

REPORT ON AUDIT OF FEDERAL AWARDS IN
ACCORDANCE WITH OMB CIRCULAR A-133

Children's Medical Center
Year Ended September 30, 2009
With Reports of Independent Auditors

Children’s Medical Center

Report on Audit of Federal Awards in Accordance with OMB Circular A-133

Year Ended September 30, 2009

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Section I – Financial Information

Report of Independent Auditors

The Board of Trustees
Children's Medical Center

We have audited the accompanying consolidated balance sheets of Children's Medical Center (the Medical Center) as of September 30, 2009 and 2008, and the related consolidated statements of operations and changes in net assets, and cash flows, for the years then ended. These financial statements are the responsibility of the Medical Center'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, 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Medical Center's internal control over financial reporting. Our audits included 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 Medical Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Children's Medical Center as of September 30, 2009 and 2008, and the consolidated results of its operations, 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.

In accordance with *Government Auditing Standards*, we have also issued our report, dated January 28, 2010, on our consideration of the Medical Center's 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.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Ernst & Young LLP

January 28, 2010

Children's Medical Center and Subsidiaries

Consolidated Balance Sheets

	September 30	2009	2008		September 30	2009	2008
	Restated				Restated		
	<i>(In Thousands)</i>				<i>(In Thousands)</i>		
Assets				Liabilities and net assets			
Current assets:				Current liabilities:			
Cash and cash equivalents	\$	47,804	\$ 32,424	Accounts payable and accrued expenses	\$	128,879	\$ 110,077
Patient accounts receivable, net of allowance for uncollectible accounts of \$21,746 in 2009 and \$21,404 in 2008		127,613	113,430	Accrued salaries and wages		85,013	84,153
Other receivables		57,316	49,823	Current portion of estimated third-party liabilities		10,886	13,926
Other current assets		10,972	9,248	Current portion of long-term debt		1,705	1,545
Current portion of assets whose use is limited		1,197	1,509	Deferred revenue		30,242	21,368
Total current assets		244,902	206,434	Total current liabilities		256,725	231,069
Investments:				Long-term liabilities:			
Unrestricted as to use		970,968	921,969	Long-term debt		541,823	543,310
Limited by Board designation		1,029,998	933,936	Mortgage note payable		42,807	43,211
Restricted by donor-imposed restriction		439,852	415,365	Long-term portion of estimated third-party liabilities		30,861	32,833
		2,440,818	2,271,270	Net pension liability		60,700	45,989
Other assets whose use is limited:				Funds held for others		32,819	34,592
By externally administered trusts		39,167	42,769	Other liabilities		135,580	93,546
Other		12,366	11,979	Total long-term liabilities		844,590	793,481
		51,533	54,748	Commitments and contingencies			
Property, plant, and equipment, net		798,479	807,755	Net assets:			
Pledges receivable, net		73,193	73,706	Unrestricted		1,878,370	1,808,160
Other assets		8,569	8,369	Temporarily restricted		346,443	321,657
Total assets		\$3,617,494	\$3,422,282	Permanently restricted		291,366	267,915
				Total net assets		2,516,179	2,397,732
				Total liabilities and net assets		\$3,617,494	\$3,422,282

See accompanying notes.

Children's Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2009	2008
		<i>Restated</i>
	<i>(In Thousands)</i>	
Revenues:		
Net patient services revenue	\$1,029,481	\$ 926,339
Research grants and contracts	146,431	141,007
Recovery of indirect costs on grants and contracts	56,978	54,190
Other operating revenue	52,897	55,710
Endowment income support for mission-related activities	15,930	5,674
Unrestricted contributions, net of fundraising expenses of \$8,945 for 2009 and \$6,251 for 2008	7,690	9,972
Net assets released from restriction used for operations	32,874	34,849
Total revenues	1,342,281	1,227,741
Expenses:		
Salaries and benefits	549,792	511,927
Supplies and other expenses	425,230	374,962
Direct research expenses of grants	146,431	141,007
Provision for uncollectible accounts	20,572	24,025
Health Safety Net assessment	12,201	10,980
Depreciation and amortization	94,041	87,534
Interest and net interest rate swap cash flows	20,381	25,988
Total expenses	1,268,648	1,176,423
Gain from current operations	73,633	51,318
Changes in estimates of prior year third-party settlements	9,031	14,154
Gain from current operations	82,664	65,472
Non-operating gains (losses):		
Income from investments	5,849	23,631
Net realized gain on investments	8,485	55,144
Increase (decrease) in value of alternative investments	74,011	(59,119)
Recognition of unrealized losses on investments	(44,944)	(59,313)
Loss on extinguishment of debt	—	(4,940)
Fundraising expenses on restricted contributions	(13,001)	(14,585)
Adjustment of interest rate swaps to fair value	(35,183)	(28,396)
Other non-operating losses	(4,726)	(1,974)
Total non-operating loss	(9,509)	(89,552)
Excess (deficit) of revenues over expenses	73,155	(24,080)

Children's Medical Center and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued)

	Year Ended September 30	2008
	2009	Restated
	<i>(In Thousands)</i>	
Changes in unrestricted net assets:		
Excess (deficit) of revenues over expenses	\$ 73,155	\$ (24,080)
Net assets released from restrictions for capital asset acquisitions	2,183	7,965
Net unrealized gain (loss) on investments	36,978	(186,986)
Net asset transfer related to donor-match program	(3,204)	(28,039)
Depreciation on endowment funds	(10,427)	-
Pension adjustment	(28,434)	(46,488)
Other	(41)	(3,189)
Increase (decrease) in unrestricted net assets	70,210	(280,817)
Changes in temporarily restricted net assets:		
Contributions	29,756	42,878
Income and net realized gain (loss) on investments	3,093	(2,861)
Recognition of unrealized losses on investments	(9,627)	(14,763)
Increase (decrease) in value of alternative investments	16,113	(16,354)
Net unrealized gain (loss) on investments	10,092	(37,948)
Depreciation on endowment funds	10,427	-
Net assets released from restrictions	(35,057)	(42,814)
Net assets transfer related to donor-match program	(11)	200
Increase (decrease) in temporarily restricted net assets	24,786	(71,662)
Changes in permanently restricted net assets:		
Contributions	20,236	67,628
Net assets transfer related to donor-match program	3,215	27,839
Increase in permanently restricted net assets	23,451	95,467
Increase (decrease) in net assets	118,447	(257,012)
Net assets at beginning of year	2,397,732	2,654,744
Net assets at end of year	\$2,516,179	\$2,397,732

See accompanying notes.

Children's Medical Center and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended September 30	
	2009	2008
		<i>Restated</i>
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ 118,447	\$ (257,012)
Non-cash activities included in change in net assets:		
Depreciation and amortization	94,041	87,534
Restricted contributions and investment income	(50,088)	(112,511)
Net realized and unrealized (gain) loss on investments	(94,049)	323,696
Loss from extinguishment of debt	-	4,940
Changes in operating assets and liabilities:		
Patient accounts receivable	(14,183)	(19,919)
Other accounts receivable	(7,493)	3,806
Other current assets	(2,766)	(1,766)
Accounts payable and accrued expenses	19,662	32,518
Estimated third-party liabilities	(5,012)	(5,039)
Other liabilities	63,846	84,572
Net cash provided by operating activities	122,405	140,819
Financing activities		
Issuance of bank term loan	-	200,000
Purchase of bonds	-	(200,000)
Issuance of mortgage note	-	43,250
Payments of mortgage note	(404)	(39)
Capital lease payments	(1,327)	(744)
Proceeds from other debt issuance	-	2,900
Decrease (increase) in pledges receivable	513	(7,567)
Restricted contributions and investment income	50,088	112,511
Net cash provided by financing activities	48,870	150,311
Investing activities		
Purchases of investments	(956,466)	(1,391,032)
Proceeds from sales of investments	880,967	1,228,443
Additions to fixed assets, net of retirements	(83,923)	(133,016)
Decrease in assets whose use is limited	3,527	10,046
Net cash used in investing activities	(155,895)	(285,559)
Net increase in cash and cash equivalents	15,380	5,571
Cash and cash equivalents at beginning of year	32,424	26,853
Cash and cash equivalents at end of year	\$ 47,804	\$ 32,424

See accompanying notes.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2009

1. Summary of Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of Children's Medical Center Corporation (the Medical Center) and its subsidiaries, Children's Hospital (the Hospital), which engages in pediatric patient care, research, training, and community service; CHB Properties, Inc., which owns and operates real property and distributes the net income of such property to the Medical Center; Longwood Research Institute, Inc., which holds real property for the benefit of the Hospital in the furtherance of its research mission; Fenmore Realty Corporation, which owns and operates real property and distributes the net income of such property to the Medical Center; and Longwood Corporation, which owns and operates real property and distributes the net income of such property to the Medical Center.

