

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

Des Plaines, Illinois

CONSOLIDATED FINANCIAL STATEMENTS

Including Independent Auditors' Report

June 30, 2011 and 2010

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Lutheran Social Services of Illinois and Subsidiary Corporations
Des Plaines, Illinois

We have audited the accompanying consolidated statements of financial position of Lutheran Social Services of Illinois (the "Agency") as of June 30, 2011 and 2010, and the related consolidated statements of activities, cash flows, and functional expenses and directly related program services revenue for the years then ended. These consolidated financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated 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 Agency's internal control over financial reporting. Accordingly, we express no such opinion. 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 the significant estimates made by management, as well as evaluating the overall consolidated 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 consolidated financial position of the Agency as of June 30, 2011 and 2010, 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.

In accordance with Government Auditing Standards, we have also issued our report dated October 13, 2011 on our consideration of Lutheran Social Services of Illinois' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Baker Tilly Virchow Krause, LLP

Chicago, Illinois
October 13, 2011

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,638,355	\$ 6,940,715
Accounts receivable, net of allowance for doubtful accounts of \$812,423 at June 30, 2011 and \$1,093,206 at June 30, 2010	10,671,767	13,510,742
Current portion of unconditional promises to give net of allowance for doubtful promises of \$0 at June 30, 2011 and \$50,000 at June 30, 2010	119,833	366,097
Prepaid expenses	156,459	192,236
Short-term investments	<u>22,887,855</u>	<u>17,531,396</u>
Total Current Assets	<u>38,474,269</u>	<u>38,541,186</u>
INVESTMENTS HELD FOR LONG-TERM PURPOSES	<u>5,163,750</u>	<u>5,061,273</u>
PROPERTY AND EQUIPMENT		
Land	4,290,135	4,290,135
Buildings and other improvements	140,808,594	140,377,771
Furniture and equipment	25,695,789	24,669,435
Construction in progress	<u>242,955</u>	<u>-</u>
Property and Equipment, at cost	171,037,473	169,337,341
Less allowance for depreciation	<u>(75,717,484)</u>	<u>(71,042,976)</u>
Property and Equipment, net	<u>95,319,989</u>	<u>98,294,365</u>
OTHER ASSETS		
Unconditional promises to give, less current portion above	19,601	29,119
Escrow deposit accounts available for HUD Projects	7,440,215	6,953,628
Tenant deposits in trust	79,945	72,745
Prepaid advertising	200,515	242,596
Prepaid bond issuance and long-term debt refinancing costs, less accumulated amortization of \$443,679 at June 30, 2011 and \$381,217 at June 30, 2010	1,191,856	1,254,318
Cash surrender value of life insurance contracts	<u>316,963</u>	<u>387,005</u>
Total Other Assets	<u>9,249,095</u>	<u>8,939,411</u>
TOTAL ASSETS	<u>\$ 148,207,103</u>	<u>\$ 150,836,235</u>

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (continued)
June 30, 2011 and 2010

LIABILITIES AND NET ASSETS		
	2011	2010
CURRENT LIABILITIES		
Line of credit	\$ 1,482,209	\$ 2,526,592
Current maturities of long-term debt:		
Mortgages payable	508,728	471,669
Notes payable related to bond issues	980,000	935,000
Accounts payable and other accrued expenses	10,119,951	9,765,946
Cash advances for special purposes	413,978	339,583
Accrued interest payable	389,907	403,384
Accrued salaries and wages	4,253,045	5,515,359
Accrued and withheld taxes	692,747	1,668,754
Security deposits	30,559	25,652
Residents' special deposits	122,331	104,157
Total Current Liabilities	18,993,455	21,756,096
LONG-TERM LIABILITIES		
Long-term debt, less current maturities above:		
Mortgages payable	15,732,988	16,241,687
Notes payable related to bond issues	22,730,000	23,710,000
Accrued interest payable	182,825	172,536
Refundable entrance fees	7,920,084	7,648,773
Deferred grant revenue from capital advance agreements	42,595,256	43,598,176
Deferred grant revenue from assisted living conversion agreement	5,044,243	5,224,399
Deferred grant revenue from federal home loan agreements	167,380	180,052
Deferred revenue from advance fees	1,127,631	1,425,062
Liability for split interest gift arrangements	912,005	1,059,326
Funds held for unrelated charitable organizations	103,726	90,692
Residents' equity	154,400	154,400
Liability for pension benefits	13,396,321	15,701,183
Other long-term liabilities	558,340	566,885
Tenant security deposits held in trust	347,630	352,585
Total Long-Term Liabilities	110,972,829	116,125,756
Total Liabilities	129,966,284	137,881,852
NET ASSETS		
Unrestricted	10,828,778	6,033,431
Temporarily restricted by donors	4,776,506	4,293,457
Permanently restricted by donors for endowment	2,635,535	2,627,495
Total Net Assets	18,240,819	12,954,383
TOTAL LIABILITIES AND NET ASSETS	\$ 148,207,103	\$ 150,836,235

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF ACTIVITIES
Year Ended June 30, 2011

	2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
SUPPORT AND REVENUE				
Public Support:				
Lutheran church support	\$ 1,056,221	\$ -	\$ -	\$ 1,056,221
United Way	233,948	101,533	-	335,481
Contributions	2,655,629	571,124	5,482	3,232,235
Bequests	323,714	125,237	2,558	451,509
Total Public Support	<u>4,269,512</u>	<u>797,894</u>	<u>8,040</u>	<u>5,075,446</u>
Other Revenue:				
Fees and grants from government agencies	79,507,765	-	-	79,507,765
Program service fees	24,804,855	-	-	24,804,855
Grant revenue from capital advance agreements	1,604,455	-	-	1,604,455
Public sales	150,622	-	-	150,622
Rents and investment return	4,285,475	717,976	-	5,003,451
Partnership distributions and loss on disposal of property	(573,561)	-	-	(573,561)
Miscellaneous	3,213,049	-	-	3,213,049
Total Other Revenue	<u>112,992,660</u>	<u>717,976</u>	<u>-</u>	<u>113,710,636</u>
Net assets released from restrictions	<u>1,070,680</u>	<u>(1,070,680)</u>	<u>-</u>	<u>-</u>
Total Public Support and Revenue	<u>118,332,852</u>	<u>445,190</u>	<u>8,040</u>	<u>118,786,082</u>
EXPENSES				
Program Services	105,288,273	-	-	105,288,273
Supporting Services:				
Management and general	7,996,702	-	-	7,996,702
Fundraising	1,936,286	-	-	1,936,286
Total Supporting Services	<u>9,932,988</u>	<u>-</u>	<u>-</u>	<u>9,932,988</u>
Total Program and Supporting Services Expense	<u>115,221,261</u>	<u>-</u>	<u>-</u>	<u>115,221,261</u>
CHANGE IN NET ASSETS BEFORE OTHER ITEMS	3,111,591	445,190	8,040	3,564,821
OTHER ITEMS				
Actuarial gain on annuity obligations	-	37,859	-	37,859
Decrease in unrecognized pension costs	1,683,756	-	-	1,683,756
CHANGE IN NET ASSETS	4,795,347	483,049	8,040	5,286,436
NET ASSETS - Beginning of Year	<u>6,033,431</u>	<u>4,293,457</u>	<u>2,627,495</u>	<u>12,954,383</u>
NET ASSETS - END OF YEAR	<u>\$ 10,828,778</u>	<u>\$ 4,776,506</u>	<u>\$ 2,635,535</u>	<u>\$ 18,240,819</u>

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF ACTIVITIES (continued)
Year Ended June 30, 2010

	2010			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
SUPPORT AND REVENUE				
Public Support:				
Lutheran church support	\$ 844,057	\$ 1,000	\$ -	\$ 845,057
United Way	310,562	123,897	-	434,459
Contributions	2,132,265	969,967	1,301	3,103,533
Bequests	1,415,289	119,138	34,844	1,569,271
Total Public Support	<u>4,702,173</u>	<u>1,214,002</u>	<u>36,145</u>	<u>5,952,320</u>
Other Revenue:				
Fees and grants from government agencies	77,301,590	-	-	77,301,590
Program service fees	24,887,479	-	-	24,887,479
Grant revenue from capital advance agreements	1,548,422	-	-	1,548,422
Public sales	120,535	-	-	120,535
Rents and investment return	2,876,707	369,595	-	3,246,302
Partnership distributions and gain on disposal of property	2,899,912	-	-	2,899,912
Miscellaneous	438,573	-	-	438,573
Total Other Revenue	<u>110,073,218</u>	<u>369,595</u>	<u>-</u>	<u>110,442,813</u>
Net assets released from restrictions	<u>1,312,869</u>	<u>(1,312,869)</u>	<u>-</u>	<u>-</u>
Total Public Support and Revenue	<u>116,088,260</u>	<u>270,728</u>	<u>36,145</u>	<u>116,395,133</u>
EXPENSES				
Program Services	99,118,623	-	-	99,118,623
Supporting Services:				
Management and general	7,778,852	-	-	7,778,852
Fundraising	1,960,714	-	-	1,960,714
Total Supporting Services	<u>9,739,566</u>	<u>-</u>	<u>-</u>	<u>9,739,566</u>
Total Program and Supporting Services Expense	<u>108,858,189</u>	<u>-</u>	<u>-</u>	<u>108,858,189</u>
CHANGE IN NET ASSETS BEFORE INCOME TAXES AND OTHER ITEMS	7,230,071	270,728	36,145	7,536,944
Provision for income taxes	<u>(1,078,335)</u>	<u>-</u>	<u>-</u>	<u>(1,078,335)</u>
CHANGE IN NET ASSETS BEFORE OTHER ITEMS	6,151,736	270,728	36,145	6,458,609
OTHER ITEMS				
Actuarial loss on annuity obligations	-	(98,701)	-	(98,701)
Increase in unrecognized pension costs	<u>(1,686,725)</u>	<u>-</u>	<u>-</u>	<u>(1,686,725)</u>
CHANGE IN NET ASSETS	4,465,011	172,027	36,145	4,673,183
NET ASSETS - Beginning of Year	<u>1,568,420</u>	<u>4,121,430</u>	<u>2,591,350</u>	<u>8,281,200</u>
NET ASSETS - END OF YEAR	<u>\$ 6,033,431</u>	<u>\$ 4,293,457</u>	<u>\$ 2,627,495</u>	<u>\$ 12,954,383</u>

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended June 30, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	\$ 5,286,436	\$ 4,673,183
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	5,837,107	5,620,308
Change in value of liability for split interest gift arrangements (including charitable annuity lead trust)	(37,858)	98,701
Contribution of endowment investment	(2,558)	-
Amortization of deferred grant revenue from various agreements	(1,604,455)	(1,548,422)
Amortization of entrance fees	(645,811)	(629,043)
Amortization of prepaid bond issuance and debt financing costs	62,462	54,792
Reduction in entrance fees liability to cover unpaid monthly resident fees	(42,337)	(38,376)
Loss (gain) on disposal of property and equipment	593,557	(5,613)
Reinvestment of investment income	(381,939)	(437,419)
Net realized and unrealized gains on investments	(3,657,332)	(1,813,516)
Decrease (increase) in cash surrender value of life insurance	30,658	(26,295)
(Decrease) increase in unrecognized pension costs	(1,683,756)	1,686,725
Current pension cost	1,224,382	902,343
Contributions restricted for long-term investment	(5,482)	(36,145)
Provision for deferred taxes	-	520,475
Changes in assets and liabilities:		
Accounts receivable	2,838,975	(4,094,901)
Unconditional promises to give	255,782	358,189
Other assets	77,858	175,375
Restricted deposit accounts	(128,855)	(19,638)
Accounts payable and other accrued expenses	354,005	494,435
Other current liabilities	(2,154,322)	665,818
Liability for pension benefits	(1,845,488)	(1,443,863)
Other long-term liabilities	(3,211)	76,668
Net Cash Flows from Operating Activities	4,367,818	5,233,781
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(3,322,772)	(3,280,618)
Proceeds from disposal of property and equipment	17,025	17,129
Purchases of investments	(6,792,981)	(4,830,996)
Proceeds from sales of investments	5,220,196	6,954,314
Proceeds from surrendering life insurance policies	39,384	1,959
Net deposits into residual receipts, replacement reserve, and minimum capital investment	(364,932)	(1,158,111)
Net Cash Flows from Investing Activities	\$ (5,204,080)	\$ (2,296,323)

