

**PINE REST CHRISTIAN MENTAL
HEALTH SERVICES**

CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
Grand Rapids, Michigan

CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

CONTENTS

REPORT OF INDEPENDENT AUDITORS	1
FINANCIAL STATEMENTS	
CONSOLIDATED BALANCE SHEETS.....	2
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS.....	4
CONSOLIDATED STATEMENTS OF CASH FLOWS.....	6
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.....	7
SUPPLEMENTARY INFORMATION	
SCHEDULE OF FUNCTIONAL EXPENSES FOR FOSTER CARE PROGRAMS.....	24



Crowe Horwath LLP
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Pine Rest Christian Mental Health Services
Grand Rapids, Michigan

We have audited the accompanying consolidated balance sheets of Pine Rest Christian Mental Health Services (the Corporation) as of June 30, 2009 and 2008, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Pine Rest Christian Mental Health Services as of June 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary schedule of functional expenses for Foster Care Programs is presented for additional analysis and is not a required part of the 2009 consolidated financial statements of the Corporation. Such information has been subjected to the auditing procedures applied to our audit of the 2009 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2009 consolidated financial statements taken as a whole.

A handwritten signature in black ink that reads "Crowe Horwath LLP".

Crowe Horwath LLP

Grand Rapids, Michigan
September 10, 2009

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
CONSOLIDATED BALANCE SHEETS
June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,508,619	\$ 3,092,210
Accounts receivables, less allowance for doubtful accounts of \$663,000 and \$770,000 in 2009 and 2008, respectively	5,095,948	5,447,518
Amounts receivable from third party payors	48,000	-
Other receivables and prepaid expenses	<u>1,487,700</u>	<u>1,970,003</u>
Total current assets	8,140,267	10,509,731
Assets whose use is limited (Note 2)		
By Board for funded depreciation	22,455,368	28,107,268
By Board for self-insurance	1,208,296	1,910,277
By Board for deferred compensation	25,724	-
By Donor restricted funds	3,544,035	4,639,305
Unexpended bond proceeds	<u>1,104,614</u>	<u>1,919,257</u>
	28,338,037	36,576,107
Property and equipment		
Land and improvements	2,324,848	2,056,758
Buildings and improvements	45,393,607	41,902,583
Equipment	12,352,000	10,392,016
Construction in progress (Note 1)	<u>573,881</u>	<u>3,311,214</u>
	60,644,336	57,662,571
Less accumulated depreciation	<u>32,252,201</u>	<u>29,595,056</u>
	28,392,135	28,067,515
Other assets		
Unamortized debt issue costs, less accumulated amortization of \$257,000 and \$230,000 in 2009 and 2008, respectively	189,716	217,246
Pledges receivable (Note 4)	45,245	191,657
Beneficial interest in net assets of the Foundation (Note 1)	16,233,603	20,469,760
Other assets	<u>-</u>	<u>250,000</u>
	<u>16,468,564</u>	<u>21,128,663</u>
	<u>\$ 81,339,003</u>	<u>\$ 96,282,016</u>

(Continued)

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
CONSOLIDATED BALANCE SHEETS
June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable and other accrued liabilities	\$ 1,526,498	\$ 2,051,856
Current portion of long-term debt (Note 5)	1,240,000	1,185,000
Salaries, wages, and related liabilities	3,102,601	3,151,610
Amounts payable to third party payors	-	518,293
Accrued interest	29,980	20,141
Due to affiliates (Note 6)	<u>13,956</u>	<u>1,564,783</u>
Total current liabilities	5,913,035	8,491,683
Deferred revenue	37,378	38,887
Deferred compensation (Note 7)	25,724	-
Other long-term liabilities	-	250,000
Swap investment liability (Note 5)	31,614	25,273
Long term debt (Note 5)	<u>11,519,325</u>	<u>12,759,325</u>
	<u>11,614,041</u>	<u>13,073,485</u>
Total liabilities	17,527,076	21,565,168
Net assets		
Unrestricted	55,972,773	65,705,994
Temporarily restricted	4,133,281	5,304,981
Permanently restricted	<u>3,705,873</u>	<u>3,705,873</u>
	<u>63,811,927</u>	<u>74,716,848</u>
	<u>\$ 81,339,003</u>	<u>\$ 96,282,016</u>