Amounts for all periods presented reflect the integration of the Immune Disease Institute, Inc. which became a wholly owned subsidiary of the Medical Center in February 2009 in a business combination that was accounted for under the pooling of interests method. The pooling of interests method requires that financial statements for periods prior to the combination, presented for comparative purposes, be restated to reflect the combined financial position, operations and changes in net assets and cash flows of the combining organizations. Consequently, amounts presented herein for 2008 have been restated.

All material inter-company balances and transactions are eliminated in the consolidation.

The Medical Center is affiliated with 16 tax-exempt physician controlled Foundations (the Foundations). These independent, not-for-profit group practices perform their own billing for professional services, and pay salaries and fringe benefits to their members. During the years ended September 30, 2009 and 2008, the Hospital made payments of \$7,263,000 and \$6,977,000, respectively, to the Foundations for administrative, supervisory, and training activities provided by their members to the Hospital. The Hospital also supports the Foundations through loans and restricted gifts for the recruitment and retention of physicians and the development of strategic quality initiatives to enhance the delivery and quality of patient care services in the amount of \$34,400,000 and \$6,200,000 in 2009 and 2008, respectively. The Hospital bills for professional services and a limited number of clinical services, and accordingly, remunerates the Foundations for physician fees associated with these services. These physician fees and other administrative payments were \$64,648,000 and \$55,920,000 for the years ended September 30, 2009 and 2008, respectively. The Medical Center does not consolidate these Foundations because it does not control them.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) 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 amounts could differ from those estimates.

In 2009 and 2008, changes in estimates of prior year third-party settlements increased the gain from operations by approximately \$9,000,000 and \$14,000,000, respectively (Note 11).

Reclassification

Certain amounts for the year ended September 30, 2008 have been reclassified to be consistent with the presentation of the amounts for the year ended September 30, 2009.

Cash and Cash Equivalents

Cash equivalents include money market instruments with average maturities of less than 90 days, excluding amounts included in investments and other assets whose use is limited.

Investments

The Medical Center follows the practice of pooling resources of unrestricted and restricted assets for long-term investment purposes. The investment pool is operated on the market value method whereby each participating fund is assigned a number of units based on the percentage of the pool it owns at the time of entry. Income, gains, and losses of the pool are allocated to the funds based on their respective participation in the pool.

Investments in marketable debt and equity securities are stated at fair market value determined principally from quoted market prices. Realized gains or losses on investment transactions are computed on an average-cost basis. Net realized gains or losses on unrestricted investments, and impairments in investment values that are determined to be other than temporary, are reported as non-operating gains (losses). Net unrealized gains or losses on unrestricted assets are recorded as an increase or decrease in unrestricted net assets. Net realized and unrealized gains or losses on restricted assets are recorded as an increase or decrease to the restricted net asset balance.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Alternative investments, which consist primarily of interests in limited liability partnerships and limited liability corporations, are reported using the equity method of accounting. Under the equity method, the Medical Center recognizes its share of the increase or decrease in the investments' net asset value in non-operating gains (losses). Certain of the alternative investments may hold some securities without readily determinable fair values and, consequently, the general partner or investment manager may estimate fair value for such securities. These estimates, which could materially affect the Medical Center's carrying value, may differ significantly from the values that would have been used had a ready market existed, and may also differ significantly from the values at which such investments may be sold, and the differences could be material.

Unrestricted investment income is reported in non-operating gains, except for income of \$15,930,000 and \$5,674,000 during 2009 and 2008, respectively, which has been designated by the Board of Trustees for support of various mission-related activities, and is recorded as operating income. Restricted investment income is recorded as an increase to the restricted net asset balance.

Investments and Other Assets Whose Use Is Limited or Restricted

Investments and other assets whose use is limited or restricted include the following: Board-designated assets for plant replacement and expansion and mission-related activities; donor-restricted assets and funds held for others (all of which participate in the investment pool); externally managed trusts associated with deferred giving arrangements; assets set aside in connection with debt service; and deferred compensation (which are invested primarily in mutual funds and government obligations, and are reported at fair market value).

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market and are recorded in other current assets on the consolidated balance sheet.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Interest costs incurred during the construction period of major projects are capitalized as a component of the cost of these assets, and are depreciated over the estimated useful lives of the assets. The costs of repairs and maintenance are charged to expense as incurred.

Depreciation and amortization is computed on the straight-line method based on the estimated useful lives of the assets. The estimated useful lives conform to the guidelines established by the American Hospital Association. The Hospital's policy is to fund depreciation expense in amounts not exceeding cumulative, allowable depreciation expense.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Original Issue Discount and Debt Issuance Fees

Unamortized original issue discount and the costs associated with the issuance of debt are amortized using the interest method over the life of the bond issue, and are recorded in other assets on the consolidated balance sheet.

Pledges

Pledges, less an allowance for uncollectible amounts, are recorded as receivable in the year made. Pledges receivable over a period greater than one year are stated at net present value.

Net Assets

The accompanying consolidated balance sheets of the Medical Center classify net assets into three categories: unrestricted, temporarily restricted, and permanently restricted. Net assets which bear no external restriction as to use or purpose are classified as unrestricted. Also included in unrestricted net assets are assets whose use is limited under debt or trust agreements. In addition, unrestricted net assets include Board-designated funds for plant replacement and expansion, and mission-related activities.

Net assets, which are restricted by donors or grantors as to use or purpose, are classified as either temporarily restricted or permanently restricted:

Temporarily restricted net assets are restricted by the donor or grantor, principally for the support of research, patient care, departmental support, medical education, community health services, and the acquisition of property, plant, and equipment. When a restriction expires, that is, when a stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Permanently restricted net assets represent contributions to the Medical Center, the principal of which may not be expended. Income from permanently restricted net assets may be unrestricted or restricted in accordance with the donor's request. In accordance with the laws of the Commonwealth of Massachusetts, gains on permanently restricted net assets are recorded as temporarily restricted net assets until appropriated for expenditure by the Board of Trustees.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Net Patient Services Revenue

Net patient services revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated contractual adjustments under reimbursement agreements with third-party payors. Contractual adjustments are accrued on an estimated basis in the period in which the related services are rendered. If estimated allowances are adjusted in future periods, the adjustments are recorded as changes in estimates of prior year third party settlements.

Revenues from Medicare and Medicaid, including Medicaid out-of-state programs, accounted for approximately 1.0% and 11.0%, respectively, of the Hospital's net patient services revenues for the year ended September 30, 2009 (1.2% and 10.0%, respectively, for 2008). Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Research Grants and Contracts

The Medical Center, through its Hospital and Immune Disease Institute, Inc. subsidiaries, engages in research activities funded by grants and contracts with federal and state governments, and various private sources. Revenues associated with grants and contracts are recognized as the related costs are incurred. Research funds received in advance are reported as deferred revenue, and are recognized as earned revenue as the related research expenditures are incurred. Recoveries of indirect costs relating to certain government grants and contracts are reimbursed at predetermined rates negotiated with government agencies. Recoveries of indirect costs relating to non-government grants are reimbursed at varying rates, depending upon sponsor policies.

Contributions

Unrestricted contributions are recorded as operating revenue; restricted contributions are recorded as additions to restricted net asset balances. Donated securities and property are recorded at fair market value as of the date of donation.

Income Taxes

The Medical Center and four of its subsidiaries, the Hospital, Children's Extended Care Center, Inc., Longwood Research Institute, Inc., and Immune Disease Institute, Inc., are exempt from income taxes on related business income pursuant to Internal Revenue Code (the Code) Section 501(c)(3). Longwood Corporation and Fenmore Realty Corporation are exempt from income taxes on related business income pursuant to Code Section 501(c)(2).