See accompanying notes to consolidated financial statements.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
Years Ended June 30, 2011 and 2010

	2011	2010
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from mortgage loan	\$ -	\$ 430,811
Proceeds from charitable annuity lead trust	-	17,203
Proceeds from split interest agreements relinquished	173,857	-
Proceeds from contributions restricted for investment in endowment	5,482	1,301
Proceeds from entrance fees	1,288,450	1,407,533
Proceeds from capital advance agreements	258,166	-
Payments on split interest gift arrangements	(114,608)	(128,412)
Payments of refundable entrance fees	(626,422)	(1,691,834)
Repayment of bonds	(935,000)	(890,000)
Repayment of other debt	(471,640)	(350,000)
Net (repayments) borrowings under line of credit	(1,044,383)	958,493
Payment of debt financing costs	-	(314,703)
Net Cash Flows from Financing Activities	(1,466,098)	(559,608)
Net Change in Cash and Cash Equivalents	(2,302,360)	2,377,850
CASH AND CASH EQUIVALENTS - Beginning of Year	6,940,715	4,562,865
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 4,638,355	\$ 6,940,715
Supplemental cash flow disclosures		
Cash paid for interest	<u>\$ 1,927,138</u>	<u>\$ 1,710,737</u>
Noncash investing and financing activities		
Capital additions financed by mortgage payable	<u>\$ -</u>	<u>\$ 7,755,889</u>
Capital additions financed by capital advances	<u>\$ 150,541</u>	<u>\$ 1,606,164</u>

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE Year Ended June 30, 2011

2011

	PROGRAM SERVICES							Matins, Inc. (91)
	Prisoner / Family Ministry (05)	Behavioral Health Services (13)	Children's Community Services (12)	Community Services (40)	Housing Services (41)	Nursing Care Services (42)	Other Operating (93)	
FUNCTIONAL EXPENSES								
Salaries	\$ 555,876	\$ 8,958,214	\$ 17,426,818	\$ 7,261,344	\$ 5,251,518	\$ 10,891,433	\$ -	\$ -
Employee health and retirement benefits, payroll taxes, etc.	97,324	1,990,681	3,657,405	1,452,306	1,293,354	2,633,444	-	-
Total Salaries and Related Expenses	653,200	10,948,895	21,084,223	8,713,650	6,544,872	13,524,877	-	-
Professional fees and contract service payments	31,519	1,263,752	9,967,346	38,747	497,938	3,535,510	7,859	1,500
Supplies	26,921	737,662	413,379	194,001	527,301	2,255,741	-	-
Communications	23,263	220,485	470,111	83,033	362,378	135,342	-	-
Occupancy	43,891	953,718	1,972,141	391,026	3,758,088	1,313,122	-	-
Advertising and printing	1,658	4,229	45,493	85,819	260,346	161,105	-	-
Local transportation	23,929	208,089	1,490,256	289,081	156,827	41,320	-	-
Meetings, seminars and education	2,173	14,485	18,908	12,790	14,490	68,466	-	-
Specific assistance to individuals	57,787	26,842	536,715	29,760	7,117	6,220	-	-
Elderly and congregate expenses	-	-	-	-	671,686	-	-	-
Equipment rental and maintenance	1,606	105,749	114,213	35,184	134,479	190,674	-	-
Miscellaneous and other operating	64	168,670	30,800	13,665	1,346,049	209,709	11,521	15
Interest	316	87,510	14,437	28,314	993,008	399,807	-	-
Bond costs	-	1,923	95	443	25,866	9,893	-	-
Total Functional Expenses	866,327	14,742,009	36,158,117	9,915,513	15,300,445	21,851,786	19,380	1,515
Depreciation	11,695	225,369	-	90,754	3,291,675	919,084	-	6,837
Total Program and Supporting Services Expense	\$ 878,022	\$ 14,967,378	\$ 36,158,117	\$ 10,006,267	\$ 18,592,120	\$ 22,770,870	\$ 19,380	\$ 8,352
DIRECTLY RELATED PROGRAM SERVICES REVENUE								
Fees and grants from governmental agencies	\$ 213,237	\$ 13,505,310	\$ 37,641,215	\$ 8,973,752	\$ 6,502,621	\$ 12,671,630	\$ -	\$ -
Program service fees	-	1,624,768	445,464	1,341,658	9,309,427	12,083,538	-	-
Grant revenue from capital advance agreements	-	-	-	-	1,604,455	-	-	-
Public sales	4,300	13,575	33,190	-	66,704	941	-	-
Rents and investment return	-	-	9,500	-	112,209	520,899	1,078,094	1
Partnership distributions and loss on disposal of property	-	1,500	-	200	(573,613)	-	-	-
Miscellaneous	5	9,306	932	8,399	3,092,095	57,423	-	-
Total Directly Related Program Services Revenue	\$ 217,542	\$ 15,154,459	\$ 38,130,301	\$ 10,324,009	\$ 20,113,898	\$ 25,334,431	\$ 1,078,094	\$ 1

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued)
Year Ended June 30, 2011

	2011					
	PROGRAM SERVICES			SUPPORTING SERVICES		
	Vesper Mgmt Corporation (90)	Subtotal Program Services	Management and General (70, 82)	Resource Development (80, 83)	The Cornerstone Foundation, Inc. (99)	Total 2011
FUNCTIONAL EXPENSES						
Salaries	\$ -	\$ 50,345,203	\$ 4,748,298	\$ 1,170,958	\$ -	\$ 56,264,459
Employee health and retirement benefits, payroll taxes, etc.	-	11,124,514	1,005,744	206,560	-	12,336,818
Total Salaries and Related Expenses	-	61,469,717	5,754,042	1,377,518	-	68,601,277
Professional fees and contract service payments	174,845	15,519,016	597,804	188,452	29,864	16,335,136
Supplies	12,164	4,167,169	60,258	61,054	1,159	4,289,640
Communications	4,602	1,299,214	136,296	27,036	1,693	1,464,239
Occupancy	560,867	8,992,853	242,615	12,530	-	9,247,998
Advertising and printing	-	558,650	217,634	72,296	9,490	858,070
Local transportation	-	2,209,502	82,933	17,312	3,280	2,313,027
Meetings, seminars and education	-	131,312	89,746	5,549	1,832	228,439
Specific assistance to individuals	-	664,441	1,822	-	-	666,263
Elderly and congregate expenses	-	671,686	-	-	-	671,686
Equipment rental and maintenance	15	581,905	133,966	7,025	-	722,896
Miscellaneous and other operating	308,813	1,832,205	148,019	46,252	29,809	2,004,588
Interest	-	86,130	86,130	5,615	-	1,923,950
Bond costs	7,857	46,077	10,725	143	-	56,945
Total Functional Expenses	1,069,163	99,924,255	7,561,990	1,820,782	77,127	109,384,154
Depreciation	818,604	5,364,018	434,712	38,377	-	5,837,107
Total Program and Supporting Services Expense	\$ 1,887,767	\$ 105,288,273	\$ 7,996,702	\$ 1,859,159	\$ 77,127	\$ 115,221,261
DIRECTLY RELATED PROGRAM SERVICES REVENUE						
Fees and grants from governmental agencies	\$ -	\$ 79,507,765	\$ -	\$ -	\$ -	\$ 79,507,765
Program service fees	-	24,804,855	-	-	-	24,804,855
Grant revenue from capital advance agreements	-	1,604,455	-	-	-	1,604,455
Public sales	-	118,710	-	31,912	-	150,622
Rents and investment return	300,738	2,021,441	-	-	2,982,010	5,003,451
Partnership distributions and loss on disposal of property	(1,648)	(573,561)	-	-	-	(573,561)
Miscellaneous	756	3,168,916	44,133	-	-	3,213,049
Total Directly Related Program Services Revenue	\$ 299,846	\$ 110,652,581	\$ 44,133	\$ 31,912	\$ 2,982,010	\$ 113,710,636

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued) Year Ended June 30, 2010

	2010 PROGRAM SERVICES							Matins, Inc. (91)
	Prisoner / Family Ministry (05)	Behavioral Health Services (13)	Children's Community Services (12)	Community Services (40)	Housing Services (41)	Nursing Care Services (42)	Other Operating (93)	
FUNCTIONAL EXPENSES								
Salaries	\$ 534,485	\$ 8,835,212	\$ 16,675,567	\$ 6,392,345	\$ 5,051,698	\$ 10,475,766	\$ -	\$ -
Employee health and retirement benefits, payroll taxes, etc.	82,646	1,806,423	3,329,062	1,241,727	1,198,718	2,494,717	-	-
Total Salaries and Related Expenses	617,131	10,641,635	20,004,629	7,634,072	6,250,416	12,970,483	-	-
Professional fees and contract service payments	38,342	1,260,122	9,404,419	72,596	736,531	3,678,892	8,569	1,500
Supplies	18,643	726,754	424,032	155,098	519,118	2,152,637	-	-
Communications	26,242	217,577	454,051	77,877	319,118	124,014	-	-
Occupancy	38,351	899,992	2,034,031	390,108	3,251,788	1,405,597	-	-
Advertising and printing	5,086	4,279	57,530	97,851	216,717	172,331	-	-
Local transportation	18,259	220,280	1,429,781	222,049	174,372	28,380	-	-
Meetings, seminars and education	859	22,248	21,541	7,167	40,149	68,264	-	-
Specific assistance to individuals	63,497	153,590	679,591	25,848	3,201	8,786	-	-
Elderly and congregate expenses	1,532	107,202	147,791	22,687	110,663	187,233	-	-
Equipment rental and maintenance	2,876	155,601	27,279	13,984	307,547	195,972	14,395	15
Miscellaneous and other operating	235	96,046	29,493	38,939	711,723	419,681	-	-
Bond costs	-	1,951	129	457	18,373	9,812	-	-
Total Functional Expenses	831,053	14,507,277	34,714,297	8,758,733	12,768,079	21,422,082	22,964	1,515
Depreciation	9,535	237,980	792	89,929	2,912,507	976,762	-	6,702
Total Program and Supporting Services Expense	\$ 840,588	\$ 14,745,257	\$ 34,715,089	\$ 8,848,662	\$ 15,680,586	\$ 22,398,844	\$ 22,964	\$ 8,217
DIRECTLY RELATED PROGRAM SERVICES REVENUE								
Fees and grants from governmental agencies	\$ 206,531	\$ 15,072,028	\$ 37,558,141	\$ 8,111,653	\$ 5,232,112	\$ 11,121,125	\$ -	\$ -
Program service fees	-	1,665,715	478,742	1,183,320	9,464,135	12,095,567	-	-
Grant revenue from capital advance agreements	-	-	-	-	1,548,422	-	-	-
Public sales	-	-	1,417	113	43,572	972	-	-
Rents and investment return	-	(3,942)	17,838	-	95,335	515,331	769,086	2
Partnership distributions and gain on disposal of property	(771)	2,800	-	3,238	2,889,876	-	-	-
Miscellaneous	5	68,340	4,844	320	148,727	66,898	-	-
Total Directly Related Program Services Revenue	\$ 205,765	\$ 16,804,941	\$ 38,060,982	\$ 9,298,644	\$ 19,422,179	\$ 23,799,893	\$ 769,086	\$ 2