See accompanying notes to consolidated financial statements.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
Years ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Changes in unrestricted net assets		
Unrestricted revenues, gains and other support		
Net patient service revenue		
Inpatient	\$ 14,123,519	\$ 13,185,778
Partial hospitalization	243,417	332,731
Outpatient	18,845,416	18,081,538
Residential	15,338,182	14,056,091
Other		
Contract services income	17,633,206	16,577,051
Realized investment return (Note 2)	(3,726,357)	2,362,996
Unrestricted contributions	1,207,581	1,138,605
Miscellaneous revenue	670,612	742,678
Change in beneficial interest in unrestricted net assets of the Foundation (Note 1)	(4,236,157)	(668,478)
Net assets released from restriction	<u>2,345,797</u>	<u>1,615,052</u>
Total revenues, gains and other support	62,445,216	67,424,042
 Expenses		
Salaries	43,566,434	40,938,067
Employee benefits	11,052,448	8,850,043
Supplies and other	10,053,952	10,132,784
Depreciation	2,674,557	2,314,080
Interest and bank charges	552,678	621,777
Bad debts	392,527	786,140
Patient assistance	1,118,139	1,169,431
Self-insurance and malpractice costs	569,156	584,719
Contracted services	<u>1,324,804</u>	<u>1,201,667</u>
Total expenses	<u>71,304,695</u>	<u>66,598,708</u>
 Excess (deficit) of revenues over expenses	 (8,859,479)	 825,334
 Other changes in net assets		
Net unrealized depreciation in investments	(1,136,483)	(3,848,295)
Changes in fair value interest rate swap (Note 5)	(6,341)	(37,491)
Net assets released from restriction	<u>269,082</u>	<u>2,775,908</u>
	<u>(873,742)</u>	<u>(1,109,878)</u>
 Changes in unrestricted net assets	 (9,733,221)	 (284,544)

(Continued)

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
Years ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Changes in temporarily restricted net assets		
Contributions restricted by donors as to use	\$ 1,443,179	\$ 1,431,437
Change in beneficial interest in temporarily restricted net assets of the Foundation (Note 1)	-	(1,337,073)
Net assets released from restriction	<u>(2,614,879)</u>	<u>(4,390,960)</u>
Change in temporarily restricted net assets	(1,171,700)	(4,296,596)
Changes in permanently restricted net assets		
Change in beneficial interest in permanently restricted net assets of the Foundation (Note 1)	<u>-</u>	<u>156,603</u>
Change in permanently restricted net assets	-	156,603
Change in net assets	(10,904,921)	(4,424,537)
Net assets, beginning of year	<u>74,716,848</u>	<u>79,141,385</u>
Net assets, end of year	<u>\$ 63,811,927</u>	<u>\$ 74,716,848</u>

See accompanying notes to consolidated financial statements.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating activities		
Change in net assets	\$ (10,904,921)	\$ (4,424,537)
Adjustments to reconcile change in net assets to net cash from operating activities		
Net unrealized and realized depreciation in investments	5,624,365	2,428,920
Depreciation and amortization	2,702,087	2,346,898
Change in beneficial interest in net assets of the Foundation	4,236,157	1,848,948
Change in fair value of interest rate swap	6,341	37,491
Restricted contributions	(19,415)	(438,634)
Loss on sale of property and equipment	(5,693)	-
Changes in operating assets and liabilities		
Accounts receivable and amounts payable to third party payors	(214,723)	553,878
Other current assets	430,524	(28,941)
Pledges receivable	146,412	85,332
Accounts payable	(525,358)	478,500
Other liabilities	<u>(1,815,782)</u>	<u>1,268,623</u>
Net cash from operating activities	(340,006)	4,156,478
Investing activities		
Purchases of property and equipment	(2,996,411)	(7,810,309)
Proceeds from sale of property and equipment	2,927	-
Purchase of investments	(9,834,668)	(38,651,693)
Proceeds from sale and maturities of investments	<u>12,448,373</u>	<u>43,150,660</u>
Net cash from investing activities	(379,779)	(3,311,342)
Financing activities		
Payments of long-term debt	(1,185,000)	(1,135,000)
Debt acquisition costs	-	(16,867)
Proceeds from restricted contributions	<u>321,194</u>	<u>1,017,309</u>
Net cash from financing activities	<u>(863,806)</u>	<u>(134,558)</u>
Change in cash and cash equivalents	(1,583,591)	710,578
Cash and cash equivalents, beginning of year	<u>3,092,210</u>	<u>2,381,632</u>
Cash and cash equivalents, end of year	<u>\$ 1,508,619</u>	<u>\$ 3,092,210</u>
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 346,191	\$ 453,542
Supplemental disclosures of non-cash flow activity		
Agreement to purchase software and licenses	\$ -	\$ 635,628

See accompanying notes to consolidated financial statements.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Business: Pine Rest Christian Mental Health Services (the Corporation) provides mental health and addiction services primarily to residents in the greater West Michigan Area and Central Iowa. Pine Rest is accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO).

In February of 2008, the Corporation separately incorporated Pine Rest Residential & Community Services as a sole member nonprofit organization. This organization incorporates all of Pine Rest's addiction, residential and community service programs and is separately accredited by the Council on Accreditation of Rehabilitation Facilities (CARF).

In addition, the Corporation has a beneficial interest in the net assets of the Pine Rest Foundation (the Foundation), which operates exclusively for the benefit of the Corporation.

Basis of Consolidation: These consolidated financial statements include the financial position and the results of operations of Pine Rest Christian Mental Health Services and Pine Rest Residential & Community Services. All significant intercompany accounts and transactions have been eliminated.

Donor-Restricted Contributions: Unconditional promises to give cash or other assets to the Corporation are reported at fair value at the date received or pledged. Conditional promises to give and indications of intention to give are reported at fair value at the date the gift is received. Gifts are reported in the following net asset classifications:

Unrestricted Net Assets - Reflect unrestricted and board-designated resources available to the Corporation.