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

New Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued the FASB Accounting Standards Codification (the Codification). The Codification is the single source of authoritative non-governmental U.S. GAAP, and is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Medical Center adopted the Codification as of September 30, 2009. The adoption of the Codification did not affect the presentation of the Medical Center's financial statements.

In September 2006, the FASB issued Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures* (Topic 820). Topic 820 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosure about fair value measurements. Topic 820 is effective for fiscal years beginning after November 15, 2007. The adoption of Topic 820 did not have a material effect on the Medical Center's consolidated balance sheets as of October 1, 2008, or September 30, 2009, or on the consolidated statements of operations and changes in net assets or cash flows for the year ended September 30, 2009. See Note 14 for related fair value disclosures. In February 2009, the FASB issued Topic 820-10-55-33, which delayed the effective date of Topic 820 for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value on a recurring basis, until fiscal years beginning after November 15, 2008. Accordingly, the Medical Center will apply the provisions of Topic 820 to non-financial assets and liabilities beginning with the fiscal year ending September 30, 2010.

In March 2008, the FASB issued ASC Topic 815-10-65-1, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of ASC Topic 815-10-50* (Topic 815-10-65-1). Topic 815-10-65-1 builds upon the existing disclosure requirements of Topic 815-10-50, *Accounting for Derivative Instruments and Hedging Activities* (Topic 815-10-50), by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under Topic 815-10-50 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The Medical Center is required to adopt Topic 815-10-65-1 for its fiscal year ending September 30, 2010.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In August 2008, the FASB issued ASC Topic 958-205-45-28, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (Topic 958-205-45-28). Topic 958-205-45-28 provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to a state-enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), and requires additional disclosures for the endowment funds of all not-for-profit organizations. The Medical Center adopted Topic 958-205-45-28 during the year ended September 30, 2009. The adoption of Topic 958-205-45-28 did not have a material effect on the Medical Center's consolidated balance sheet at September 30, 2009, or on the consolidated statement of operations and changes in net assets for the year ended September 30, 2009.

In April 2009, the FASB issued ASC Topic 320-10-65-1, *Recognition and Presentation of Other-Than-Temporary Impairments* (Topic 320-10-65-1). Topic 320-10-65-1 amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. Topic 320-10-65-1 states that the entity should assess whether the entity (a) has the intent to sell the debt security, or (b) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the investor must recognize other-than-temporary impairment. If it is determined that the amortized cost of the debt security will not recover, the amount of the other-than-temporary impairment will be segregated into two factors; the amount representing credit loss will be recognized in non-operating gains (losses), and the amount representing other factors will be recognized through unrestricted net assets. Topic 320-10-65-1 was adopted by the Medical Center as of September 30, 2009.

In May 2009, the FASB issued ASC Topic 855, *Subsequent Events* (Topic 855). Topic 855 establishes general standards of accounting and disclosure requirements for subsequent events, events that occur after the balance sheet date but before the financial statements are issued. In addition, certain events subsequent to the balance sheet date may require recognition in the financial statements as of the balance sheet date based on the requirements of Topic 855. The Medical Center adopted the provisions of Topic 855 as of September 30, 2009, and evaluated the impact of subsequent events through January 28, 2010, representing the date at which the financial statements were issued. See Note 16 for a discussion of the Medical Center's material subsequent event.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Business Combination – Immune Disease Institute, Inc.

On February 20, 2009, the Medical Center became the sole corporate member of the Immune Disease Institute, Inc. (IDI) in a business combination accounted for as a pooling of interests. The accompanying consolidated financial statements for 2009 are presented to include the combined operating results, changes in net assets and cash flows of the Medical Center and IDI for the full fiscal year. In addition, the consolidated financial statements for 2008 have been restated to give effect to the combination. The effect of the restatement is included in the table below:

	2008 as Originally Reported	Effect of Restatement	2008 As Restated
Consolidated balance sheet			
Unrestricted net assets – October 1, 2007	\$2,080,763	\$ 8,215	\$2,088,978
Total net assets – October 1, 2007	2,644,017	10,727	2,654,744
Total assets – September 30, 2008	3,392,191	30,091	3,422,282
Total liabilities – September 30, 2008	1,000,078	24,472	1,024,550
Unrestricted net assets – September 30, 2008	1,804,643	3,617	1,808,260
Total net assets – September 30, 2008	2,392,113	5,619	2,397,732
Consolidated statement of operations and changes in net assets			
Total revenues	\$1,189,174	\$38,567	\$1,227,741
Gain from operations	67,826	(2,354)	65,472
Deficit of revenues over expenses	(21,686)	(2,394)	(24,080)

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments and Other Assets Whose Use Is Limited or Restricted

Investments and other assets whose use is limited or restricted consist of the following at fair value for years ended September 30 (in thousands):

	2009	2008
Pooled investments:		
Investment pool by manager type:		
Equity securities	\$1,174,476	\$1,284,991
Fixed income securities	770,913	609,341
Other	89,632	71,370
Total pooled investments	2,035,021	1,965,702
Non-pooled investments:		
Cash equivalents	200,156	118,730
Equity securities	2,790	1,283
Fixed income securities	18,731	49,788
Real estate	197,683	149,255
Total non-pooled investments	419,360	319,056
Externally administered trusts (marketable debt and equity securities)	39,167	42,769
Total investments and other assets whose use is limited	\$2,493,548	\$2,327,527

Included in the pooled investments above are alternative investments of \$941,000,000 and \$760,000,000 as of September 30, 2009 and 2008, respectively.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments and Other Assets Whose Use Is Limited or Restricted (continued)

These investments and other assets whose use is limited or restricted are presented in the accompanying consolidated balance sheets as follows for years ended September 30 (in thousands):

	<u>2009</u>	<u>2008</u>
Investments, unrestricted as to use	\$ 970,968	\$ 921,969
Investments and other assets whose use is limited or restricted:		
By Board designation for plant replacement and expansion, and mission-related activities	1,029,998	933,936
By donor-imposed restriction	439,852	415,365
Under long-term debt agreements	1,197	1,509
By externally administered trusts	39,167	42,769
Other:		
As funds held for others	1,676	1,586
Under deferred compensation agreements	9,552	9,253
Other	1,138	1,140
	<u>12,366</u>	<u>11,979</u>
Total investments and other assets whose use is limited	<u>\$2,493,548</u>	<u>\$2,327,527</u>

The components of investment earnings include (in thousands):

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Year ended September 30, 2009			
Interest and dividend income:			
Operating revenue	\$ 15,930	\$ –	\$ 15,930
Non-operating revenue	5,849	–	5,849
Increase in temporarily restricted net assets	–	96	96
Increase in value of alternative investments	74,011	16,113	90,124
Net realized gain	8,485	2,997	11,482
Other-than-temporary losses	(44,944)	(9,627)	(54,571)
Net unrealized gains	36,978	10,092	47,070
Total return on investments	<u>\$ 96,309</u>	<u>\$19,671</u>	<u>\$115,980</u>

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments and Other Assets Whose Use Is Limited or Restricted (continued)

	Unrestricted	Temporarily Restricted	Total
Year ended September 30, 2008			
Interest and dividend income:			
Operating revenue	\$ 5,674	\$ —	\$ 5,674
Non-operating revenue	23,631	—	23,631
Increase in temporarily restricted net assets	—	2,005	2,005
Decrease in value of alternative investments	(59,119)	(16,354)	(75,473)
Net realized gain (loss)	55,144	(4,866)	50,278
Other-than-temporary losses	(59,313)	(14,763)	(74,076)
Net unrealized losses	(186,986)	(37,948)	(224,934)
Total return on investments	<u>\$ (220,969)</u>	<u>\$ (71,926)</u>	<u>\$ (292,895)</u>

Investment income is reported net of fees of \$3,553,000 and \$5,682,000 for the years ended September 30, 2009 and 2008, respectively.