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES AND DIRECTLY RELATED PROGRAM SERVICES REVENUE (continued)
Year Ended June 30, 2010

	2010						Total 2010
	PROGRAM SERVICES			SUPPORTING SERVICES			
	Vesper Mgmt Corporation (90)	Subtotal Program Services	Management and General (70, 82)	Resource Development (80, 83)	The Cornerstone Foundation, Inc. (99)	Subtotal Fundraising	
FUNCTIONAL EXPENSES							
Salaries	\$ -	\$ 47,965,073	\$ 4,528,273	\$ 1,174,399	\$ -	\$ 1,174,399	\$ 53,667,745
Employee health and retirement benefits, payroll taxes, etc.	-	10,153,293	903,987	193,643	-	193,643	11,250,923
Total Salaries and Related Expenses	-	58,118,366	5,432,260	1,368,042	-	1,368,042	64,918,668
Professional fees and contract service payments	179,531	15,380,502	689,236	200,039	32,597	232,636	16,302,374
Supplies	24,570	4,020,852	50,521	73,244	1,644	74,888	4,146,261
Communications	4,569	1,223,448	151,504	21,473	1,264	22,737	1,397,689
Occupancy	470,620	8,490,487	225,928	11,610	-	11,610	8,728,025
Advertising and printing	-	553,794	169,401	63,331	13,358	76,689	799,884
Local transportation	-	2,093,121	74,133	15,770	2,850	18,620	2,185,874
Meetings, seminars and education	-	160,228	67,990	7,113	1,614	8,727	236,945
Specific assistance to individuals	-	934,513	2,000	-	-	-	936,513
Elderly and congregate expenses	-	108,363	-	-	-	-	108,363
Equipment rental and maintenance	115	577,108	197,343	7,908	-	7,908	782,359
Miscellaneous and other operating	319,175	1,615,292	144,818	43,832	30,791	74,623	937,225
Interest	7,894	38,616	87,031	5,864	-	5,864	1,708,187
Bond costs	1,006,474	94,032,474	10,753	145	-	145	49,514
Total Functional Expenses	851,942	5,086,149	475,934	58,225	84,118	1,902,489	103,237,881
Depreciation	1,858,416	99,118,623	7,778,852	1,876,596	84,118	58,225	5,620,308
Total Program and Supporting Services Expense	\$ -	\$ 99,118,623	\$ 7,778,852	\$ 1,876,596	\$ 84,118	\$ 1,960,714	\$ 108,858,199
DIRECTLY RELATED PROGRAM SERVICES REVENUE							
Fees and grants from governmental agencies	\$ -	\$ 77,301,590	\$ -	\$ -	\$ -	\$ -	\$ 77,301,590
Program service fees	-	24,887,479	-	-	-	-	24,887,479
Grant revenue from capital advance agreements	-	1,548,422	-	-	-	-	1,548,422
Public sales	-	46,074	-	74,461	-	74,461	120,535
Rents and investment return	350,385	1,744,035	5,364	-	1,496,903	1,496,903	3,246,302
Partnership distributions and gain on disposal of property	4,769	2,899,912	-	-	-	-	2,899,912
Miscellaneous	33,317	322,451	116,122	-	-	-	438,573
Total Directly Related Program Services Revenue	\$ 388,471	\$ 108,749,993	\$ 121,486	\$ 74,461	\$ 1,496,903	\$ 1,571,364	\$ 110,442,813

See accompanying notes to consolidated financial statements.

LUTHERAN SOCIAL SERVICES OF ILLINOIS AND SUBSIDIARY CORPORATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies

Nature of Activities

Lutheran Social Services of Illinois, including the subsidiary corporations included herein (the "Agency"), is a multi-functional social service agency which is the social ministry expression of the three Illinois Synods of the Evangelical Lutheran Church in America. It is a corporation organized under the laws of the State of Illinois pursuant to the provisions of the "General Not-For-Profit Corporation Act." It is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The Agency qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and is not a private foundation under Section 509(a)(2). The Agency receives a significant portion of its operating funds from public support, fees and grants from government agencies and program service fees. The Agency's fiscal year ends on June 30. Significant accounting policies followed by the Agency are presented below.

In accordance with authoritative accounting guidance related to reporting of related entities by not-for-profit organizations, twenty-two (22) affiliated not-for-profit corporations incorporated under the Illinois "General Not-For-Profit Corporation Act" are included as subsidiaries in the consolidated financial statements. These corporations are considered subsidiary corporations because Lutheran Social Services of Illinois has control over and an economic interest in these corporations. In addition, LSSI Rockford Property, Inc., which is a for-profit subsidiary, is also consolidated as the Agency owns 100 percent of that company. These subsidiary corporations are:

- Assisi Homes-Downer Place, Inc.
- Aurora Senior Housing, Inc.
- Batavia Council on Aging, Inc.
- The Cornerstone Foundation, Inc. ("Foundation")
- Deer Creek Manor, Inc.
- Dekalb Housing for the Handicapped, Inc.
- Forsberg Christian Retirement Center, Inc.
- Freeport Senior Housing, Inc.
- Freeport Senior Housing II, Inc.
- Fox Hill Senior Housing, Inc.
- LSSI Rockford Property, Inc.
- Luther Center, Inc.
- Matins, Inc.
- Northwest Chicago Group Homes, Inc.
- Our Savior's Senior Housing, Inc.
- Peterson Meadows, Inc.
- Rochelle Senior Housing, Inc.
- Rolling Meadows Senior Living, Inc.
- Salem Village III, Inc.
- Spring Ridge Housing for Seniors, Inc.
- Tabor Lutheran Senior Housing, Inc.
- Vesper Management Corporation
- Victorian Woods Senior Living, Inc.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Nature of Activities (continued)

Human services that the Agency provides include:

Behavioral Health Services - a broad range of counseling, mental health and substance abuse services for both adults and adolescents; residential treatment for emotionally disturbed adolescents and assistance to children and adolescents with developmental disabilities.

Community Child Care Services - comprehensive, developmentally-oriented, Child Care and Head Start programs in the Chicagoland area.

Foster Care and Adoption Services - community-based child welfare services to children and their families.

Senior Services - a wide spectrum of services for senior citizens including a broad range of community-based services to the older adult population including case/care management, homemaker services, adult day services, elder abuse intervention and escorted transportation; residential skilled nursing care services including subacute care, long-term care, dementia care, assisted living, outpatient services and geriatric assessment; and owned and managed housing facilities for the aged.

Prisoner and Family Ministry - a variety of services for prisoners in Illinois prisons and jails and for their families, including transportation for visits by children of inmates, storybook readings by inmates for their children, community re-entry programs, pastoral care and, in cooperation with Habitat for Humanity, prisoner carpentry projects.

Consolidated Financial Statement Presentation

The accompanying consolidated financial statements include the accounts of the Agency. All significant transactions among these corporations have been eliminated.

Basis of Accounting

The consolidated financial statements have been prepared using the accrual basis of accounting.

Cash and Cash Equivalents

The Agency considers all liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents. However, all investments held in trust for the Illinois Finance Authority (IFA) and the Illinois Health Facilities Authority (IHFA) Bond Issues are considered long-term investments.

Cash and cash equivalents are subject to the line of credit borrowing arrangement which, among other restrictions, requires the Agency to maintain certain unrestricted cash and investment balances.

Receivables

Accounts receivable are uncollateralized funding source obligations, which generally are payable within 30 days from the invoice or billing date. Accounts receivable are stated at the invoice amount.

Payments of accounts receivable are applied to the specific invoices identified on the funding source's remittance advice or, if unspecified, to the earliest unpaid invoices.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Receivables (continued)

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected. The allowance for doubtful accounts is based on management's assessment of the collectibility of specific funding source accounts and the aging of accounts receivable. If actual results are higher than the historical experience, management's estimates of the recoverability of amounts due to the Agency could be adversely affected. All accounts or portions thereof deemed to be uncollectible or to require an excessive collection cost are written off to the allowance for doubtful accounts.

Promises to Give

Unconditional promises to give are recognized as revenue or gains in the period received and as assets, decreases in liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional. There were no conditional promises to give as of June 30, 2011 and 2010.

The carrying amount of unconditional promises to give is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected. Amounts that are expected to be collected after one year have been discounted at the time the pledge is recorded. The discount rates used range from 1.00% to 4.50%. The allowance for uncollectible amounts is based on management's assessment of the collectibility of specific promises to give. All accounts or portions thereof deemed to be uncollectible or to require an excessive collection cost are written off to the allowance for uncollectible promises to give.

Income Taxes

The Agency is recognized by the Internal Revenue Service as a tax exempt organization under Section 501(c)(3) of the Internal Revenue Code and, except for taxes pertaining to unrelated business income, is exempt from federal and state income taxes.

The Agency follows current accounting guidance, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Agency may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Agency and various positions related to the potential sources of unrelated business income. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes as described in Note 23.

With few exceptions, the Agency is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for the years before 2007. The Agency is not currently under examination by any taxing jurisdiction. It is the Agency's policy to recognize interest and penalties related to unrecognized tax expense when paid.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Investments

Investments are generally recorded at fair value based upon quoted market prices, when available, or estimates of fair value with gains and losses included in the consolidated statements of activities. The Agency considers all investments unrelated to debt service with original maturities from three months to one year to be short-term investments. Donated securities are recorded at fair value on the date received or at nominal value when the fair value is not readily available.

The Agency currently allows a portion of the total portfolio to be invested in hedge fund(s) of funds which, in turn invest in hedge funds utilizing primarily long/short equity strategies. The hedge funds are managed by separate investment managers. The Agency may withdraw funds from the hedge fund(s) of funds on an annual basis. The underlying hedge funds may sell securities, borrowed but not yet purchased (a short sale), whereby a liability is created to purchase the security at prevailing prices. The hedge funds' ultimate obligations to satisfy a short sale may exceed the amounts recognized on their statements of financial condition. However, due to the nature of the Agency's investment, such risks are limited to the fund of funds' investment in each hedge fund. The Agency does not intend to use significant economic leverage within its hedge fund of funds strategy.

The Agency's external investment advisors are engaged to monitor and report on portfolio performance and to make recommendations to a joint Cornerstone Foundation and Lutheran Social Services of Illinois investment committee, which are further subject to the Board of Directors' approval as to investment manager selection and/or replacement, and asset allocations. Once those recommendations are approved, Agency management executes the necessary transactions to cause the investment portfolio to conform to the use of investment managers and the asset allocation percentages as approved. Monitoring and rebalancing of the investment portfolio is conducted on an on-going basis by Agency management subject to the tolerances within the approved investment policy.

Property and Equipment

Property and equipment are stated at cost, if purchased, or fair value at the date of the gift, if donated. All acquisitions of property and equipment in excess of \$1,000 and all expenditures for repairs, maintenance, improvements and betterments that materially prolong the useful lives of assets are capitalized. Maintenance, repairs, and minor improvements are expensed as incurred. When assets are retired or otherwise disposed of, their costs and related accumulated depreciation are removed from the accounts and resulting gains or losses are included in the change in net assets.

Property and equipment are depreciated using the straight-line method over their estimated useful lives as follows:

Buildings	25-40 years
Other improvements	5-25 years
Furniture and equipment	3-7 years

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets

The Agency reviews long-lived assets for impairment whenever events or changes in circumstances indicate 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 future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell. To date, there have been no such losses recorded.

