</b>	<b>Susquehanna Housing, Inc.</b>	<b>Consolidating entries</b>	<b>Total</b>
Temporarily restricted net assets:										
Contributions and bequests	\$ 1,859,326	—	—	—	—	—	—	—	1,859,326	
Investment losses, net of expenses	(6,634)	—	(6,326)	—	—	—	—	—	(12,960)	
Unrealized gains on investments	2,005,205	—	414,264	—	—	—	—	—	2,419,469	
Net assets released from restrictions – continuing operations	(1,621,857)	—	(72,258)	—	—	—	—	—	(1,694,115)	
Net assets released from restrictions – capital	(106,896)	—	—	—	—	—	—	—	(106,896)	
Change in beneficial interest in trust	743,723	—	—	—	—	—	—	—	743,723	
Increase in temporarily restricted net assets	<u>2,872,867</u>	<u>—</u>	<u>335,680</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>3,208,547</u>	
Permanently restricted net assets:										
Contributions and bequests	191,217	—	49,460	—	—	—	—	—	240,677	
Increase in fair value of funds held in trust by others	3,623,490	—	930,437	—	—	—	—	—	4,553,927	
Increase in permanently restricted net assets	<u>3,814,707</u>	<u>—</u>	<u>979,897</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>4,794,604</u>	
Increase (decrease) in net assets	3,804,583	(51,147)	2,063,764	37,624	(36,937)	(152,242)	(566,517)	23	552,242	5,651,393
Net assets (deficit), beginning of year	<u>79,315,532</u>	<u>400,000</u>	<u>23,362,308</u>	<u>(848,814)</u>	<u>(559,821)</u>	<u>—</u>	<u>566,517</u>	<u>35,954</u>	<u>(400,000)</u>	<u>101,871,676</u>
Net assets (deficit), end of year	<u>\$ 83,120,115</u>	<u>348,853</u>	<u>25,426,072</u>	<u>(811,190)</u>	<u>(596,758)</u>	<u>(152,242)</u>	<u>—</u>	<u>35,977</u>	<u>152,242</u>	<u>107,523,069</u>

See accompanying independent auditors' report.