The Medical Center retains professional investment managers for the management of all pooled investments. These managers invest in temporary cash investments, fixed income securities, and equities. In addition, as part of their investment strategy, certain managers may engage in short selling and futures and options trading. Management believes that the risk of accounting loss, associated with short selling and futures and options-trading strategies, is no greater than that associated with other investment strategies which do not involve off-balance sheet risk.

Management continually reviews its investment portfolio where the market value is below cost, and in cases where the decline is considered to be other-than-temporary, an adjustment is recorded to realize the loss. The Medical Center recorded a realized loss for other-than-temporary declines in the fair value of investments of approximately \$54,571,000 and \$74,076,000 for the years ended September 30, 2009 and 2008, respectively, of which \$44,944,000 and \$59,313,000, respectively, is included in unrestricted investment income, and \$9,627,000 and \$14,763,000, respectively, is included in changes in temporarily restricted net assets. Aggregate gross unrealized losses as of September 30, 2009 were \$2,697,000 on investments with a fair value of \$54,901,000. These investments were in a loss position for more than 12 consecutive months. Aggregate gross unrealized losses as of September 30, 2008 were \$14,043,000 on investments with a fair value of \$142,239,000. Included in those losses were investments in a loss position for more than 12 consecutive months, which totaled \$6,921,000 with a fair value of \$70,666,000. Management considers these investments core holdings, and believes that, given the modest percentage declines below cost, these investments are likely to recover the existing unrealized losses prior to sale.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Contributions

Contributions received and pledged to the Medical Center were as follows for the years ended September 30 (in thousands):

	2009	2008
Gross contributions	\$66,221	\$127,842
Provision for uncollectible pledges	(32)	(1,063)
Accretion (discounts)	438	(50)
Net contributions	\$66,627	\$126,729

These contributions are reported in the accompanying financial statements in accordance with donors' restrictions as follows for years ended September 30 (in thousands):

	2009	2008
Unrestricted contributions	\$16,635	\$ 16,223
Temporarily restricted	29,756	42,878
Permanently restricted	20,236	67,628
Net contributions	\$66,627	\$126,729

In addition to the \$66,221,000 and \$127,942,000 in gross contributions raised, the Medical Center raised \$14,514,000 and \$11,411,000 in non-governmental grant awards, to bring the total funds raised to \$80,735,000 and \$139,253,000 for the years ended September 30, 2009 and 2008, respectively.

Contributions pledged to the Medical Center are due as follows as for years ended September 30 (in thousands):

	2009	2008
Due in less than one year	\$36,458	\$31,383
Due in one to five years	45,355	54,018
Due in more than five years	3,442	735
	85,255	86,136
Less discount to present value	(7,796)	(8,119)
Less allowance for uncollectible pledges	(4,266)	(4,311)
Total pledges receivable, net	\$73,193	\$73,706

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Free Care, Health Safety Net, and Community Services

The Hospital provides care to patients who meet certain criteria under its free care policy without expectation of payment or at amounts less than its established rates. As the Hospital does not pursue collection of amounts determined to qualify as free care, they are not reported as net patient services revenue. The Hospital also supports the delivery of health care services to the indigent through payments to the Health Safety Net Trust (HST) (formerly the Uncompensated Care Pool), which is administered by the Commonwealth of Massachusetts. The amounts of net receipts to HST, provision for uncollectible accounts, and free care were as follows for years ended September 30 (in thousands):

	2009	2008
HST receipts	\$ (6,667)	\$ (6,643)
HST tax	12,201	10,980
Net disbursements to HST	5,534	4,337
Provision for uncollectible accounts	20,572	24,025
Total HST expense	26,106	28,362
Free care (deductions from revenue at standard charge)	6,564	6,749
Total free care and HST	<u>\$32,670</u>	<u>\$35,111</u>

The Hospital also provides resources to support numerous initiatives aimed at contributing to the physical and psychological well-being of children, youth, and families living in the Hospital's community. The initiatives include programs at the Hospital, and in collaboration with community-based organizations, to provide comprehensive services to adolescent mothers and children, HIV outreach services, services to reduce infant mortality, assistance to the homeless, and training and other related services to individuals with developmental disabilities. The Hospital also provides medical services to the community through its emergency room, which operates 24 hours a day, and is available to all regardless of ability to pay.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Property, Plant, and Equipment

Property, plant, and equipment consist of the following for years ended September 30 (in thousands):

	2009	2008
Land and improvements	\$ 17,423	\$ 17,077
Buildings and improvements	1,128,113	1,074,725
Equipment	485,042	443,985
Construction-in-progress	37,952	50,391
	1,668,530	1,586,178
Less accumulated depreciation and amortization	(870,051)	(778,423)
	\$ 798,479	\$ 807,755

At September 30, 2009, the Medical Center had commitments of \$78,152,000 to complete projects relating to capital construction and software development.

6. Asset Retirement Obligations

Conditional asset retirement obligations amounted to \$17,362,000 and \$16,959,000 as of September 30, 2009 and 2008, respectively. These obligations are recorded in other liabilities in the accompanying consolidated balance sheets. There are no assets that are legally restricted for purposes of settling asset retirement obligations.

During 2009 and 2008, retirement obligations incurred and settled were \$2,219,000 and \$3,944,000, respectively. Accretion expense of \$1,480,000 and \$1,389,000 was recorded during the years ended September 30, 2009 and 2008, respectively.

7. Other Assets

Other assets consist of the following for years ended September 30 (in thousands):

	2009	2008
Unamortized debt issuance costs	\$8,219	\$8,019
Other assets	350	350
	\$8,569	\$8,369

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Leases

The Medical Center and Subsidiaries leases buildings under operating leases which expire at various dates through 2028. The obligations under non-cancelable leases as of September 30, 2009 are as follows (in thousands):

2010	\$ 25,128
2011	25,415
2012	22,481
2013	21,128
2014	20,401
Thereafter	164,530
Total operating leases	<u>\$279,084</u>

Rent expense was approximately \$30,076,000 and \$18,604,000 for the years ended September 30, 2009 and 2008, respectively.

9. Long-Term Debt and Mortgage Note

Long-term debt consists of the following for years ended September 30 (in thousands):

	<u>2009</u>	<u>2008</u>
Bank term loan	\$200,000	\$200,000
Massachusetts Health and Educational Facilities Authority (MHEFA) issues:		
Series K	30,800	30,800
Series J	74,200	74,200
Series I	49,075	49,075
Series H	80,000	80,000
Series G	105,250	105,250
Other	4,203	5,530
	<u>543,528</u>	<u>544,855</u>
Less current portion of long-term debt	1,705	1,545
	<u>\$541,823</u>	<u>\$543,310</u>

The estimated fair market value of long-term debt as of September 30, 2009 and 2008 approximated its carrying value.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt and Mortgage Note (continued)

Summary information for each issue and the mortgage note follows:

Bank Term Loan

On August 28, 2008, the Hospital entered into a term loan agreement with a bank in the amount of \$200,000,000. Proceeds from the loan were used to purchase the Children's Hospital Series L-1 and L-2 MHEFA Revenue Bonds from the bank. These bonds were previously purchased by the bank during 2008 under the terms of the standby bond purchase agreement which was triggered when remarketing efforts on these bonds began to fail. The Hospital recorded a related extinguishment loss during 2008 of \$4,940,000. The bank loan bears interest at a variable rate (1.4% at September 30, 2009), and was scheduled to mature on October 15, 2009. Interest payments are due monthly. In 2009, the Hospital extended the terms of this loan through October 15, 2011.

Series L-2 Bonds

On May 9, 2006, the Hospital issued Series L-2 MHEFA Revenue Bonds in the aggregate principal amount of \$120,000,000. Proceeds from the bonds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures.

In connection with the issuance of these variable rate demand bonds, the Hospital entered into a standby bond purchase agreement with a bank, whereby the bank agreed to purchase any tendered bond which is not otherwise purchased. During 2008, the bank purchased \$120,000,000 of the Series L-2 Revenue Bonds, which were subsequently sold back to the Hospital as described under the bank term loan above.

Series L-1 Bonds

On May 5, 2004, the Hospital issued Series L-1 MHEFA Revenue Bonds in the aggregate principal amount of \$80,000,000. Proceeds from the bonds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures.