Escrow Deposit Accounts Available for HUD Projects

At June 30, 2011 and 2010, the Agency had restricted cash totaling \$7,440,215 and \$6,953,628, respectively, mainly related to replacement reserves, tenant security deposits, residual receipts and minimum capital investments required by the U.S. Department of Housing and Urban Development ("HUD"). HUD regulations require these funds be held in segregated accounts.

Prepaid Advertising

Prepaid advertising costs include costs incurred in connection with acquiring the initial continuing care contracts for the residential units, then not in service. Such costs are expensed on a straight-line basis over the average expected remaining lives of the residents under the contract or the contract term, if shorter.

Non-direct advertising and promotion costs are charged to operations when incurred, and for the years ended June 30, 2011 and 2010 was \$481,458 and \$458,759, respectively.

Prepaid Bond Issuance and Refinancing Costs

Expenses associated with the issuance and refinancing of bonds are being amortized on the straight-line method over the term of the refinanced bonds. Accumulated amortization at June 30, 2011 and 2010 was \$443,679 and \$381,217, respectively.

Capital Advance and Assisted Living Conversion Grant Agreements

The deferred grant revenue from the capital advance and assisted living conversion grant agreements with HUD are being amortized over the terms of the agreements using the straight-line method.

Refundable Entrance Fees and Advance Fees

In 2011 and 2010, two basic refund plans are available to prospective residents; a Refundable plan and a Non-Refundable plan. Under the terms of the Refundable Plans, the resident would receive, upon termination of the Residency Agreement and reoccupancy of the unit, a refund equal to the amount of the entrance fee paid less any non-refundable portion. Under the terms of the Non-Refundable Plan, the resident would receive, upon termination of the Residency Agreement and reoccupancy of the unit, a refund equal to the amount of the entrance fee paid, less the sum of a 4% service fee and 2% of the entrance fee per month of occupancy. After 48 months, residents under the Non-Refundable Plan would not receive a refund.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Refundable Entrance Fees and Advance Fees (continued)

Fees paid by a resident upon entering a continuing care contract, net of the portion thereof that is refundable to the resident, are recorded as deferred revenue and are amortized to the change in net assets using the straight-line method over the estimated remaining life expectancy of the resident, which is updated annually for each resident. The refundable portion, which is refundable only if another resident reoccupies the contract holder's unit, is also recorded as deferred revenue and is amortized to the change in net assets using the straight-line method over the estimated remaining life of the unit, which is consistent with the estimated useful lives used for depreciation.

During the years ended June 30, 2011 and 2010, refundable entrance fees to various residents were reduced by \$42,337 and \$38,376, respectively, in order to cover monthly residence fees owed by the same residents.

Split Interest Gift Arrangements

The Agency has entered into split interest gift arrangements that are mainly comprised of gift annuities and charitable trusts. Gift annuities provide that the annuitants will receive payments for life. The payments will continue even if related assets have been exhausted. At the death of the annuitants, all remaining assets, if any, are directed in accordance with the related agreements.

Charitable trusts provide that the income beneficiaries will receive payments for life, so long as there are assets available in the trust. At the death of the income beneficiaries, all remaining assets are directed in accordance with the related agreements.

At June 30, 2011 and 2010, the Agency held investments of \$2,061,765 and \$1,978,204, respectively, associated with these split interest agreements, which are recorded as investments held for long-term purposes on the consolidated statements of financial position.

The liability for split interest gift arrangements represents the present value of these obligations due to the annuitants and income beneficiaries. The present value was calculated based upon life expectancies using a discount factor that ranges from 5.00% to 8.25%.

Charitable Annuity Lead Trust

The Agency was a beneficiary of a charitable annuity lead trust whereby \$17,203 was received annually until December 2009. The present value of this annuity was recorded as an asset using a discount rate of 8%. Interest income earned on the charitable annuity lead trust (all unrestricted) for 2011 and 2010 was \$0 and \$1,264, respectively.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Net Assets

Net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Agency are classified and reported as follows:

Unrestricted Net Assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily Restricted Net Assets - Net assets subject to donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Agency pursuant to those stipulations.

Permanently Restricted Net Assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Agency.

Distributions

The Agency's regulatory agreement with HUD stipulates, among other things, that the Agency will not make distributions of assets or income to any of its officers or directors.

Support and Revenues

Revenue is presented on the consolidated statements of activities net of provisions for doubtful accounts and billing adjustments.

The Agency receives a significant portion of its operating funds from grants and awards. These funds are reported as unrestricted support as the grants reimburse the Agency for services provided.

The Agency records contributions in accordance with current authoritative accounting guidance relating to accounting for contributions received and contributions made. The Agency receives contributions through pledges, bequests, life insurance premium payments, split interest gift arrangements and outright cash gifts. Contributions are classified as unrestricted, temporarily restricted or permanently restricted based on donor restrictions. Split interest gift arrangement contributions are classified partially as temporarily restricted and partially as a liability for the present value of the obligation. Upon the death of the annuitants or income beneficiaries, the remaining amount is classified as unrestricted or temporarily restricted based on donor directions.

Contributions that are restricted by the donor are reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the contribution is recognized. All other donor restricted contributions are reported as an increase in temporarily restricted or permanently restricted net assets, as appropriate. When a restriction expires, the temporarily restricted net assets are reclassified to unrestricted net assets. Investment income and realized and unrealized gains/losses resulting from contributions are reported as unrestricted or temporarily restricted net assets, as designated by the donor. Investment income and realized and unrealized gains/losses restricted by a donor are reported as increases/decreases in unrestricted net assets if the restrictions are met in the reporting period in which the investment income and realized and unrealized gains/losses are recognized.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 1 - Summary of Significant Accounting Policies (continued)

Donated Services, Materials and Property

The Agency uses the services of volunteers who contribute their time and materials to provide services to the various programs. Volunteer hours utilized in 2011 and 2010 were not reflected in the financial statements as it is not possible to accurately establish a value for these hours and they generally do not require specialized skills.

Donations of property and equipment are recorded as support at their estimated fair value at the date of donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, the Agency reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor.

Functional Allocation of Costs

Certain costs have been allocated among the programs and supporting services benefited.

Estimates

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

Reclassification

For comparability, certain 2010 amounts have been reclassified to conform with classifications adopted in 2011. The reclassifications have no effect on reported amounts of net assets or change in net assets.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 2 - Unconditional Promises To Give

Unconditional promises to give at June 30 consist of the following:

	2011	2010
Receivable in less than one year	\$ 119,833	\$ 416,097
Receivable in one to five years	20,000	30,000
Total unconditional promises to give	139,833	446,097
Less allowance for doubtful promises	-	(50,000)
Less unamortized discount	(399)	(881)
Net unconditional promises to give	\$ 139,434	\$ 395,216
Current portion	\$ 119,833	\$ 366,097
Long-term portion	19,601	29,119
Net unconditional promises to give	\$ 139,434	\$ 395,216

NOTE 3 - Fair Value Measurements

The Agency follows authoritative accounting guidance which provides a framework for measuring, reporting and disclosing fair value under generally accepted accounting principles. These standards apply to all assets and liabilities that are measured, reported and/or disclosed on a fair value basis.

As defined in these standards, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Agency uses various valuation methods including the market, income and cost approaches. The assumptions used in the application of these valuation methods are developed from the perspective of market participants pricing the asset or liability. Inputs used in the valuation methods can be either readily observable, market corroborated, or generally unobservable inputs. Whenever possible the Agency attempts to utilize valuation methods that maximize the use of observable inputs and minimizes the use of unobservable inputs. Based on the observability of the inputs used in the valuation methods the Agency is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Assets and liabilities measured, reported and/or disclosed at fair value will be classified and disclosed in one of the following three categories:

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 3 - Fair Value Measurements (continued)

- Level 1 Quoted market prices in active markets for identical assets or liabilities.
- Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3 Unobservable inputs that are not corroborated by market data.

The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy.

	June 30, 2011			
	Level 1	Level 2	Level 3	Total
Cash and money market trust funds	\$ -	\$ 1,597,015	\$ -	\$ 1,597,015
Mutual funds	14,932,731	-	-	14,932,731
Co-mingled funds	-	5,466,612	-	5,466,612
Guaranteed investment contract	-	-	1,398,168	1,398,168
Beneficial interest in funds held in trust	-	-	596,541	596,541
Hedge funds of funds	-	-	1,998,722	1,998,722
Investments - trust accounts for split interest gift arrangements	2,061,765	-	-	2,061,765
Other investments	-	51	-	51
Total	\$ 16,994,496	\$ 7,063,678	\$ 3,993,431	\$ 28,051,605
	June 30, 2010			
	Level 1	Level 2	Level 3	Total
Cash and money market trust funds	\$ -	\$ 1,588,903	\$ -	\$ 1,588,903
Mutual funds	10,214,895	-	-	10,214,895
Co-mingled funds	-	4,653,039	-	4,653,039
Certificates of deposit	-	280,710	-	280,710
Guaranteed investment contract	-	-	1,398,168	1,398,168
Beneficial interest in funds held in trust	-	-	510,316	510,316
Hedge funds of funds	-	-	1,968,434	1,968,434
Investments - trust accounts for split interest gift arrangements	1,978,204	-	-	1,978,204
Total	\$ 12,193,099	\$ 6,522,652	\$ 3,876,918	\$ 22,592,669

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
AND SUBSIDIARY CORPORATIONS**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 3 - Fair Value Measurements (continued)

Cash and money market trust funds, co-mingled funds, certificates of deposit, and other investments - These investments are measured at fair value using multiple sources of information that are corroborated by market data, and are considered Level 2 items. Co-mingled funds are redeemable monthly at the net asset value reported by the investment managers.

Mutual funds and investments - trust accounts for split interest gift arrangements - These investments are measured at fair value using quoted market prices. They are classified as Level 1 as they are traded in an active market.

Guaranteed investment contract - This investment is not traded in an active market and is classified as level 3. The valuation was determined by the Agency's investment manager.

Hedge funds of funds - Investments in hedge funds, fund of funds and other alternative investments have no readily determinable fair value for these investments and are classified as Level 3 as the valuation is based on significant unobservable inputs that are not corroborated by market data. The valuation was determined by the Agency's investment managers.

Beneficial interest in funds held in trust - For the trusts that the Agency is named as the beneficiary in which they are not the trustee of the assets, they are considered Level 3 items as the valuation is based on significant unobservable inputs that are not corroborated by market data.

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components; accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are included within the valuation methodology.

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2011:

	Guaranteed investment contract	Beneficial interest in funds held in trust	Hedge funds of funds
	<u> </u>	<u> </u>	<u> </u>
Balance at July 1, 2010	\$ 1,398,168	\$ 510,316	\$ 1,968,434
Net realized and unrealized gains included in the change in net assets	-	80,046	30,288
Interest income	-	3,621	-
Additional investment	-	2,558	-
Balance at June 30, 2011	<u>\$ 1,398,168</u>	<u>\$ 596,541</u>	<u>\$ 1,998,722</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTE 3 - Fair Value Measurements (continued)

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2010:

	Guaranteed investment contract	Beneficial interest in funds held in trust	Interest in charitable annuity lead trust	Hedge funds of funds
Balance at July 1, 2009	\$ 1,398,168	\$ 430,859	\$ 15,939	\$ 1,950,965
Net realized and unrealized gains included in the change in net assets	-	44,294	-	17,469
Interest income	-	-	1,264	-
Additional investment (cash received)	-	35,163	(17,203)	-
Balance at June 30, 2010	<u>\$ 1,398,168</u>	<u>\$ 510,316</u>	<u>\$ -</u>	<u>\$ 1,968,434</u>

The Agency's financial instruments, excluding investments, consist principally of cash, accounts receivable, other assets, cash surrender value of life insurance, accounts payable, and other liabilities, all of which whose carrying value approximates fair value as they are short term in nature. Due to the special terms of the agreements, it is not practical to estimate the fair value of the long-term debt related to the HUD loans and Capital Advance or Assisted Living Conversion Agreements.