Temporarily Restricted Net Assets - Reflect contributed assets whose use by the Corporation has been limited by donors. The principal and income are transferred to unrestricted net assets when used for the purpose designated by the donor.

Permanently Restricted Net Assets - Reflect contributed net assets that have been restricted as to use by donors and are to be preserved to provide a permanent source of income. Income generated from these contributions is not restricted.

Cash and Cash Equivalents: Cash and cash equivalents includes deposits in financial institutions and short-term investments with original maturities of 90 days or less. Deposits in financial institutions may, at times, exceed federally-insured limits.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets Whose Use Is Limited: Assets whose use is limited include designated assets set aside by the Board of Directors for funded depreciation and self-insurance as well as designated assets set aside for donor restrictions and for unexpended bond proceeds.

Investments: Investments in equity and debt securities are measured at fair value based on quoted market prices.

Revenue Recognition and Contractual Allowances: Revenues are recognized at the time services are provided. Contractual allowances are recorded to reduce related billings, as necessary, to the estimated amount to be paid by each third party payor. The Corporation believes it is in compliance with all applicable laws and regulations governing the Medicare program, however, there is at least a reasonable possibility that recorded amounts are subject to change in the near term. Retroactive revenue adjustments based upon audits, reviews, and adjustments by Medicare are recognized on an estimated basis in the period such adjustments become known or as years are no longer subject to such audits, reviews or adjustments. Management believes adequate provision for anticipated settlement adjustments has been made in the financial statements.

Allowance for Doubtful Accounts: The Corporation evaluates the allowance for bad debts based on a review of current payor status and historical collection experience.

Property, Plant, and Equipment: Property and equipment are stated at cost, if purchased, or at fair market value on date of acquisition, if donated. Depreciation is provided by use of the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years. When properties are retired or otherwise disposed of, the appropriate accounts are relieved of cost and accumulated depreciation, and any resulting gain or loss is recognized.

At June 30, 2009, construction in progress includes costs to date of \$574,000 incurred for the addition of a Voice over Internet Protocol Phone System, a Phase Two Network Infrastructure Upgrade, a Dictation Voice Recognition and generators as well as various other small projects. All projects are expected to be completed during 2010.

Beneficial Interest in Net Assets of the Foundation: The Foundation was formed for charitable purposes to hold and manage the endowment and other funds exclusively for the benefit of the Corporation. Accordingly, the Corporation is required to present its beneficial interest in the net assets of the Foundation in its consolidated balance sheets which consist of the following at June 30:

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

	<u>2009</u>	<u>2008</u>
Investments, fair market value	\$ 15,232,818	\$ 20,342,233
Cash and cash equivalents	1,049,089	132,243
Pledges receivable	11,363	69,613
Annuities payable	<u>(59,667)</u>	<u>(74,329)</u>
 Net assets	 <u>\$ 16,233,603</u>	 <u>\$ 20,469,760</u>

The change in net assets of the Foundation is reported in the Corporation's consolidated statements of operations and changes in net assets and consist of the following at June 30:

	<u>2009</u>	<u>2008</u>
Gifts and contributions	\$ 283,398	\$ 357,242
Special event net revenues	136,792	180,100
Investment income	472,220	613,732
Realized gain (loss) on investments	(3,201,372)	315,110
Unrealized gain (loss) on investments	(710,564)	(2,120,208)
Investment manager fees	(116,309)	(142,277)
Other expenses	(32,325)	(119,069)
Annual gift to support the Corporation	(983,481)	(932,832)
Other support given to the Corporation	<u>(84,566)</u>	<u>-</u>
 Change in net assets	 <u>\$ (4,236,207)</u>	 <u>\$ (1,848,202)</u>

Charity Care and Community Benefit: It is the policy of the Corporation to recognize that all patients are not equally capable of withstanding the burden of payment for health care services, either by themselves or through a third-party insurance carrier. Those patients who do not have the ability to pay for services are eligible for benevolent care.

Patients are considered eligible for charity care if they cannot meet the agreed payment schedule and/or are denied Medicaid coverage and provide documented evidence for such inability to pay for services. Eligibility is based on federal poverty income guidelines, which are reviewed annually. The Corporation provided benevolent care of \$4,108,004 in 2009 and \$4,711,261 in 2008.

Debt Issuance Costs: Costs incurred in connection with the issuance of debt are amortized using the bonds outstanding method over the term of the related debt.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes: The Corporation is a not-for-profit corporation pursuant to Section 501(c)(3) of the Internal Revenue Code and is exempt from income taxes on related income pursuant to Section 501(a).

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), issued July 2006, was effective as of January 1, 2007. The Corporation has adopted FIN 48 and accordingly will recognize a tax benefit only if it is more likely than not the tax position will be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized will be the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more-likely-than-not test, no tax benefit will be recorded. Currently, the Corporation does not have any contingencies associated with income tax positions in accordance with SFAS No. 5, Accounting for Contingencies, which provides the recording of a contingency based on the probability of certain events to transpire that range from probable to remote as opposed to applying a more likely than not recognition threshold, as the Corporation is tax exempt as an organization described under the Internal Revenue Service Code 501(c)(3).