In connection with the issuance of these variable rate demand bonds, the Hospital entered into a standby bond purchase agreement with a bank, whereby the bank agreed to purchase any tendered bond which is not otherwise purchased. During 2008, the bank purchased \$80,000,000 of the Series L-1 Revenue Bonds, which were subsequently sold back to the Hospital as described under the bank term loan above.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt and Mortgage Note (continued)

Series J and K Bonds

On July 12, 2002, the Hospital issued Series J and K MHEFA Revenue Bonds in the aggregate principal amount of \$105,000,000. Proceeds from the bonds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures, and refund the Series E Revenue Bonds. Interest on the bonds is variable based on 14-day (Series J) and weekly auctions (Series K), and was 0.18% on both Series J and K at September 30, 2009. Interest payments are due every 14 days on Series J and weekly for Series K. The first annual principal payment on Series J and K is due in 2022. Final principal payments are due in 2025 for Series K and in 2036 for Series J. There is no put feature back to the Hospital by bondholders and, as such, no commercial bank liquidity feature is required.

Series G, H, and I Bonds

On May 31, 2001, the Hospital issued Series G, H, and I MHEFA Revenue Bonds in the aggregate principal amount of \$234,325,000. Proceeds from the bonds were used to reimburse and fund certain capital renovation and equipment expenditures, refund the Series F Revenue Bonds, and fund the construction of a new 12-story research building and a 10-story clinical expansion building. Interest on the bonds is variable based on daily (Series G) and weekly auctions (Series H and I), and was 0.30%, 0.17%, and 0.30% on Series G, H, and I, respectively, at September 30, 2009. Interest payments are due monthly on Series G and weekly for Series H and I. The first annual principal payment on Series G is due in 2030 and on Series H and I in 2026. Final principal payments are due in 2035 for Series G and 2040 for Series H and I. There is no put feature back to the Hospital by bondholders and, as such, no commercial bank liquidity feature is required.

Other

In October 2001, IDI established a variable interest rate (5.5% at September 30, 2009) line of credit at Citizens Bank for \$2,000,000. At September 30, 2009 and 2008, IDI had \$913,000 and \$713,000, respectively, outstanding under the line of credit.

During 2004 and 2005, IDI, financed \$1,120,000 through the MHEFA Pool M1-A program and \$1,220,000 through the MHEFA Pool M3-B program. The financings were used for the purchase of certain equipment and bear interest at a variable rate (1.7% at September 30, 2009). Interest payments are due monthly. During 2008, IDI obtained additional MHEFA financing of \$2,900,000. Principal and interest are paid semi-annually through 2013 at annual interest rates ranging from 3.0% to 4.4%. Total obligations under all capital leases approximated \$3,285,000 at September 30, 2009. Future obligations amount to \$1,117,000 in 2010, \$998,000 in 2011, \$755,000 in 2012 and \$629,000 in 2013. Amounts representing capital interest approximates \$214,000 at September 30, 2009.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt and Mortgage Note (continued)

Mortgage Note

On August 1, 2008, Fenmore Realty Corporation entered into a mortgage note in the amount of \$43,250,000. The note is secured by certain real estate investments with a value of approximately \$66,730,000 at September 30, 2009. The note bears interest at a fixed rate of 6.53%, and matures at varying annual amounts through 2018. The principal and interest payments are \$3,291,000 each year through 2018.

Interest Rate Swap Agreements

Inception Date	Notional Amount	Fixed Interest Rate	Maturity Date
December 2007	\$120,000,000	3.42%	December 2041
May 2006	119,875,000	3.57	April 2040
August 2004	70,000,000	4.00*	October 2027
November 2003	50,000,000	3.13	November 2040
December 2001	35,000,000	4.72	December 2021
December 2001	35,000,000	4.72	December 2026
May 2001	105,250,000	4.58	December 2036

*Fixed at 4.0% through October 1, 2027, if the variable-rate tax-exempt index reaches 4.5%.

The Medical Center uses interest rate swap agreements in order to manage its interest rate risk associated with its outstanding debt. These swaps effectively convert interest rates on variable rate bonds to fixed rates. The interest rate swap agreements meet the definition of derivative instruments. Consequently, the fair value of the swaps (a liability of \$88,642,000 and \$53,459,000 at September 30, 2009 and 2008, respectively) is reported in other liabilities in the accompanying balance sheets, and the change in fair value during the year of \$35,183,000 and \$28,396,000 for the years ended September 30, 2009 and 2008, respectively, is reported as a non-operating loss in the statements of operations and changes in net assets. The swaps, while serving as an economic hedge, do not qualify as an accounting hedge.

Cash flows under the swaps netted to payments of approximately \$15,118,000 and \$7,287,000 in 2009 and 2008, respectively, and are included in interest expense.

Guaranteed Debt

As security to the Hospital's bank term loan, and Series G, H, I, J, K, L-1, and L-2 bondholders, the Medical Center has executed unconditional and irrevocable guaranties of full and punctual payment of all obligations of the Hospital under the terms of the related loan agreements.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt and Mortgage Note (continued)

The Hospital has also guaranteed \$630,000 of the principal of \$4,410,000 of revenue bonds issued by MHEFA on behalf of the Community Health Center Capital Funds. As of September 30, 2009, there have not been any requirements to honor calls under this guarantee.

In accordance with the terms of the loan agreements for Series G, Series H, Series I, Series J, and Series K, certain funds were established with independent trustees. The purpose of each fund and its respective balance at September 30 is as follows (in thousands):

	2009	2008
Bond funds – to receive debt service payments from the Hospital, and to disburse such payments to the bondholders	\$ 1,197	\$ 1,509
	1,197	1,509
Current portion	(1,197)	(1,509)
	\$ –	\$ –

Interest paid was \$20,381,000 and \$28,184,000 for the years ended September 30, 2009 and 2008, respectively. In 2009, there was no interest capitalized in connection with ongoing construction projects. In 2008, interest capitalized in connection with ongoing construction projects approximated \$1,658,000.

10. Restricted Net Assets

Temporarily restricted net assets at September 30 are comprised of the following (in thousands):

	2009	2008
Mission-related activities	\$163,375	\$142,933
Accumulated gains on permanently restricted net assets	183,068	178,724
	\$346,443	\$321,657

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Restricted Net Assets (continued)

Permanently restricted net assets at September 30 are restricted as follows (in thousands):

	2009	2008
Investments to be held in perpetuity, the income from which is:		
Unrestricted as to use	\$ 27,446	\$ 25,402
Restricted for patient care-related activities	129,339	117,601
Restricted for research	118,071	111,071
Restricted for medical education	16,510	13,841
	\$291,366	\$267,915

The Medical Center follows the requirements of the Massachusetts UPMIFA as they relate to its permanently restricted endowments. The Medical Center's endowments consist of numerous individual funds established for a variety of purposes. Its endowments consist solely of donor-restricted endowment funds. As required by U.S. GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The State of Massachusetts requires the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Medical Center classifies permanently restricted net assets as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment funds that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure. The Medical Center 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 purpose of the Medical Center 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, and (6) the investment policies of the Medical Center.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Restricted Net Assets (continued)

The components of endowment-related activities include the following:

	Board Designated Funds	Temporarily Restricted Funds	Permanently Restricted Funds	Total Endowment Funds
Year ended September 30, 2009				
Endowment net assets at beginning of year	\$238,368	\$183,279	\$265,551	\$687,198
Investment return:				
Investment income	2,575	4,191	–	6,766
Net appreciation	15,149	21,150	–	36,299
Total investment return	17,724	25,341	–	43,065
Contributions	–	–	18,376	18,376
Net asset reclassifications	20,948	–	3,778	24,726
Amounts appropriated for expenditure	(13,588)	(20,371)	–	(33,959)
Endowment net assets at end of year	<u>\$263,452</u>	<u>\$188,249</u>	<u>\$287,705</u>	<u>\$739,406</u>
Year ended September 30, 2008				
Endowment net assets at beginning of year	\$302,301	\$257,890	\$172,448	\$ 732,639
Investment return:				
Investment income	2,878	4,472	–	7,350
Net depreciation	(38,503)	(63,487)	–	(101,990)
Total investment return	(35,625)	(59,015)	–	(94,640)
Contributions	–	–	63,401	63,401
Net asset reclassifications	9,330	–	29,702	39,032
Reclassification	(17,400)	–	–	(17,400)
Amounts appropriated for expenditure	(20,238)	(15,596)	–	(35,834)
Endowment net assets at end of year	<u>\$238,368</u>	<u>\$183,279</u>	<u>\$265,551</u>	<u>\$ 687,198</u>

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Restricted Net Assets (continued)

The Medical Center's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to 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 Medical Center must hold in perpetuity, and the unexpended appreciation on those funds and unrestricted funds which the Board has designated to function as endowments in support of mission related activities. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in manners that are expected to generate a long-term rate of return of approximately 8% per annum. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Medical Center 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 Medical Center targets a diversified asset allocation that consists of equities, fixed income, and alternative investments.