The Agency's tax-exempt bonds, with interest rates ranging from 4.125% to 5.90%, are recorded at historical cost. The fair value of the tax-exempt bonds was determined using the most recent trade data available. The tax-exempt bonds are considered level 2. The carrying amount and fair value are as follows:

	June 30, 2011		June 30, 2010	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
LSSI tax-exempt bonds	\$ 17,595,000	\$ 12,427,349	\$ 18,140,000	\$ 14,265,296
Peterson Meadows tax-exempt bonds	<u>6,115,000</u>	<u>3,580,169</u>	<u>6,505,000</u>	<u>5,798,251</u>
Total	<u>\$ 23,710,000</u>	<u>\$ 16,007,518</u>	<u>\$ 24,645,000</u>	<u>\$ 20,063,547</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 4 - Short-Term Investments

Investments and related unrealized appreciation (depreciation) as of June 30, 2011 are summarized as follows:

	<u>Cost or Gift Value</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Total Investments at Fair Value</u>
LSSI Funds:			
LKCM Fund	\$ 451,687	\$ 67,420	\$ 519,107
Met West-Intermediate Bond Fund	1,229,676	114,922	1,344,598
PIMCO Low Duration Fund	1,265,805	50,596	1,316,401
Julius Baer / Artio Global Fund	591,218	(102,408)	488,810
PRIMECAP-Odyssey Fund	344,149	107,990	452,139
Dimensional Emerging Markets	251,151	(6,204)	244,947
Subtotal Mutual funds	<u>4,133,686</u>	<u>232,316</u>	<u>4,366,002</u>
Mellon Trust Barrow Hanley	701,894	27,867	729,761
Janus-INTECH	421,203	51,174	472,377
Subtotal Co-mingled funds	<u>1,123,097</u>	<u>79,041</u>	<u>1,202,138</u>
Common Sense Offshore, Ltd.	780,000	(118,886)	661,114
Subtotal	<u>6,036,783</u>	<u>192,471</u>	<u>6,229,254</u>
Cornerstone Funds:			
PRIMECAP-Odyssey Fund	1,201,142	269,777	1,470,919
Met West-Intermediate Bond Fund	1,534,872	136,204	1,671,076
PIMCO Low Duration Fund	1,634,866	22,309	1,657,175
LKCM Fund	1,493,713	419,096	1,912,809
Vanguard Windsor II Fund	362,927	14,076	377,003
Artio Global Investors	1,880,292	(46,926)	1,833,366
The Hartford Global Real Asset Fund	658,721	78,824	737,545
Dimensional Emerging Markets	909,262	(2,426)	906,836
Subtotal Mutual funds	<u>9,675,795</u>	<u>890,934</u>	<u>10,566,729</u>
Janus-INTECH Risk-Managed Growth Fund	1,257,020	241,470	1,498,490
Barrow Hanley Large Cap Value Fund	2,427,063	338,921	2,765,984
Subtotal Co-mingled funds	<u>3,684,083</u>	<u>580,391</u>	<u>4,264,474</u>
ELCA Endowment Fund	395,558	94,232	489,790
Common Sense Long-Biased Offshore, Ltd.	1,330,091	7,517	1,337,608
Subtotal	<u>15,085,527</u>	<u>1,573,074</u>	<u>16,658,601</u>
Total investments	<u>\$ 21,122,310</u>	<u>\$ 1,765,545</u>	<u>\$ 22,887,855</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 4 - Short-Term Investments (continued)

Investments and related unrealized appreciation (depreciation) as of June 30, 2010 are summarized as follows:

	<u>Cost or Gift Value</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Total Investments at Fair Value</u>
LSSI Funds:			
LKCM Fund	\$ 707,391	\$ (181,586)	\$ 525,805
Met West-Intermediate Bond Fund	1,487,574	177,971	1,665,545
PIMCO Low Duration Fund	1,545,761	69,287	1,615,048
Julius Baer / Artio Global Fund	631,303	(219,899)	411,404
PRIMECAP-Odyssey Fund	500,000	-	500,000
Subtotal Mutual Funds	<u>4,872,029</u>	<u>(154,227)</u>	<u>4,717,802</u>
Mellon Trust Barrow Hanley	1,131,223	(235,285)	895,938
Janus-INTECH	553,520	(97,756)	455,764
Subtotal Co-mingled funds	<u>1,684,743</u>	<u>(333,041)</u>	<u>1,351,702</u>
Common Sense Offshore, Ltd.	780,000	(97,159)	682,841
ELCA Mission Fund	280,659	-	280,659
Subtotal	<u>7,617,431</u>	<u>(584,427)</u>	<u>7,033,004</u>
Cornerstone Funds:			
PRIMECAP-Odyssey Fund	1,100,000	(50,375)	1,049,625
Met West-Intermediate Bond Fund	852,081	132,205	984,286
PIMCO Low Duration Fund	814,675	9,494	824,169
LKCM Fund	1,428,793	(199,665)	1,229,128
Vanguard Windsor II Fund	350,000	-	350,000
Artio Global Investors	1,344,994	(285,109)	1,059,885
Subtotal Mutual funds	<u>5,890,543</u>	<u>(393,450)</u>	<u>5,497,093</u>
Janus-INTECH Risk-Managed Growth Fund	1,264,016	(158,140)	1,105,876
Barrow Hanley Large Cap Value Fund	2,534,617	(339,156)	2,195,461
Subtotal Co-mingled funds	<u>3,798,633</u>	<u>(497,296)</u>	<u>3,301,337</u>
ELCA Endowment Fund	393,000	21,369	414,369
Common Sense Long-Biased Offshore, Ltd.	1,330,091	(44,498)	1,285,593
Subtotal	<u>11,412,267</u>	<u>(913,875)</u>	<u>10,498,392</u>
Total investments	<u>\$ 19,029,698</u>	<u>\$ (1,498,302)</u>	<u>\$ 17,531,396</u>

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NOTE 4 - Short-Term Investments (continued)

For the investments held within Foundation, Inc., investment income and net realized and unrealized gains/losses are allocated monthly to unrestricted and temporarily restricted net assets based on the relationship of the net asset of each fund to the total net assets, as adjusted for additions to or deductions from those funds. All other investment earnings are recorded as increases/decreases in unrestricted net assets.

The Agency's hedge fund positions in Common Sense Long-Biased Offshore, Ltd. and Common Sense Offshore, Ltd. may include alternative investments. For the years ended June 30, 2011 and 2010, the Agency recorded unrealized gains of \$30,288 and \$17,469, respectively. There were no realized gains or losses or other income recorded from these investments during the years ended June 30, 2011 and 2010.

Investments are subject to the line of credit borrowing arrangement which among other restrictions required the Agency to maintain unrestricted cash and investment balances of \$5,160,000 at June 30, 2011 and 2010.

NOTE 5 - Investments - Held for Long-Term Purposes

Investments held in trust for the IFA and IHFA Revenue Bonds and other investments are stated at cost, which approximates fair value. Investments related to life annuity contracts and for the Andrew E. Seaver Trust Fund are stated at fair value. Investments and unrealized appreciation at June 30, 2011 are summarized as follows:

	<u>Cost</u>	<u>Unrealized Appreciation</u>	<u>Fair Value</u>
Investments Held in Trust for IFA and IHFA Bond issues:			
IFA Revenue Bonds, Series 2006, Lutheran Social Services of Illinois Project			
Guaranteed investment contract	\$ 1,398,168	\$ -	\$ 1,398,168
Money market and cash	759,632	-	759,632
IHFA Revenue Refunding bonds, Series 1999, Peterson Meadows, Inc.			
Money market and cash	<u>837,383</u>	-	<u>837,383</u>
Subtotal	<u>2,995,183</u>	-	<u>2,995,183</u>
Cornerstone Foundation, Inc. Investments related to life annuity contracts			
Charitable equity fund	928,954	243,334	1,172,288
Charitable bond fund	840,246	32,399	872,645
Money market fund	<u>16,832</u>	-	<u>16,832</u>
Subtotal	<u>1,786,032</u>	<u>275,733</u>	<u>2,061,765</u>
Andrew E. Seaver Trust Fund			
Common stock	30,367	6,807	37,174
Corporate bonds	53,357	2,937	56,294
Real estate	1,620	1,416	3,036
Commodities	5,272	1,589	6,861
Cash	<u>3,386</u>	-	<u>3,386</u>
Subtotal	<u>94,002</u>	<u>12,749</u>	<u>106,751</u>
Unrestricted investments			
Other investments	<u>51</u>	-	<u>51</u>
Total Investments	<u>\$ 4,875,268</u>	<u>\$ 288,482</u>	<u>\$ 5,163,750</u>

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June 30, 2011 and 2010

NOTE 5 - Investments - Held for Long-Term Purposes (continued)

Investments and unrealized appreciation (depreciation) at June 30, 2010 are summarized as follows:

	<u>Cost</u>	<u>Unrealized Appreciation (Depreciation)</u>	<u>Fair Value</u>
Investments IFA and IHFA Bond Issues:			
IFA Revenue Bonds, Series 2006, Lutheran Social Services of Illinois Project			
Guaranteed investment contract	\$ 1,398,168	\$ -	\$ 1,398,168
Money market and cash	751,302	-	751,302
IHFA Revenue Refunding bonds, Series 1999, Peterson Meadows, Inc.			
Money market and cash	<u>837,601</u>	-	<u>837,601</u>
Subtotal	<u>2,987,071</u>	<u>-</u>	<u>2,987,071</u>
Cornerstone Foundation, Inc. Investments related to life annuity contracts			
Charitable equity fund	1,035,998	(35,956)	1,000,042
Charitable bond fund	931,550	20,140	951,690
Money market fund	<u>26,472</u>	-	<u>26,472</u>
Subtotal	<u>1,994,020</u>	<u>(15,816)</u>	<u>1,978,204</u>
Andrew E. Seaver Trust Fund			
Common stock	30,152	(798)	29,354
Corporate bonds	50,417	2,557	52,974
Real estate	1,770	969	2,739
Commodities	4,351	516	4,867
Cash	<u>6,013</u>	-	<u>6,013</u>
Subtotal	<u>92,703</u>	<u>3,244</u>	<u>95,947</u>
Unrestricted investments			
Other investments	<u>51</u>	-	<u>51</u>
Total Investments	<u>\$ 5,073,845</u>	<u>\$ (12,572)</u>	<u>\$ 5,061,273</u>

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 5 - Investments - Held for Long-Term Purposes (continued)

The following schedules summarize the investment return, which includes interest on cash and cash equivalents, short-term and long-term investments, and its classification in the consolidated statements of activities:

	2011		
	Unrestricted	Temporarily Restricted	Total
Interest and dividend income	\$ 473,195	\$ 38,287	\$ 511,482
Net realized and unrealized gains	<u>2,977,643</u>	<u>679,689</u>	<u>3,657,332</u>
Total investment return	<u>\$ 3,450,838</u>	<u>\$ 717,976</u>	<u>\$ 4,168,814</u>
	2010		
	Unrestricted	Temporarily Restricted	Total
Interest and dividend income	\$ 493,537	\$ 47,897	\$ 541,434
Net realized and unrealized gains	<u>1,491,818</u>	<u>321,698</u>	<u>1,813,516</u>
Total investment return	<u>\$ 1,985,355</u>	<u>\$ 369,595</u>	<u>\$ 2,354,950</u>

NOTE 6 - Line of Credit

The Agency has an agreement with J.P. Morgan Chase Bank, N.A. for a consolidated line of credit of \$4,160,000, which was renewed on April 30, 2011 for an additional year. This agreement expires on April 30, 2012 and is supported by certain assets held at J.P. Morgan Chase Bank, N.A., a first mortgage on certain real estate and assignment of rents and leases on that same real estate. Additionally, this consolidated line of credit is supported by a Guaranty Agreement for \$960,000, which was provided by Forsberg Christian Retirement Center, Inc., an LSSI subsidiary corporation. Forsberg also provided a Mortgage, Security Agreement and Assignment of Leases and Rents in favor of J.P. Morgan Chase Bank, N.A. for the same amount. The outstanding consolidated line of credit balance at June 30, 2011 and 2010 was \$1,482,209 and \$2,526,592, respectively.