Use of Estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Excess (Deficit) of Revenues over Expenses: The statements of operations and changes in net assets includes excess (deficit) of revenues over expenses. Changes in unrestricted net assets excluded from excess (deficit) of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments considered temporary, changes in financial instrument fair value for interest rate swaps, unrealized gains and losses on equity investments and uses of donor-restricted contributions related to capital expenditures.

Financial Instruments: The Corporation's carrying amount for its financial instruments, which include cash and cash equivalents, accounts receivable, marketable securities, accounts payable, assets or liabilities associated with the interest rate swap, and long-term debt at June 30, 2009 and 2008 are carried at their estimated fair values. The estimated fair value amounts have been determined by the Corporation using available market information and appropriate valuation methodologies.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation utilizes an interest rate swap agreement to manage the volatility associated with interest rate fluctuations in the normal course of business, which has been designated as a cash flow hedge. The fair value of the interest rate swap agreement is recorded on the balance sheet and represents the estimated receipts or payments that would be required to terminate the agreement. Changes in fair value are included in other changes in net assets.

Concentrations: The Corporation had the following inpatient and outpatient revenue and accounts receivable concentrations as of and for the year ending June 30, 2009:

	<u>2009</u>		<u>2008</u>	
	<u>Revenue %</u>	Accounts <u>Receivable %</u>	<u>Revenue %</u>	Accounts <u>Receivable %</u>
Medicare	13.2 %	10.2 %	14.3 %	8.3 %
Medicaid	16.0 %	11.1 %	17.0 %	12.3 %
Managed care, commercial and other	45.4 %	45.6 %	45.8 %	47.8 %
Blue Cross/Blue Shield	15.7 %	10.6 %	14.5 %	11.7 %
Self pay	9.7 %	22.5 %	8.4 %	19.9 %

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to June 30, 2009 to determine the need for any adjustments to and/or disclosures within the financial statements for the year ended June 30, 2009. Management has performed this analysis through September 10, 2009.

Reclassifications: Certain prior year amounts have been reclassified to conform with the current year presentation. These reclassifications had no effect on net assets.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 2 - ASSETS WHOSE USE IS LIMITED

Assets whose use is limited consist of the following and are stated at fair value:

	2009		2008	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
By Board for funded depreciation:				
Government and agency securities	\$ 1,758,028	\$ 1,818,719	\$ 2,845,598	\$ 2,856,252
Certificates of deposit	994,374	994,374	-	-
Corporate bonds	6,028,530	6,069,092	4,834,815	4,735,870
Equity securities	14,929,145	13,437,797	20,352,853	20,381,096
Accrued interest	<u>135,386</u>	<u>135,386</u>	<u>134,050</u>	<u>134,050</u>
	23,845,463	22,455,368	28,167,316	28,107,268
By Board for self-insurance:				
Government and agency securities	1,167,974	1,208,296	1,903,151	1,910,277
By Board for deferred compensation:				
Equity securities	25,561	25,724	-	-
Donor-restricted funds:				
Money market funds	1,483,959	1,483,959	1,821,319	1,821,319
Government and agency securities	<u>1,991,329</u>	<u>2,060,076</u>	<u>2,807,474</u>	<u>2,817,986</u>
	3,475,288	3,544,035	4,628,793	4,639,305
Unexpended bond proceeds:				
Money market funds	689,064	689,064	1,007,052	1,007,052
Government agency securities	-	-	478,276	494,848
Corporate bonds	415,550	415,550	415,550	415,550
Accrued interest	<u>-</u>	<u>-</u>	<u>1,807</u>	<u>1,807</u>
	<u>1,104,614</u>	<u>1,104,614</u>	<u>1,902,685</u>	<u>1,919,257</u>
	<u>\$ 29,618,900</u>	<u>\$ 28,338,037</u>	<u>\$ 36,601,945</u>	<u>\$ 36,576,107</u>

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 2 - ASSETS WHOSE USE IS LIMITED (Continued)

Realized investment return, as reported in the statements of operations and changes in net assets, consists of the following:

	<u>2009</u>	<u>2008</u>
Investment income	\$ 981,980	\$ 1,243,723
Realized gains (losses)	(4,487,882)	1,419,375
Investment management fees	<u>(220,455)</u>	<u>(300,102)</u>
 Realized investment return	 <u>\$ (3,726,357)</u>	 <u>\$ 2,362,996</u>

The composition of temporarily impaired investments and length of time such investments were in an unrealized loss position as of June 30, 2009 and 2008 follows:

	2009					
	<u>Less than twelve months</u>		<u>Twelve 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>
Government and agency securities	\$ 1,102,547	\$ (32,322)	\$ -	\$ -	\$ 1,102,547	\$ (32,322)
Corporate bonds	385,155	(9,078)	1,228,381	(71,934)	1,613,536	(81,012)
Equity securities	<u>2,417,914</u>	<u>(394,095)</u>	<u>5,344,179</u>	<u>(2,025,748)</u>	<u>7,762,093</u>	<u>(2,419,843)</u>
	<u>\$ 3,905,616</u>	<u>\$ (435,495)</u>	<u>\$ 6,572,560</u>	<u>\$ (2,097,682)</u>	<u>\$ 10,478,176</u>	<u>\$ (2,533,177)</u>
	2008					
	<u>Less than twelve months</u>		<u>Twelve 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>
Government and agency securities	\$ 2,835,528	\$ (47,814)	\$ 636,734	\$ (4,169)	\$ 3,472,262	\$ (51,983)
Corporate bonds	2,145,905	(43,074)	1,873,189	(68,035)	4,019,094	(111,109)
Equity securities	<u>8,151,539</u>	<u>(1,347,711)</u>	<u>1,754,010</u>	<u>(609,617)</u>	<u>9,905,549</u>	<u>(1,957,328)</u>
	<u>\$ 13,132,972</u>	<u>\$ (1,438,599)</u>	<u>\$ 4,263,933</u>	<u>\$ (681,821)</u>	<u>\$ 17,396,905</u>	<u>\$ (2,120,420)</u>

Temporarily impaired investments at June 30, 2009 and 2008 consist primarily of government and agency securities, corporate bonds, and equity securities of various companies which are in temporarily impaired positions primarily due to general market conditions. Management of the Corporation believes the impairments are temporary in nature due to market conditions and therefore, these investments are not considered other-than-temporarily impaired.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE 3 - FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standard No. 157, "Fair Value Measurements" (SFAS No. 157), defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the Corporation's principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The Corporation determines the fair market values of its investments and derivative contracts based on the fair value hierarchy established in SFAS No. 157, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the Corporation's own assumptions based on market data and on assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The Standard describes three levels within its hierarchy that may be used to measure fair value:

Level 1 Inputs: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 Inputs: Significant other observable inputs other than Level 1 quoted prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Inputs: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair value of the equity securities and money market funds are determined based upon quoted and readily available market prices and are subject to fluctuation in market conditions. As such, fair values can be verified utilizing quoted market prices and do not involve significant management judgments (Level 1 inputs).

The fair value of government and agency securities, certificates of deposit and corporate bonds are determined based on recent trading histories and published closing prices. The valuation model involves current and past trading histories, published closing prices, discounted cash flows and option pricing models in order to determine the fair value of instruments as of the date of measurement. As such, significant fair value inputs can generally be verified and do not involve significant management judgments (Level 2 inputs).

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE 3 - FINANCIAL INSTRUMENTS (Continued)

The fair value of the beneficial interest in the net assets of the Foundation is determined based on the existing determined value of total net assets. The valuation model involves an evaluation of the total assets of the Foundation less all Foundation liabilities in order to arrive at the total net assets held within the Foundation, as of the measurement date. As such, significant fair value inputs can generally be verified and do not involve significant management judgments (Level 2 inputs).

The derivative contracts consist of the interest rate swap. The fair value of the derivative is determined based on the relative values of the fixed and floating rate portions of the interest rate contract. The valuation model utilized involves current interest rates, projected yield curves and volatility factors to determine the fair value of the instruments as of the date of measurement. As such, significant fair value inputs can generally be verified and do not involve significant management judgments (Level 2 inputs).

The following tables present the Corporation's assets and liabilities measured at fair value on a recurring basis under SFAS 157 at June 30, 2009:

	<u>Fair Value Measurements at 06/30/09</u>			
	Quoted Prices in Active Markets for Identical Assets <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>	<u>Total</u>
Assets:				
Government and agency securities	\$ -	\$ 5,087,091	\$ -	\$ 5,087,091
Certificates of deposit	-	994,374	-	994,374
Corporate bonds	-	6,484,642	-	6,484,642
Equity securities	13,463,521	-	-	13,463,521
Accrued interest	-	135,386	-	135,386
Money market funds	<u>2,173,023</u>	<u>-</u>	<u>-</u>	<u>2,173,023</u>
Total investments	15,636,544	12,701,493	-	28,338,037
	-	-	-	-
Beneficial interest in net assets of the Foundation	<u>-</u>	<u>16,233,603</u>	<u>-</u>	<u>16,233,603</u>
Total assets	<u>\$ 15,636,544</u>	<u>\$ 28,935,096</u>	<u>\$ -</u>	<u>\$ 44,571,640</u>
Liabilities:				
Interest rate swap	\$ -	\$ 31,614	\$ -	\$ 31,614

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 4 - PLEDGES RECEIVABLE

The Corporation has unconditional promises receivable from various contributors at June 30 as follows:

	<u>2009</u>	<u>2008</u>
Amounts receivable in:		
Less than one year	\$ 172,240	\$ 474,019
One to three years	<u>47,039</u>	<u>198,576</u>
Total amounts receivable	219,279	672,595
Less: Discounting of future pledges	<u>(1,794)</u>	<u>(6,919)</u>
 Net pledges receivable	 <u>\$ 217,485</u>	 <u>\$ 665,676</u>

An unconditional promise represents a promise made by a contributor to give a specified amount to the Corporation in the future, which is not contingent on the Corporation performing any specific action such as raising matching amount or completing a service. Management feels that the pledges are fully collectible, and thus no allowance for uncollectible pledges is deemed necessary.