The Medical Center has a policy of appropriating, for distribution each year, no more than 5% of its endowment funds' "three-year trailing average market value". In establishing this policy, the Medical Center considered the long-term expected return on its endowments.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Medical Center to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets are \$10,427,000 as of September 30, 2009. These deficiencies resulted from unfavorable market fluctuations.

The Hospital's faculty match program is a donor match program where the Hospital matches certain permanently restricted gifts from donors under a pre-defined ratio. This program has resulted in several major gifts to the Hospital in support of certain strategic purposes.

Net assets were released from donor or grantor restrictions during the year ended September 30 by incurring expenses satisfying the following restricted purposes (in thousands):

	<u>2009</u>	<u>2008</u>
Mission-related activities	\$32,874	\$34,849
Property, plant, and equipment	2,183	7,965
	<u>\$35,057</u>	<u>\$42,814</u>

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Net Patient Services Revenue

The Hospital has agreements with numerous third-party payors that provide for payments at amounts different from its established charges. Medicaid payments are based on a contract with the Massachusetts Executive Office of Health and Human Services, and reimbursed for services on a standardized payment-per-encounter basis for outpatients and a standardized per-adjusted-discharge basis for inpatients. The current year payments are reflective of current year inflation adjusted for prior year diagnoses, procedures, and case mix.

Contracts with managed care providers provide for payments based on a variety of methodologies, including discounted charges, per-case, and per-diem arrangements for inpatients, and discounted charges and fee schedule arrangements for outpatients. Commercial insurers reimburse the Hospital for services on the basis of established charges. Since the Hospital is a pediatric institution, it is exempt from the Federal Prospective Payment System, which governs Medicare reimbursement; therefore, the Hospital's Medicare reimbursement is based upon Medicare's proportionate share of reasonable costs.

During 2009 and 2008, in connection with special legislative appropriations, the Hospital received \$21,333,000 and \$21,697,000, respectively, from the Federal Children's Hospital's GME program for reimbursement of graduate medical education expense. During 2008, the Hospital received \$7,141,000 from the State Medicaid program in connection with the disproportionate share program. This funding was discontinued in 2009. In 2009, the Hospital also recognized \$729,000 from Massachusetts Medicaid for pediatric cases with a case mix index greater than five. There is no guarantee that similar appropriations will occur in the future, or at what level.

Differences between estimated and final settlements are recorded as contractual adjustments in the year determined. The Hospital recorded favorable adjustments of approximately \$9,031,000 and \$14,154,000 in 2009 and 2008, respectively, as a result of final settlements and other adjustments to prior year estimates.

The Hospital grants credit without collateral to its patients. The concentration of credit risk by payor as measured by patient accounts receivables, net of contractual adjustments, was as follows for the years ended September 30:

	2009	2008
Other managed care	35%	36%
Blue Cross	27	23
Medicaid	16	15
Commercial	9	10
Self-pay	7	9
Neighborhood Health Plan	4	5
Other governmental	2	2
Total	100%	100%

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Employees' Retirement Plans

The Hospital sponsors two non-contributory, defined benefit retirement plans (the Regular Employees' Pension Plan and the Maintenance Employees' Pension Plan), which cover substantially all employees of the Hospital. The Hospital does not provide postretirement benefits other than pension to its retirees.

The Regular Employees' Pension Plan and the Maintenance Employee' Pension Plan are cash balance plans under which benefits are based on the annuitized value of a participant's account, which consists of basic credits (determined on age, years of vesting service, and compensation), plus interest credits thereon. The measurement date of these plans is September 30.

Reconciliation of Funded Status and Accumulated Benefit Obligation

A reconciliation of the changes in the Hospital's pension plans' projected benefit obligation and the fair value of assets, and the accumulated benefit obligation of the plans as of September 30, follows (in thousands):

	2009	2008
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 308,303	\$ 303,516
Service cost	24,508	23,402
Interest cost	19,759	18,374
Amendments	9	-
Actuarial loss (gain)	32,069	(27,532)
Benefits paid	(7,346)	(9,457)
Benefit obligations at end of year	377,302	308,303
Change in plan assets		
Fair value of plan assets at beginning of year	262,314	304,962
Actual return on plan assets	19,634	(51,777)
Employer contribution	42,000	18,586
Benefits paid	(7,346)	(9,457)
Fair value of plan assets at end of year	316,602	262,314
Funded status	\$ (60,700)	\$ (45,989)
Accumulated benefit obligation	\$297,165	\$242,792

The funded status of the plans of \$(60,700,000) and \$(45,989,000), at September 30, 2009 and 2008, respectively, is reported in the accompanying balance sheets under long-term liabilities.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Employees' Retirement Plans (continued)

Net periodic pension cost includes the following components for years ended September 30 (in thousands):

	2009	2008
Components of net periodic benefit cost		
Service cost	\$24,508	\$23,402
Interest cost	19,759	18,374
Expected return on plan assets	(17,549)	(22,144)
Amortization of prior service cost	118	118
Recognized net actuarial gain	1,441	(217)
Net periodic pension cost	\$28,277	\$19,533

Included in unrestricted net assets at September 30, 2009 and 2008 are the following amounts that had not yet been recognized in net periodic pension cost: unrecognized prior service costs of \$576,302 and \$686,000, respectively, and unrecognized actuarial loss of \$30,808,663 and \$2,265,000, respectively. The prior service cost included as other changes in unrestricted net assets, and expected to be recognized in net periodic pension cost during the fiscal year ending September 30, 2010 is \$118,000.

The weighted-average assumptions used to develop pension expense for the years ended September 30 are as follows:

	2009	2008
Weighted-average assumptions for pension cost		
Discount rate	6.12%	6.00%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	5.00	5.00

To develop the expected long-term rate of return on plan assets assumption, the Medical Center considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The weighted-average assumptions used to develop the projected benefit obligation for years ended September 30 are as follows:

	2009	2008
Weighted-average assumptions for benefit obligation		
Discount rate	5.95%	6.50%
Rate of compensation increase	5.00	5.00

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Employees' Retirement Plans (continued)

Plan Assets

The plans' investment objectives are to achieve long-term growth in excess of long-term inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize risk, the plans intend to minimize the variability in yearly returns. The plans also intend to diversify their holdings among asset classes, investment managers, sectors, industries, and companies. The asset policy guidelines include total equities between 50% and 75%, total fixed income between 10% and 40%, and other strategies between 5% and 25%.

The Hospital's pension plans' weighted-average asset allocations at September 30, by asset category, are as follows:

	2009	2008
Domestic equities	40%	46%
International equities	12	19
Fixed income	23	9
Other	25	26
Total	100%	100%

Contributions

The Hospital expects to contribute approximately \$27,819,000 to its pension plans in 2010.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, are expected to be paid as follows (in thousands):

Fiscal Year	Pension Benefits
2010	\$ 17,672
2011	11,542
2012	13,160
2013	12,881
2014	14,866
Years 2015 – 2019	121,718

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Employees' Retirement Plans (continued)

Certain physicians, by virtue of their joint appointments at the Hospital and Harvard University, are eligible for participation in the Harvard Retirement Plan for Teaching Faculty (the Harvard Plan), a defined contribution plan, and do not participate in the Hospital's plans. The Hospital's pension expense related to the Harvard Plan was approximately \$3,217,000 and \$3,074,000 for the years ended September 30, 2009 and 2008, respectively.