The agreement also provides for monthly interest at the Commercial Bank Floating Rate, which is for any day the greater of the bank's prime commercial rate or LIBOR plus 2.50%, which was 3.25% at both June 30, 2011 and June 30, 2010. The agreement reflects required minimum unrestricted cash and investments balances totaling \$5,160,000, issuance of consolidated financial statements and maintenance of books and records. As of June 30, 2011 and for the fiscal year then ended, the Agency was in compliance with all of these covenants.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 7 - Long-Term Debt

Long-term debt at June 30 consists of the following:

	2011	2010
Mortgages Payable to		
Wells Fargo with monthly payments of \$51,135, including principal and interest at 9.0%, due July 1, 2019. After applying an FHA interest subsidy to monthly installment payments, interest is reduced to an approximate effective rate of 1%. The mortgage is secured by land and building (Salem Village III, Inc.).	\$ 3,515,165	\$ 3,798,425
Heartland Bank with monthly payments of \$21,254, including interest at 6.0%, due August 1, 2034, secured by land and building and cannot be prepaid (Batavia Council on Aging, Inc.).	3,188,366	3,250,089
HUD, due July 1, 2019, with interest at the rate of 1% per annum which will not be compounded, payable at maturity, secured by restricted deposits, land and building (Salem Village III, Inc.)	1,028,977	1,028,977
HUD with monthly payments of \$5,056, including interest at 7.63%, due July 1, 2021, secured by land and building and cannot be prepaid (DeKalb Housing for the Handicapped, Inc.).	430,578	457,298
Centennial Mortgage, Inc. with monthly payments of \$38,491, including interest at 4.45%, due May 1, 2045, secured by land and building (Luther Center, Inc.)	8,078,630	8,178,567
Total Mortgages Payable	16,241,716	16,713,356
Less: Current Maturities	(508,728)	(471,669)
Long-Term Portion of Mortgages Payable	\$ 15,732,988	\$ 16,241,687

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NOTE 7 - Long-Term Debt (continued)

	2011	2010
Notes Payable Related to Bond Issues		
Tax exempt bonds issued through the IFA, Series 2006, Revenue Bonds (Lutheran Social Services of Illinois), serial and term maturity dates through 2028, interest rates ranging from 4.125% to 5.25%, secured by property of the corporations which constitute the Obligated Group (Lutheran Social Services of Illinois and Vesper Management Corporation).	\$ 17,595,000	\$ 18,140,000
Tax exempt bonds issued through the IHFA, Series 1999, Revenue Refunding Bonds (Peterson Meadows Project), serial and term dates through 2022, interest rates ranging from 5.80% to 5.90%, secured by a first mortgage on the real estate.	6,115,000	6,505,000
Total Notes Payable Related to Bond Issues	23,710,000	24,645,000
Less: Current Maturities	(980,000)	(935,000)
Long-Term Portion of Notes Payable Related to Bond Issues	22,730,000	23,710,000
Total Long-Term Debt	\$ 38,462,988	\$ 39,951,687

The loan agreement related to the IFA, Series 2006, Revenue Bonds (Lutheran Social Services of Illinois) contains covenants that include requirements to maintain certain financial ratios such as historical debt service coverage ratio. Additional covenants include requirements and/or restrictions related to the use and operations of the facilities, the issuance of consolidated financial statements, the issuance of new debt, transfer of assets, and disposition of property. As of June 30, 2011 and 2010, and for the fiscal years then ended, the Agency was in compliance with all of these covenants.

The loan agreements and master trust indenture related to the IHFA Bond Issues, Series, 1999 (Peterson Meadows Project), contain covenants that include requirements to maintain and calculate certain financial ratios as defined in the loan agreements. Additional covenants include requirements and/or restrictions related to use and operations of the facilities, the issuance of financial statements, the issuance of new debt, transfer of assets and disposition of property. As of June 30, 2011 and for the fiscal year then ended, the Agency was in compliance with all these covenants.

As of June 30, 2010 the Agency was not in compliance with the debt service coverage covenant for the Series 1999, Revenue Refunding Bonds (Peterson Meadows Project). Calculated debt service coverage for the year ended June 30, 2010 was -0.33:1 compared with its required ratio of 1.1:1. Failure to meet the required debt service coverage ratio is not, by itself, an event of default. As of June 30, 2010, the Agency was not in default on its bonds outstanding. Pursuant to the terms of the master trust indenture, management retained the services of a consultant firm and worked with them to reduce expenses and generate additional revenues in order to bring the Agency into compliance.

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June 30, 2011 and 2010

NOTE 7 - Long-Term Debt (continued)

Scheduled annual principal maturities of the above mortgages and notes for the next five years are as follows:

2012	\$	1,488,728
2013		1,583,827
2014		1,677,329
2015		1,789,494
2016		1,900,649
Later years		<u>31,511,689</u>
Total	\$	<u>39,951,716</u>

NOTE 8 - Capital Advance Agreements

The Agency has funded the construction of various housing projects through Capital Advance Agreements with HUD, which provided for borrowings not to exceed \$55,292,200 at June 30, 2011 and 2010. The agreements are given to the Projects in the form of mortgage notes and bear no interest and require no repayment provided that the housing to which it relates remains available for low-income elderly or developmentally disabled persons in accordance with the appropriate regulations. The amounts drawn at June 30, 2011 and 2010 are \$55,292,200 and \$54,883,493, respectively. Grant revenue from the capital advance agreements is being recognized over the terms of the agreements on a straight-line basis. During the years ended June 30, 2011 and 2010, the Agency recognized revenue of \$1,411,627 and \$1,358,318, respectively, on these agreements.

The deferred grant revenue recorded at June 30 consists of capital advance agreements for the following HUD projects:

	2011			
	Year of Expiration	Amount Drawn to Date	Grant Revenue Recognized to Date	Deferred Grant Revenue
Assisi Homes-Downer Place, Inc.	2039	\$ 7,057,900	\$ 1,947,009	\$ 5,110,891
Our Savior's Senior Housing, Inc.	2035	6,059,600	2,411,184	3,648,416
Tabor Lutheran Senior Housing, Inc.	2038	5,884,600	1,659,136	4,225,464
Rochelle Senior Housing, Inc.	2036	3,531,400	1,297,472	2,233,928
Freeport Senior Housing, Inc.	2033	3,197,300	1,410,570	1,786,730
Northwest Chicago Group Homes, Inc.	2034	1,483,800	638,985	844,815
Freeport Senior Housing II, Inc.	2042	3,039,200	649,842	2,389,358
Aurora Senior Housing, Inc.	2040	3,895,500	952,926	2,942,574
Victorian Woods Senior Living, Inc.	2046	6,524,200	805,291	5,718,909
Spring Ridge Housing for Seniors, Inc.	2048	7,759,800	618,184	7,141,616
Rolling Meadows Senior Living, Inc.	2049	3,290,600	157,665	3,132,935
Deer Creek Manor, Inc.	2049	<u>3,568,300</u>	<u>148,680</u>	<u>3,419,620</u>
Total		<u>\$ 55,292,200</u>	<u>\$ 12,696,944</u>	<u>\$ 42,595,256</u>

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NOTE 8 - Capital Advance Agreements (continued)

	2010			
	Year of Expiration	Amount Drawn to Date	Grant Revenue Recognized to Date	Deferred Grant Revenue
Assisi Homes-Downer Place, Inc.	2039	\$ 7,057,900	\$ 1,764,477	\$ 5,293,423
Our Savior's Senior Housing, Inc.	2035	6,059,600	2,259,696	3,799,904
Tabor Lutheran Senior Housing, Inc.	2038	5,884,600	1,503,592	4,381,008
Rochelle Senior Housing, Inc.	2036	3,531,400	1,209,008	2,322,392
Freeport Senior Housing, Inc.	2033	3,197,300	1,329,966	1,867,334
Northwest Chicago Group Homes, Inc.	2034	1,483,800	601,581	882,219
Freeport Senior Housing II, Inc.	2042	3,039,200	573,390	2,465,810
Aurora Senior Housing, Inc.	2040	3,895,500	852,618	3,042,882
Victorian Woods Senior Living, Inc.	2046	6,524,200	641,503	5,882,697
Spring Ridge Housing for Seniors, Inc.	2048	7,759,800	422,968	7,336,832
Rolling Meadows Senior Living, Inc.	2049	3,042,191	69,718	2,972,473
Deer Creek Manor, Inc.	2049	3,408,002	56,800	3,351,202
Total		<u>\$ 54,883,493</u>	<u>\$ 11,285,317</u>	<u>\$ 43,598,176</u>

NOTE 9 - Federal Home Loan Grant Agreements

The Agency received grants totaling \$190,000 from One Mortgage Partners Corporation, a member of the Federal Home Loan Bank of Chicago, to partially fund the construction of two housing projects. The grants are in the form of mortgage notes which bear no interest and require no repayment provided that the housing to which they relate remains available for low-income elderly persons in accordance with the appropriate regulations and other grant requirements. Grant revenue from the agreements is being recognized over the terms of the agreements on a straight-line basis. During the years ended June 30, 2011 and 2010, the Agency recognized revenue of \$12,672 and \$9,948, respectively, on these agreements. The deferred revenue recorded at June 30, 2011 and 2010 is \$167,380 and \$180,052, respectively.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 10 - Assisted Living Conversion Grant Agreement

The Agency has funded the conversion of 56 units at Salem Village III, Inc. (the "Project") housing project to assisted living units through an Assisted Living Conversion Grant Agreement with HUD, which provided for borrowings not to exceed \$6,339,159. This agreement provides funding for physical costs of the conversion, legal, architectural and consulting fees, and temporary relocation costs, including vacancy losses. The agreement requires no principal and interest payments as long as the Project is used for approved purposes until July 1, 2039. The agreement is secured by the related building.

Deferred grant revenue from this agreement is being recognized over the term of the agreement on a straight-line basis, beginning with the in-service date of the converted units. During the years ended June 30, 2011 and 2010, the Agency recognized revenue of \$180,156 in both years on these agreements. The deferred revenue recorded at June 30, 2011 and 2010 was \$5,044,243 and \$5,224,399, respectively.

NOTE 11 - Pension Plan

Prior to January 1, 2010 the Agency was a participant in the retirement plan for employees of the United Way of Metropolitan Chicago and participating agencies, which covered substantially all employees hired prior to July 1, 2006. As of January 1, 2010, the Pension Equity Plan for employees of Lutheran Social Services of Illinois was separated from the United Way plan. This change had no effect on plan assets, liabilities, employee benefits or Agency funding requirements. The Agency uses a June 30 measurement date for the plan.

As of July 1, 2006, entry by new employees into the Agency's pension plan was frozen. All Agency employees who were hired prior to July 1, 2006 became eligible to participate in the pension plan in accordance with the terms of the plan, and all employees who were participants in the plan on July 1, 2006 shall continue as participants until their benefits are distributed in accordance with the terms of the plan.