NOTE 5 - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2009</u>	<u>2008</u>
Kent Hospital Finance Authority, Variable Rate Demand Limited Obligation Revenue Refunding Bonds, Series 2001	\$ 2,540,000	\$ 3,725,000
Kent Hospital Finance Authority, Variable Rate Demand Limited Obligation Revenue Refunding Bonds, Series 2006	10,030,000	10,030,000
Mortgages payable	<u>189,325</u>	<u>189,325</u>
	12,759,325	13,944,325
Less current portion of long-term debt	<u>1,240,000</u>	<u>1,185,000</u>
	<u>\$ 11,519,325</u>	<u>\$ 12,759,325</u>

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 5 - LONG-TERM DEBT (Continued)

Scheduled maturities of long-term debt are as follows:

2010	\$ 1,240,000
2011	3,305,000
2013	-
2014	-
Thereafter	<u>8,214,325</u>
	<u>\$ 12,759,325</u>

At June 30, 2009, the Corporation had an available line of credit of \$2,000,000. There were no borrowings on the line of credit as of June 30, 2009 and 2008. Interest is payable at the bank prime rate less 0.5% (2.75% at June 30, 2009). The line expires November 1, 2010.

The Kent Hospital Finance Authority issued Variable Rate Demand Limited Obligation Revenue Refunding Bonds, Series 2006 on behalf of the Corporation. The Series 2006 bonds were issued under a master trust indenture by the Kent Hospital Finance Authority. The bonds were issued at a variable rate and are remarketed weekly with the option of converting to a fixed rate at allowable conversion dates and mature on October 1, 2031. Monthly interest payments are required (3.50% at June 30, 2009). The bonds are secured by an unused letter of credit for \$10,153,658 that is scheduled to expire on October 16, 2011. The master-trust indenture requires the Corporation to meet certain financial covenants. As of June 30, 2009, the Corporation is in compliance with its covenants for the bonds.

The Kent Hospital Finance Authority issued Variable Rate Demand Limited Obligation Revenue Refunding Bonds, Series 2001 on behalf of the Corporation. The Series 2001 bonds were issued under a master trust indenture by the Kent Hospital Finance Authority. The bonds are issued at a variable rate and are remarketed weekly with the option of converting to a fixed rate at allowable conversion dates and mature on November 1, 2010. Monthly interest payments are required (4.10% at June 30, 2009). The bonds are secured by an unused letter of credit for \$2,571,315 that is scheduled to expire on November 16, 2010. The master-trust indenture requires the Corporation to meet certain financial covenants. As of June 30, 2009, the Corporation is in compliance with its covenants for the bonds.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 5 - LONG-TERM DEBT (Continued)

The Corporation has an interest rate swap agreement with a notional amount of \$1,270,000, which converts the variable interest rate on a portion of the Series 2001 bonds to a fixed rate. In accordance with the terms of the agreement, the Corporation pays a fixed rate of 3.41% and receives a variable (prime) rate on the notional amount of the swap. Interest rate differentials to be paid or received as a result of the interest rate swap are recognized as an adjustment in other changes in net assets. The swap expires November 1, 2010. The Corporation is exposed to loss for the potential settlement of amounts due by the counter-party under the agreement. At June 30, 2009, the fair value of the estimated future payments required to settle the interest rate swap agreement represented a liability of \$31,614.

At June 30, 2009, the Corporation has evaluated the possible liability related to rebatable arbitrage due on its outstanding 2006 bond issuance. Management has recorded a liability in the amount of \$72,742 as a provision for future rebatable arbitrage.

The mortgage notes payable of \$189,325 matures on December 3, 2022. The mortgages carry an interest rate of zero percent and will be forgiven by the holder at the maturity date as long as the associated property is used for its intended purpose.

NOTE 6 - JOINT OPERATING AGREEMENT

The Corporation's Board of Directors entered into a Joint Operating Agreement ("Agreement") effective July 1, 1998 with St. Mary's Health Services and Metropolitan Hospital to manage the financial and clinical aspects of inpatient and partial hospitalization behavioral health services in the greater West Michigan area. The Agreement combines the inpatient and partial hospitalization mental health services of all three organizations under common management and operations. No initial capital contributions were required as part of the venture and none have been made since inception. The initial term of the Agreement is ten years, with automatic renewals of successive ten-year terms absent the notification of termination by any party. The parties to the Agreement also entered into a series of contractual agreements to provide specific clinical, financial, or support services. The Corporation has a 58% beneficial interest in the venture, with St. Mary's Health Services having 40%, and Metropolitan Hospital having 2%. All residual profits and losses are allocated in accordance with each entity's beneficial interest. At June 30, 2009 and 2008, the Corporation has recorded amounts due to the members of the Agreement of \$13,956 and \$1,564,783, respectively.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 6 - JOINT OPERATING AGREEMENT (Continued)

A summary of operations of the inpatient and partial hospitalization under the Agreement, inclusive of normal charges forgiven of \$470,000 in 2009 and \$573,000 in 2008 is as follows:

	Years Ended June 30	
	<u>2009</u>	<u>2008</u>
Net patient service revenues:		
Inpatient	\$ 39,201,000	\$ 36,393,000
Partial hospitalization	1,203,000	1,273,000
Professional	300,000	250,000
Other	<u>77,000</u>	<u>98,000</u>
	40,781,000	38,014,000
Expenses:		
Inpatient - direct patient care	14,676,000	13,677,000
Partial hospitalization - direct patient care	476,000	487,000
Hospital psychiatry	5,311,000	4,624,000
Hospital services	5,199,000	4,880,000
Contractual services	5,230,000	4,942,000
Support services	6,068,000	5,546,000
Depreciation	211,000	278,000
Self-insurance	<u>983,000</u>	<u>984,000</u>
	<u>38,154,000</u>	<u>35,418,000</u>
Excess of revenues over expenses	<u>\$ 2,627,000</u>	<u>\$ 2,596,000</u>
Pine Rest Christian Mental Health Services	\$ 1,523,000	\$ 1,506,000
St. Mary's Health Services	\$ 1,051,000	\$ 1,038,000
Metropolitan Hospital	\$ 53,000	\$ 52,000

NOTE 7 - RETIREMENT PLAN

The Corporation has a voluntary tax-sheltered retirement program, which covers substantially all employees. Matching contributions to the retirement program were \$526,000 in 2009 and \$526,000 in 2008, based upon the provisions of the plan. In addition, the Corporation made discretionary contributions of \$526,000 in 2009 and \$514,000 in 2008.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 7 - RETIREMENT PLAN (Continued)

On April 1, 2009, the Corporation offered certain employees an unqualified deferred compensation plan created in accordance with IRC Section 457. The Plan is available for a select group of management or highly compensated employees as defined in Sections 201, 301, and 401 of the Employee Retirement Income Security Act of 1974 (ERISA). The deferred compensation is not available to the employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights are, until made available to the employee or other beneficiary, solely the property and rights of the Corporation without being restricted to the provisions of benefits under the Plan and are thus subject to the claims of the Corporation's general creditors. Participants' rights created under the Plan are equivalent to those of general creditors of the Corporation.

The Corporation's liability to each participant is equal to the amount of the participant's deferred compensation adjusted by an amount equal to the investment performance in a related asset account. The related asset accounts are recorded at market value, which is equal to the liability to plan participants. The Corporation has not matched participant's contributions and thus has not recorded an expense for the matching portion of the deferral for the year-ended June 30, 2009.

NOTE 8 - CONTINGENCIES

The Corporation has established a program for professional liability risks that provides full coverage by Michigan Professional Insurance Exchange (MPIE) up to \$500,000 per claim and \$5,000,000 on an occurrence basis. Amounts exceeding MPIE umbrella coverage would be the responsibility of the Corporation. As of October 1, 2008, the Corporation has no self-insurance layer as our reinsurer, ACE, attaches at the \$500,000 per claim level for another \$5,000,000 of coverage. As such, the Corporation has \$5,500,000 of insurance per claim. Above that level, the Corporation would be self-insured.

The Corporation's policy is to provide for estimated losses incurred in connection with malpractice claims and known incidents for which an amount of loss can be reasonably estimated. The Corporation is aware of certain incidents that may result in the assertion of claims, and other claims may be asserted in the future arising from services provided to patients or other incidents. Management believes, after considering legal counsels' evaluations of all actions and claims, that insurance coverage is adequate to cover expected settlements and no accrual has been recorded as of year end.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 9 - OPERATING LEASE COMMITMENTS

The Corporation leases various facilities and equipment under noncancelable operating leases, which expire through December 2016. Terms of the leases provide for various amounts of monthly rent, some of which include taxes, insurance, and maintenance costs associated with each facility.

Minimum lease commitments under noncancelable operating leases as of June 30, 2009 are as follows:

2010	\$ 843,107
2011	668,318
2012	506,209
2013	415,065
2014	404,821
Thereafter	<u>453,644</u>
	<u>\$ 3,291,164</u>

Total rent expense for 2009 and 2008 was \$1,177,888 and \$1,182,118, respectively.

NOTE 10 - RELATED PARTY TRANSACTIONS

The Corporation has a 20% interest in Care Resources, a tax exempt entity established to provide care to individuals in lieu of their Medicare benefits. Each of the members is a 20% guarantor of a line of credit with Care Resources. Accordingly, at June 30, 2009, the Corporation has recorded a liability of \$241,282 related to its guarantee.

NOTE 11 - RESTRICTED NET ASSETS

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

	<u>2009</u>	<u>2008</u>
Capital projects	\$ 3,403,074	\$ 3,765,447
Programs and services	<u>730,207</u>	<u>1,539,534</u>
	<u>\$ 4,133,281</u>	<u>\$ 5,304,981</u>

Permanently restricted net assets are invested in perpetuity. Income generated by these invested funds is not restricted.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 12 - ACQUISITIONS

On December 31, 2005, the Corporation acquired Child Guidance, Inc., a mental health treatment clinic that provides services in Northern Michigan, for \$1 under the terms of an asset purchase agreement. The acquisition was accounted for as net assets contributed. Contributions of net assets between the two not-for-profit organizations included assets, primarily fixed assets, of \$1,800,000 and liabilities, including primarily mortgage obligations and accounts payable, of \$1,033,000. Under the terms of the agreement, the excess net assets over the purchase price of \$767,000 on the acquisition date represented a temporarily restricted contribution to be used for future programs, operational deficits, indigent care, medical staffing costs and other expenditures related to treatment services in the service area. At June 30, 2009 and 2008, unexpended temporarily restricted contributions were \$0 and \$459,710, respectively.