13. Professional Liability

The Hospital's primary professional and general liability insurance coverage is provided by Controlled Risk Insurance Company, Ltd. (CRICO), a corporation formed and wholly owned by the Harvard-affiliated medical institutions. The Hospital owns approximately 10% of CRICO's stock. The premiums that the Hospital pays to CRICO are actuarially determined based on asserted claims, and reported but unasserted claims, and have been discounted at a rate of 5.5%. CRICO obtains excess coverage from other insurers.

The Hospital's professional liability insurance policy is on a claims-made basis. The Hospital accrues a liability for claims incurred but not reported. At September 30, 2009 and 2008, the liability was \$3,338,000 and \$3,044,000, respectively.

Professional liability insurance expenses, net of recoveries, are as follows for years ended September 30 (in thousands):

	<u>2009</u>	<u>2008</u>
Professional liability insurance premiums, net of recoveries	\$4,368	\$3,778
Increase in reserve for incurred but not reported professional liability claims	294	606
Total	<u>\$4,662</u>	<u>\$4,384</u>

14. Fair Value of Financial Instruments

As described in Note 1, on October 1, 2008, the Medical Center adopted the methods of calculating fair value defined in Topic 820 to value its financial assets and liabilities, where applicable. Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value. ASC Topic 820 applies to other accounting pronouncements that require or permit fair value measurements, and does not require new fair value measurements. Fair value measurements are applied based on the unit of account from the reporting entity's perspective.

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Fair Value of Financial Instruments (continued)

The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

Topic 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Medical Center uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, and considers non-performance risk in its assessment of fair value. Financial instruments carried at fair value as of September 30, 2009 are classified in the table below in one of the three categories described above (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 247,422	\$ —	\$ —	\$ 247,422
Commingled equity securities	—	324,466	—	324,466
Fixed income securities	—	240,160	—	240,160
Equity securities	212,207	—	—	212,207
Mutual funds	330,376	—	—	330,376
	<u>\$790,005</u>	<u>\$564,626</u>	<u>\$ —</u>	<u>\$1,354,631</u>
Liabilities				
Interest rate swap agreements	\$ —	\$ 88,642	\$ —	\$ 88,642

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Fair Value of Financial Instruments (continued)

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers.

The amounts reported in the table above exclude assets invested in the Hospital's defined benefit pension plan (Note 12) and alternative investments which are reported under the equity method of accounting.

The following methods and assumptions were used in estimating the fair value of financial instruments:

Accounts payable and accrued expenses: The carrying amount reported in the combined balance sheets for accounts payable and accrued expenses approximates its fair value.

Estimated third-party payor settlements: The carrying amount reported in the combined balance sheets for estimated third-party payor settlements approximates its fair value.

The Medical Center's long-term debt obligations are reported in the accompanying statements of financial position at principal value less unamortized discount or premium, which totaled approximately \$542,000,000 and \$543,000,000 at September 30, 2009 and 2008, respectively. The carrying value of these obligations approximated their fair value at September 30, 2009 and 2008.

15. Functional Expenses

The Medical Center is a multifaceted pediatric patient care provider dedicated to the improvement of the quality of life for children and their families. In its leadership role in pediatric medicine, the Medical Center focuses its efforts in three major areas: patient care, research, and medical education. Expenses related to providing these services are estimated for years ended September 30 as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Patient care	\$ 919,644	\$ 862,641
Research	297,636	268,338
Medical education	51,368	45,444
Total expenses	<u>\$1,268,648</u>	<u>\$1,176,423</u>

Children's Medical Center and Subsidiaries

Notes to Consolidated Financial Statements (continued)

16. Subsequent Events

On November 18, 2009, the Hospital issued Series M MHEFA Revenue Bonds in the aggregate principal amount of \$126,110,000. Proceeds of the bonds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures. The bonds, with a final maturity in December 2039, were issued at a net discount in the amount of \$1,780,287 to bear interest at yields which increase from 5.30% to 5.40% as maturities lengthen. Interest payments are due semiannually. The first annual principal payment is due in 2033.

The Medical Center is negotiating with a third party to acquire an interest in a portfolio of private equity fund limited partner interests owned by such third party. The interests to be acquired by the Medical Center would represent approximately \$100 million of capital commitments, of which approximately 90% are unfunded. No binding agreement has been reached with respect to the proposed transaction, and there is no assurance that a binding agreement will be executed by the parties. If the transaction is consummated as currently structured, the Medical Center would become liable for satisfying future capital calls with respect to the purchased portfolio of private equity interests over an expected time period of approximately three to nine years.

Section II – OMB Circular A-133
Audit of Federal Awards

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Children's Medical Center

We have audited the consolidated financial statements of Children's Medical Center (the Medical Center) as of and for the year ended September 30, 2009, and have issued our report thereon dated January 28, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Medical Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section, and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, Audit Committee, management, federal awarding agencies, and pass-through entities, and is not intended to be, and should not be, used by anyone other than these specified parties.

Ernst + Young LLP

January 28, 2010

Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

The Board of Trustees
Children's Medical Center

Compliance

We have audited the compliance of Children's Medical Center (the Medical Center) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*, that are applicable to each of its major federal programs for the year ended September 30, 2009. The Medical Center's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Medical Center's management. Our responsibility is to express an opinion on the Medical Center's compliance based on our audit.

The Medical Center's consolidated financial statements include the operations of Immune Disease Institute, Inc. (IDI), which received \$25,943,946 in federal awards from July 1, 2008 through June 30, 2009, which is not included in the schedule of expenditures of federal awards during the year ended September 30, 2009. Our audit, described below, did not include the operations of IDI because IDI engaged other auditors to perform an audit in accordance with OMB Circular A-133.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Medical Center's compliance with those requirements, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Medical Center's compliance with those requirements.

In our opinion, the Medical Center complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2009. However, the results of our auditing procedures disclosed instances of non-compliance with those requirements, which are required to be reported in accordance with OMB Circular A-133, and which are described in the accompanying schedule of findings and questioned costs as items 2009-1 and 2009-2.

Internal Control Over Compliance

The management of the Medical Center is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Medical Center's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect non-compliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that non-compliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section, and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Medical Center's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Medical Center's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and the use of the Board of Trustees, Audit Committee, management, federal awarding agencies, and pass-through entities, and is not intended to be, and should not be, used by anyone other than those specified parties.