During the year ended June 30, 2009, the Agency froze additional benefit accruals under the plan, resulting in a plan curtailment. Under the terms of the plan, participants were required to work a minimum of 1,000 hours in a plan calendar year in order to earn an additional benefit for that calendar year. Whereas the effective date of the benefit accrual freeze was May 1, 2009, benefits earned by certain plan participants working at least 1,000 hours from January 1, 2009 through May 1, 2009 were not material. Participants in the Agency's defined benefit plan became eligible for employer contributions under the Agency's defined contribution plan effective January 1, 2009.

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NOTE 11 - Pension Plan (continued)

Included in unrestricted net assets at June 30, 2011 and 2010 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized actuarial net losses of \$17,889,137 and \$19,572,893, respectively. The actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension costs during the fiscal year ending June 30, 2012 is \$1,248,517.

The table below presents details about the Agency plan including the changes in accumulated benefit obligations the fair value of plan assets, and funded status for the years ended June 30 (actuarial values of the benefit obligation were calculated as of June 30, 2011 and 2010, respectively).

	<u>2011</u>	<u>2010</u>
Change in benefit obligation		
Accumulated benefit obligation at beginning of year	\$ 42,891,949	\$ 38,614,395
Provision for expenses	370,000	440,000
Interest cost	2,086,565	2,227,714
Actuarial loss	275,729	3,814,614
Benefits paid	<u>(2,234,417)</u>	<u>(2,204,774)</u>
Accumulated benefit obligation at end of year	<u>\$ 43,389,826</u>	<u>\$ 42,891,949</u>

Since benefit accruals have been frozen, the projected benefit obligation is equal to the accumulated benefit obligation at June 30, 2011 and 2010.

	<u>2011</u>	<u>2010</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 27,190,766	\$ 24,058,417
Actual return on assets	3,191,668	3,893,260
Employer contribution	1,845,488	1,443,863
Benefits paid	<u>(2,234,417)</u>	<u>(2,204,774)</u>
Fair value of plan assets at end of year	<u>\$ 29,993,505</u>	<u>\$ 27,190,766</u>
Funded status of the plan	<u>\$ (13,396,321)</u>	<u>\$ (15,701,183)</u>
Components of net periodic benefit cost		
Provision for expense	\$ 370,000	\$ 440,000
Interest cost	2,086,565	2,227,714
Expected return on plan assets	(2,317,097)	(2,382,429)
Recognized actuarial loss	<u>1,084,914</u>	<u>617,058</u>
Total pension cost	<u>\$ 1,224,382</u>	<u>\$ 902,343</u>

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NOTE 11 - Pension Plan (continued)

The underfunded status of the plan of \$13,396,321 and \$15,701,183 at June 30, 2011 and 2010, respectively, is recognized in the accompanying consolidated statements of financial position as long-term accrued pension liabilities. No plan assets are expected to be returned to the Agency during the fiscal year ending June 30, 2012.

The following are average assumptions used to determine benefit obligations at June 30:

	2011	2010
Discount rate	5.10%	5.10%
Expected return on assets	7.50%	7.50%

There were no participant contributions made to the plan during the years ended June 30, 2011 and 2010.

The following are weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30:

	2011	2010
Discount rate	5.10%	6.15%
Expected return on plan assets	7.50%	7.80%

The Agency's expected long-term return on plan assets assumption is based on a periodic review and modeling of the plan's asset allocation over a long-term horizon. Expectations of returns for each asset class are the most important of the assumptions used in the review and modeling and are based on comprehensive reviews of historical data and economic/financial market theory. The expected long-term rate of return on assets was selected from within the reasonable range of rates determined by historical real returns for the asset classes covered by the investment policy.

The Agency's plan assets at June 30, 2011, by asset category are as follows:

	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ -	\$ 337,743	\$ -	\$ 337,743
Mutual funds	23,733,925	3,156,806	-	26,890,731
Hedge fund of funds	-	-	2,765,031	2,765,031
Total	\$ 23,733,925	\$ 3,494,549	\$ 2,765,031	\$ 29,993,505

The Agency's plan assets at June 30, 2010, by asset category are as follows:

	Level 1	Level 2	Level 3	Total
Cash and money market funds	\$ -	\$ 508,002	\$ -	\$ 508,002
Mutual funds	20,379,382	3,704,145	-	24,083,527
Hedge fund of funds	-	-	2,599,237	2,599,237
Total	\$ 20,379,382	\$ 4,212,147	\$ 2,599,237	\$ 27,190,766

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 11 - Pension Plan (continued)

Cash and money market funds and mutual funds - These investments are measured at fair value using multiple sources of information that are corroborated by market data, and are considered Level 2 items.

Mutual funds - These investments are measured at fair value using quoted market prices. They are classified as Level 1 as they are traded in an active market.

Hedge fund of funds - Investments in hedge funds, fund of funds and other alternative investments have no readily determinable fair value for these investments and are classified as Level 3 as the valuation is based on significant unobservable inputs that are not corroborated by market data. The valuation was determined by the investment managers.

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2011:

	Hedge fund of funds
Balance at July 1, 2010	\$ 2,599,237
Net realized and unrealized gains included in the change in net assets	445,701
Purchases, sales, issuances and settlements, net	<u>(279,907)</u>
Balance at June 30, 2011	<u>\$ 2,765,031</u>

The changes in level 3 assets measured at fair value on a recurring basis are summarized below for the year ended June 30, 2010:

	Hedge fund of funds
Balance at July 1, 2009	\$ 7,025,275
Net realized and unrealized gains included in the change in net assets	770,880
Purchases, sales, issuances and settlements, net	<u>(5,196,918)</u>
Balance at June 30, 2010	<u>\$ 2,599,237</u>

The Agency's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions.

The objectives of the target allocations are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plan's actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 11 - Pension Plan (continued)

The investment policy is periodically reviewed by the Agency. The policy is established and administered in a manner so as to comply at all times with applicable government regulations.

The estimated net periodic benefit cost for 2012 is:

Provision for expense	\$	370,000
Interest cost		2,101,549
Expected return on assets		(2,357,810)
Amortization of net loss		1,248,517
Estimated net periodic benefit cost	\$	<u>1,362,256</u>

The following pension benefit payments are expected to be paid:

2012	\$	4,365,950
2013		2,635,565
2014		3,218,449
2015		3,145,717
2016		2,737,602
2017-2021		13,471,957

The Agency is anticipating making \$2,527,000 in contributions to the plan during the year ending June 30, 2012.

The discount rate and expected rate of return on plan assets are critical assumptions which significantly affect pension accounting. Even relatively small changes in these rates would significantly change the recorded pension expense and accrued liability. The expected return on plan assets is computed based on an asset valuation method which recognizes gains/losses over a period of five years. Management believes the discount rate and expected rate of return on plan assets used in determining its year-end pension accounting are reasonable based on currently available information. However, it is at least reasonably possible that these assumed rates will be revised in the near term, based on future events and changes in circumstances.

NOTE 12 - Defined Contribution Retirement Plan

The Agency has adopted a defined contribution retirement plan under Internal Revenue code section 403(b). All Agency employees (except temporary and leased employees) who have completed one year of service are eligible to participate in the Plan. All such eligible employees, who are at least age 21, may elect to make contributions to the Plan through salary deductions. There is no minimum service requirement to make employee contributions to the Plan. Under the Plan, the Agency may make a discretionary annual employer contribution to eligible participants. During the years ending June 30, 2011 and 2010, the Agency's employer contribution to the Plan was \$449,819 and \$446,401, respectively.

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NOTE 13 - Worker's Compensation Trust

The Agency has a self-funded Worker's Compensation Trust (the "Trust") which is organized and operated under the provisions of the Illinois Religious and Charitable Risk Pooling Trust Act. The trustees of the Trust are appointed by the Agency.

The Agency makes monthly contributions to the Trust. The Agency has recorded a liability for unpaid contributions, which includes unpaid claims and claims incurred but not reported, of \$1,677,604 and \$1,412,437 at June 30, 2011 and 2010, respectively. The estimated liability is classified as accounts payable and other accrued expenses on the consolidated statements of financial position.

NOTE 14 - Accrued Salaries and Wages

Accrued salaries and wages include accrued vacation pay of \$2,698,558 and \$2,607,811 at June 30, 2011 and 2010, respectively.

NOTE 15 - Accrued Unemployment

The Agency pays for Illinois unemployment compensation on a claims-made basis. \$355,427 and \$353,219 was accrued as the estimated liability for these claims at June 30, 2011 and 2010, respectively. These amounts are classified as accounts payable and other accrued expenses on the consolidated statements of financial position.

NOTE 16 - Permanently Restricted Net Assets

Net assets have been received to be held in perpetuity for several programs. The amounts of these net assets as of June 30 are shown below by program and purpose:

	2011	2010
Adoption services	\$ 131,736	\$ 131,736
Behavioral health	16,248	16,248
Child and adolescent	203,223	203,223
Children and disabled individuals	302,802	297,802
Children and older adults	1,167,791	1,167,309
Endowment for general use	376,834	374,276
Leadership and awards	116,090	116,090
Nursing care facilities	109,333	109,333
Older adults	158,542	158,542
Other programs	5,575	5,575
Services outside metropolitan Chicago	47,361	47,361
Total	<u>\$ 2,635,535</u>	<u>\$ 2,627,495</u>

The income from these assets must be used in support of the aforementioned programs and purposes.

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NOTE 17 - Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following programs, purposes and periods as directed by the donors as of June 30:

	2011	2010
Adoption services	\$ 81,970	\$ 4,547
Administration	346,793	356,793
Behavioral health	313,514	263,255
Child and adolescent	427,017	486,884
Children and disabled individuals	702,691	581,673
Children and older adults	593,609	362,643
Disaster relief	1,230,337	1,045,396
Leadership and awards	126,081	106,141
Nursing care facilities	68,474	92,789
Older adults	35,011	12,865
Other programs	812,009	976,421
Prisoner and family ministry	39,000	4,050
Total	\$ 4,776,506	\$ 4,293,457

NOTE 18 - Net Assets Released From Restrictions

Net assets were released from temporary donor restrictions by expending funds for the following purposes during the years ended June 30:

	2011	2010
Adoption services	\$ 15,000	\$ 15,000
Administration	10,000	-
Behavioral health	125,650	60,423
Child and adolescent	202,519	319,968
Children and disabled individuals	36,000	45,000
Children and older adults	39,500	30,361
Leadership and awards	17,500	12,500
Nursing care facilities	50,000	102,800
Older adults	14,285	9,921
Other programs	416,650	41,159
Transfer to/(from) unrestricted net assets to/(from) temporarily restricted net assets for amounts restricted for periods after June 30, for split interest gift arrangements and charitable trusts	19,679	(110,374)
Expiration of time restrictions	123,897	786,111
Total	\$ 1,070,680	\$ 1,312,869

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NOTE 19 - Endowment Funds

The Agency follows current authoritative accounting guidance relating to endowments of not-for-profit organizations and enhanced disclosures for all endowment funds. Guidance is provided on classifying net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management of Institutional Funds Act (UPMIFA). A key component of the guidance and UPMIFA is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. Another key component of the guidance is a requirement for expanded disclosures about all endowment funds.

The Agency's endowment consists of approximately 40 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the board of trustees of Cornerstone to function as endowment. As required by Generally Accepted Accounting Principles ("GAAP"), net assets associated with endowment funds, including funds designated by the Foundation's board of trustees to function as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law -The Agency classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment and (b) the original value of subsequent gifts to the permanent endowment.