On May 31, 2005, the Corporation acquired Pathfinder Resources, Inc. and Pathfinder Properties, Inc., a treatment center for drug and alcohol addictions, for \$1 under the terms of an asset purchase agreement. The acquisition was accounted for as net assets contributed. Contributions of net assets between two not-for-profit organizations included assets, including primarily fixed assets and accounts receivable, of \$2,779,000 and liabilities, including primarily mortgage obligations and accounts payable of \$1,754,000. Under the terms of the agreement, the excess net assets over the purchase price of \$1,025,000 on the acquisition date represented a temporarily restricted contribution to be utilized over the next five years to fund future programs, operational deficits, indigent care, and capital expenditure related to treatment services. At June 30, 2009 and 2008, unexpended temporarily restricted contributions were \$31,845 and \$421,027, respectively.

NOTE 13 - ENDOWMENT COMPOSITION

The Corporation's endowment primarily consists of funds managed by various investment managers. The endowment includes donor-restricted endowment funds. As required by applicable standards, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Endowment net assets composition consists of all permanently restricted net assets of the Corporation, totaling \$3,705,873 at June 30, 2009 and 2008, respectively. The Corporation received \$156,603 in permanently restricted contributions which were added to the endowment for the year ended June 30, 2008. There were no changes to the endowment net assets for the year ended June 30, 2009.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009 and 2008

NOTE 13 - ENDOWMENT COMPOSITION (Continued)

As of June 30, 2009, The State of Michigan has not passed legislation regarding the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Because of this, the Corporation continues to follow the rules covered by The Uniform Management of Institutional Funds Act (UMIFA). The Board of Directors of the Corporation has interpreted UMIFA as requiring the preservation of the fair value of original gifts 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 (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment. All endowment funds are classified as permanently restricted.

The Corporation has adopted investment and spending policies for endowment funds which attempt to provide a predictable stream of funding to programs supported by the endowment. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity. Under this policy, the endowment assets are invested in a manner to produce results that exceed the price and yield results of the S&P 500 index, while assuming an appropriate level of investment risk.

The Board of Directors has not allowed for the spending of any endowment funds. The Corporation has remained in compliance with this policy. Additionally, the Corporation maintains the value of the endowment funds at all times, with any deficiencies resulting from negative investment returns being recorded in unrestricted net assets.

NOTE 14 - FUNCTIONAL EXPENSES

The Corporation provides mental health care services to patients in Western Michigan and Central Iowa. The expenses related to providing these mental health services were \$59,954,828 and \$54,776,489 at June 30, 2009 and 2008, respectively, and general and administrative expense (principally related to support services, administrative, and other expenses) were \$10,918,339 and \$11,146,015 in 2009 and 2008. Fundraising expenses amounted to \$431,528 and \$676,204 for the years ended June 30, 2009 and 2008.

PINE REST CHRISTIAN MENTAL HEALTH SERVICES
SCHEDULE OF FUNCTIONAL EXPENSES FOR FOSTER CARE PROGRAMS
Years ended June 30, 2009

	<u>Cedar Lodge</u>		<u>Maple Lodge</u>		<u>Birch Lodge</u>	
	<u>Social Services</u>	<u>Maintenance</u>	<u>Social Services</u>	<u>Maintenance</u>	<u>Social Services</u>	<u>Maintenance</u>
Functional expenses						
Salaries	\$ -	\$ 2,126,305	\$ -	\$ 300,455	\$ -	\$ 294,381
Employee benefits	-	526,709	-	74,011	-	73,354
Professional fees	-	48,439	-	8,214	-	7,365
Supplies	801	288,673	81	42,027	72	39,692
Utilities	-	14,569	-	6,449	-	4,600
Postage and shipping	-	835	-	138	-	180
Occupancy	-	36,555	-	6,863	-	19,404
Local transportation	10,588	3,120	2,985	637	2,201	925
Conferences and travel	-	5,320	-	834	-	791
Subscriptions	-	620	-	461	-	-
Specific assistance	-	14,008	-	3,141	-	3,008
Membership dues	-	13,132	-	2,246	-	2,881
Miscellaneous	-	(34,248)	-	(5,713)	-	(5,186)
Parent organization overhead	2,506	718,826	552	83,350	386	79,174
Depreciation	-	223,356	-	23,291	-	24,336
	<u>\$ 13,895</u>	<u>\$ 3,986,219</u>	<u>\$ 3,618</u>	<u>\$ 546,404</u>	<u>\$ 2,659</u>	<u>\$ 544,905</u>
 Patient days		13,610		2,336		2,091