The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Agency in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Agency 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 Agency 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 Agency
7. The investment policies of the Agency

Endowment net asset composition by type of fund consists of the following as of June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 872,671	\$ 2,635,535	\$ 3,508,206
Board-designated endowment funds	<u>10,798,200</u>	<u>2,364,065</u>	<u>-</u>	<u>13,162,265</u>
Total endowment funds	<u>\$ 10,798,200</u>	<u>\$ 3,236,736</u>	<u>\$ 2,635,535</u>	<u>\$ 16,670,471</u>

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NOTE 19 - Endowment Funds (continued)

Endowment net asset composition by type of fund consists of the following as of June 30, 2010:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 511,127	\$ 2,627,495	\$ 3,138,622
Board-designated endowment funds	<u>8,833,362</u>	<u>2,100,612</u>	<u>-</u>	<u>10,933,974</u>
Total endowment funds	<u>\$ 8,833,362</u>	<u>\$ 2,611,739</u>	<u>\$ 2,627,495</u>	<u>\$ 14,072,596</u>

Changes in endowment net assets for the years ended June 30 are as follows:

	<u>2011</u>			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2010	<u>\$ 8,833,362</u>	<u>\$ 2,611,739</u>	<u>\$ 2,627,495</u>	<u>\$ 14,072,596</u>
Investment return				
Investment income	115,364	41,153	-	156,517
Net appreciation realized and unrealized	<u>1,776,642</u>	<u>695,002</u>	<u>-</u>	<u>2,471,644</u>
Total investment return	1,892,006	736,155	-	2,628,161
Contributions	558,604	128,737	8,040	695,381
Appropriation for expenditure	<u>(485,772)</u>	<u>(239,895)</u>	<u>-</u>	<u>(725,667)</u>
Endowment net assets: June 30, 2011	<u>\$10,798,200</u>	<u>\$ 3,236,736</u>	<u>\$ 2,635,535</u>	<u>\$ 16,670,471</u>
	<u>2010</u>			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2009	<u>\$ 7,089,143</u>	<u>\$ 2,492,422</u>	<u>\$ 2,591,350</u>	<u>\$ 12,172,915</u>
Investment return				
Investment income	113,709	45,470	-	159,179
Net appreciation realized and unrealized	<u>742,853</u>	<u>330,434</u>	<u>-</u>	<u>1,073,287</u>
Total investment return	856,562	375,904	-	1,232,466
Contributions	1,184,413	122,288	36,145	1,342,846
Appropriation for expenditure	<u>(429,367)</u>	<u>(246,264)</u>	<u>-</u>	<u>(675,631)</u>
Redesignation of net assets	<u>132,611</u>	<u>(132,611)</u>	<u>-</u>	<u>-</u>
Endowment net assets: June 30, 2010	<u>\$ 8,833,362</u>	<u>\$ 2,611,739</u>	<u>\$ 2,627,495</u>	<u>\$ 14,072,596</u>

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NOTE 19 - Endowment Funds (continued)

Funds with Deficiencies - 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 UPMIFA requires the Agency to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$2,592 and \$36,827 as of June 30, 2011 and 2010, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters - The Agency has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to Agency programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Agency must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the governing board, the endowment assets are invested in a manner that is intended to produce results that exceed 5% annually while assuming a moderate level of investment risk.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the Agency 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 Agency 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.

Spending Policy and How the Investment Objectives Relate to Spending Policy - The Agency has a policy of appropriating for distribution each year 4-5% of its endowment fund's average fair value over the lower of the prior 4 or 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is appropriated. In establishing this policy, the Agency considered the long-term expected return on its endowment. Accordingly, over the long term, the Agency expects the current spending policy to allow its endowment to grow at an average of approximately 3% annually. This is consistent with the Agency's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

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NOTE 20 - Lease Agreements

The Agency has entered into lease agreements for land and buildings, under which rental expense for 2011 and 2010 was \$1,914,279 and \$1,966,501, respectively.

Minimum future rental commitments for all operating leases in effect as of June 30, 2011 are summarized as follows:

2012	\$ 1,452,468
2013	971,317
2014	681,594
2015	637,692
2016	385,529
Thereafter	<u>946,690</u>
Total	<u>\$ 5,075,290</u>

Significant clauses contained in the lease agreements include the following:

- Escalation clauses not exceeding 5% on any given lease,
- Sharing of operation and maintenance costs,
- Ability to cancel a lease if funding for the related program is insufficient,
- Various options to extend the lease term, and
- Liability insurance requirements.

Minimum lease payments exclude rentals under renewal options which, as of June 30, 2011, are not reasonably assured of being exercised.

The Agency leases property to tenants under operating leases with terms expiring in various years through 2017. Rental income for the years ended June 30, 2011 and 2010 was \$834,638 and \$891,353, respectively. The following is a schedule by years of future minimum rentals under leases in effect as of June 30, 2011:

2012	\$ 839,080
2013	410,639
2014	281,220
2015	290,853
2016	272,900
Thereafter	<u>277,332</u>
Total	<u>\$ 2,372,024</u>

The cost and accumulated depreciation of property held for lease is as follows:

Land	\$ 113,390
Building and building improvements	<u>2,332,673</u>
Property at cost	2,446,063
Less: accumulated depreciation	<u>(1,725,180)</u>
Property, net	<u>\$ 720,883</u>

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NOTE 21 - Amortization of Debt Issue Costs

Legal and accounting fees, printing costs, and other expenses associated with the issuance of the IFA, Series 2006, Revenue Bonds (Lutheran Social Services of Illinois), the IHFA, Series 1999, Revenue Refunding Bonds (Peterson Meadows, Inc.) and other mortgages held by the Agency are being amortized on the straight-line method over the term of the debt. Amortization expense charged to the consolidated statements of activities for the years ended June 30, 2011 and 2010 was \$62,462 and \$54,792, respectively.

NOTE 22 - Salem Village Fire and Casualty

On January 24, 2011, a fire broke out in one of the resident apartments of Salem Village III, Inc. (the "Project"), necessitating the immediate evacuation of all units and significant restoration work following the suppression of the fire. The following outlines the costs incurred and the insurance claims filed relating to the fire.

Total insurance claims filed consist of the following:

Restoration and temporary relocation costs	\$ 1,262,151
Costs incurred relating to assisted living tenants	482,092
Lost rent associated with the fire	263,238
Fixed asset replacements	954,177
Total insurance claims filed	<u>\$ 2,961,658</u>

The net fire and casualty activity recorded in the 2011 financial statements is as follows:

Total claims submitted to the insurance company	\$ 2,961,658
Restoration and temporary relocation costs	(1,262,151)
Loss on disposal of assets related to fire damage	(581,324)
Costs incurred relating to assisted living tenants	(482,092)
Lost rent associated with the fire	(263,238)
Total	<u>\$ 372,853</u>

The net fire and casualty activity, recorded in the 2011 financial statements was used to pay for fixed asset replacements.

The general contractor and two subcontractors handling the restoration work are currently in dispute among themselves regarding amounts claimed for services performed. Two mechanics' liens totaling \$987,991 have been filed by two subcontractors against the Project. Management believes the disputes will be resolved without material adverse effect on the Project.

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NOTE 23 - Luther Center

On April 30, 2010, Luther Center Associates, a partnership in which LSSI Rockford Property, Inc. (formerly Luther Center, Inc., a for-profit subsidiary of LSSI) owned a 0.2% general partnership interest, sold Luther Center Apartments, a 201 unit independent senior living facility in Rockford, Illinois, to Luther Center, Inc. (a renamed, newly established subsidiary of LSSI).

Per the terms of the Luther Center Partnership Agreement, LSSI Rockford Property, Inc. was entitled to a percentage of the proceeds on sale of Luther Center, which percentage varied according to the amount of sale proceeds.

The sale price of Luther Center, including \$200,000 for personal property, was \$8,360,000. During the year ended June 30, 2010, the gain on the sale, after related expenses of \$116,371, recorded by LSSI Rockford Property, Inc. was \$2,777,928, before a provision for income taxes on the gain of \$1,078,335, or 39%. LSSI Rockford Property Inc. received \$1,106,200 in cash and \$1,340,800 in a note from Luther Center, Inc. Subsequent to that year end, LSSI Rockford Property, Inc. received an additional pre-tax distribution of \$447,299 related to the sale of Luther Center, Inc. LSSI Rockford Property, Inc. has a tax year ending December 31. The proceeds represented by the note will be treated for income tax purposes as an installment sale. Accordingly, \$557,860 of the income tax provision was treated as currently payable, and was included in accrued and withheld taxes as of June 30, 2010 on the consolidated statements of financial position, and \$520,475 was treated as deferred, and was included in other long-term liabilities as of June 30, 2011 and 2010 on the consolidated statements of financial position.

The note payable by Luther Center, Inc. to LSSI Rockford Property, Inc. has been eliminated in the consolidated financial statements of LSSI.

In connection with the purchase, Luther Center Inc. issued a mortgage note to Centennial Mortgage, Inc. in the amount of \$8,186,700 at an annual interest rate of 4.45%, payable in monthly principal and interest installments of \$38,491, beginning June 1, 2010, with interest only payable May 31, 2010. Prepayment is closed prior to June 1, 2012. The note is subject to prepayment penalty beginning at 8% beginning June, 1, 2012 and declining 1% per year thereafter until it reaches 0% on June 1, 2020, with no prepayment penalty thereafter.

During the year ended June 30, 2011, LSSI Rockford Property, Inc. recorded a net loss from operations in the amount of \$45,505.

NOTE 24 - Contingencies

The Agency is a defendant in various lawsuits. The final results of such litigation cannot be determined at this time. In the opinion of management, any ultimate liability in these lawsuits would either be within insurance limits or would have no adverse effect on the consolidated financial statements.

As an employer, the Agency is subject to allegations of violation of various laws relating to employment. The Agency's attorneys have advised management that, relative to currently pending complaints, no judgment can be formed as to the likelihood of an unfavorable outcome. Management expects no material liability will be incurred as a result of these complaints.

**LUTHERAN SOCIAL SERVICES OF ILLINOIS
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011 and 2010

NOTE 24 - Contingencies (continued)

The grants received by the Agency are subject to audit, and the Agency could become liable for any expenditures disallowed upon audit. Management believes, however, that such disallowance, if any, would not be material.

NOTE 25 - Certain Concentrations

Receivables

As of June 30, the Agency's accounts receivable include amounts due from all sources as follows:

	2011	2010
Illinois Department of Public Aid	\$ 1,334,685	\$ 2,402,220
Illinois Department of Children and Family Services	1,684,326	2,711,734
Illinois Department on Aging	1,458,900	1,938,618
Illinois Department of Human Services:		
Office of Alcoholism and Substance Abuse	864,444	1,503,752
Office of Mental Health/Developmental Disabilities	796,167	408,934
Chicago Department of Human Services	431,299	378,048
Managed Housing and Urban Development (HUD) Projects	224,355	715,811
Medicare	998,286	1,083,722
Private Pay - Nursing Homes	1,361,451	1,479,211
Private Pay - Other Client Fees	607,947	585,701
Other	1,722,330	1,396,197
Total	11,484,190	14,603,948
Less: Allowance for doubtful accounts	(812,423)	(1,093,206)
Accounts receivable, net of allowance	\$ 10,671,767	\$ 13,510,742

The Agency receives a significant portion of its revenue and other support from several government units. If these government units terminated their support of the Agency, the Agency's ability to provide the services described in Note 1 could be significantly reduced.

Concentrations of Credit

The Agency maintains its cash deposits at several financial institutions which, at times, may exceed federally insured limits of \$250,000. The Agency has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on these deposits.

NOTE 26 - Subsequent Events

Lutheran Social Services of Illinois has evaluated subsequent events through October 13, 2011, which is the date that the financial statements were approved and available to be issued.