Ernst & Young LLP

June 30, 2010

Children's Medical Center
Schedule of Expenditures of Federal Awards

For the year ended September 30, 2009

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures
MAJOR PROGRAM:		
<u>Research and Development</u>		
Direct Programs:		
Department of Health and Human Services/Public Health Service:		
Innovations in Applied Public Health Research	93.061	\$ 270,663
Centers for Genomics and Public Health	93.063	2,117
Food and Drug Administration Research	93.103	598,617
Maternal and Child Health Fed'l Consolidated Programs	93.110	1,313,270
Biological Response to Environmental Health Hazards	93.113	503,028
Oral Diseases and Disorders Research	93.121	1,264,307
Emergency Medical Services for Children	93.127	227,587
Human Genome Research	93.172	335,407
Nat'l Institute on Deafness & Other Comm. Disorders	93.173	423,108
National Research Service Awards	93.186	277,159
Research and Training in Alternative Medicine	93.213	284
National Research Service Awards Health Services Research Training	93.225	196,741
Research on Healthcare Costs, Quality and Outcomes	93.226	124,170
National Center on Sleep Disorders Research	93.233	87,918
Mental Health Research Grants	93.242	3,896,115
Substance Abuse and Mental Health Services-Projects of Regional and National Significance	93.243	1,040,304
Poison Control Stabilization and Enhancement Grants	93.253	601,385
Alcohol Research Career Development Awards for Scientists and Clinicians	93.271	123,830
Alcohol Research Programs	93.273	295,401
Drug Abuse Scientist Development Awards	93.277	99,939
Drug Abuse Research Programs	93.279	1,474,636
Mental Health Research Career/Scientist Dev. Awards	93.281	(5,682)
Centers for Disease Control and Prevention Investigations and Technical Assistance	93.283	561,593
Biomedical Imaging Research	93.286	582,768
Minority Health and Health Disparities Research	93.307	362,295
Trans-NIH Research Support	93.310	1,926,850
General Clinical Research Centers	93.333	2,657
Nursing Research	93.361	177,262
Research Infrastructure	93.389	335,240
Academic Research Enhancement Award	93.390	674,687
Cancer Cause and Prevention Research	93.393	495,683
Cancer Detection and Diagnosis Research	93.394	175,236
Cancer Treatment Research	93.395	853,353
Cancer Biology Research	93.396	4,884,677
Cancer Research Manpower	93.398	394,355
Cancer Control	93.399	27,788
Head Start	93.600	127,744
Developmental Disabilities University Affiliated Programs	93.632	451,253
ARRA - Trans-NIH Recovery Act Research Support	93.701	584,580
Heart and Vascular Diseases Research	93.837	7,642,024
Lung Diseases Research	93.838	3,694,828
Blood Diseases and Resources Research	93.839	10,869,386
Arthritis, Musculoskeletal and Skin Diseases Research	93.846	2,387,427
Diabetes, Endocrinology and Metabolism Research	93.847	6,623,660
Digestive Diseases and Nutrition Research	93.848	3,720,527
Kidney Diseases, Urology and Hematology Research	93.849	5,139,975
Clinical Research Related to Neurological Disorders	93.853	10,373,163
Biological Basis Research in the Neurosciences	93.854	224,155
Allergy, Immunology and Transplantation Research	93.855	13,396,185
Microbiology and Infectious Diseases Research	93.856	255,213
Biomedical Research and Research Training	93.859	2,568,657
Population Research	93.864	417,195
Research for Mothers and Children	93.865	9,182,729
Aging Research	93.866	57,296
Vision Research	93.867	3,655,537
Medical Library Assistance	93.879	1,319,660
Grants for Residency Training in General Internal Medicine and/or General Pediatrics	93.884	212,837
Specially Selected Health Projects	93.888	56,244
Senior International Fellowships	93.989	201,214
Adolescent Family Life - Demonstration Projects	93.995	466,074
DHHS/NIH Contracts	N/A	<u>3,777,280</u>
Total Department of Health and Human Services		112,009,592
Department of the Army:		
Military Medical Research and Development	12.420	2,239,877
Department of Energy:		
Office of Science Financial Assistance Program	81.049	201,723
Department of Education:		
National Institute on Disability & Rehabilitation Research	84.133	628,171
Research in Special Education	84.324	<u>3,712</u>
Total Department of Education		631,884

Children's Medical Center
Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures
Direct Programs (continued):		
U.S. Air Force:		
Air Force Defense Research Sciences Program	12.800	5,160
Total Direct Programs		<u><u>115,088,236</u></u>
Pass Through Programs (by Prime Recipient):		
America's Health Insurance Plans, Inc:		
Contracts	N/A	342,864
Baylor College of Medicine:		
Research Infrastructure	93.389	63,836
Beth Israel Deaconess Medical Center Inc.:		
National Center on Sleep Disorders Research	93.233	\$ (1,730)
Biomedical Imaging Research	93.286	68,114
ARRA - Trans-NIH Recovery Act Research Support	93.701	476
Cancer Detection and Diagnosis Research	93.394	7,140
Cancer Centers Support Grants	93.397	7,119
Blood Diseases and Resources Research	93.839	300,852
Arthritis, Musculoskeletal and Skin Diseases Research	93.846	315,175
Diabetes, Endocrinology and Metabolism Research	93.847	178,117
Allergy, Immunology and Transplantation Research	93.855	109,708
Microbiology and Infectious Diseases Research	93.856	<u>41,602</u>
Total Beth Israel Deaconess Medical Center Inc.		1,026,572
Boston Area Diabetes Endocrinology Research Center:		
Diabetes, Endocrinology and Metabolism Research	93.847	30,828
Boston Biomedical Research Institute:		
Child Health and Human Development Extramural Research	93.865	72,428
Boston Medical Center/BCH Healthy Start Initiative:		
Blood Diseases and Resources Research	93.839	67,413
Child Health and Human Development Extramural Research	93.865	28,290
Healthy Start Initiative	93.926	<u>98,095</u>
Total Boston Medical Center		193,798
Boston University/BU Medical :		
Oral Diseases and Disorders Research	93.121	(18,249)
Human Genome Research	93.172	39,302
Nat'l Institute on Deafness & Other Comm. Disorders	93.173	46,314
Heart and Vascular Diseases Research	93.837	98,885
Total Boston University	Contracts	<u>24,377</u>
Total Boston University		190,629
Brigham & Women's Hospital:		
Maternal and Child Health Fed'l Consolidated Programs	93.110	1,396
Heart and Vascular Diseases Research	93.113	143,283
Biometry and Risk Estimation-Health Risks from Environmental Exposures	93.115	96,441
Oral Diseases and Disorders Research	93.121	64,049
Human Genome Research	93.172	38,433
Mental Health Research Grants	93.242	4,428
Drug Abuse Research Programs	93.279	56,460
Trans-NIH Research Support	93.310	55,619
Research Infrastructure	93.389	21,821
Cancer Detection and Diagnosis Research	93.394	30,224
Cancer Biology Research	93.396	21,768
Cancer Centers Support Grants	93.397	218,616
ARRA - Trans-NIH Recovery Act Research Support	93.701	8,649
Heart and Vascular Diseases Research	93.837	7,411
Lung Diseases Research	93.838	236,122
Blood Disease and Resources Research	93.839	72,438
Arthritis, Musculoskeletal and Skin Diseases Research	93.846	31,206
Digestive Diseases and Nutrition Research	93.848	122,463
Kidney Diseases, Urology and Hematology Research	93.849	274,880
Allergy, Immunology and Transplantation Research	93.855	267,004
Biomedical Research and Research Training	93.859	133,858
Child Health and Human Development Extramural Research	93.865	68,643
Medical Library Assistance	93.879	<u>142,079</u>
Total Brigham & Women's Hospital		2,117,291
Brown University	Contracts	13,900
Cambodian Health Committee:		
Allergy, Immunology and Transplantation Research	93.855	7,251
CAS Medical Systems, Inc.:		
Clinical Research Related to Neurological Disorders	93.853	177,698
Case Western Reserve University:		
National Center on Sleep Disorders Research	93.233	65,704
Center for Biomedical Informatics:		
Medical Library Assistance	93.879	44,719

Children's Medical Center
Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures	
Pass Through Programs (by Prime Recipient) (continued):			
Center for Integration of Medicine and Innovative Technology:			
Military Medical Research and Development	12.420	\$ 27,863	
	Contracts	<u>233,762</u>	
Total Center for Integration of Medicine and Innovative Technology			261,625
Children's Hospital - Philadelphia:			
National Center on Sleep Disorders Research	93.233		18,051
Children's Hospital - Pittsburgh:			
Digestive Diseases and Nutrition Research	93.848	14,004	
Allergy, Immunology and Transplantation Research	93.855	<u>266,743</u>	
Total Children's Hospital - Pittsburgh			280,747
Children's Mercy Hospital:			
Kidney Diseases, Urology and Hematology Research	93.849		56,911
Children's Research Institute:			
Emergency Medical Services for Children	93.127	95,274	
Heart and Vascular Diseases Research	93.837	40,064	
Child Health and Human Development Extramural Research	93.865	<u>144,335</u>	
Total Children's Research Institute			279,673
Dana-Farber Cancer Institute:			
Cancer Treatment Research	93.395	1,000,847	
Cancer Biology Research	93.396	(4,935)	
Cancer Centers Support Grants	93.397	146,169	
Cancer Research Manpower	93.398	26,278	
Heart and Vascular Diseases Research	93.837	172,519	
Blood Diseases and Resources Research	93.839	60,242	
Clinical Research Related to Neurological Disorders	93.853	64,572	
Microbiology and Infectious Diseases Research	93.856	14,830	
Child Health and Human Development Extramural Research	93.865	250,854	
	Contracts	<u>137,563</u>	
Total Dana-Farber Cancer Institute			1,868,940
Dimock Community Health Center:			
HIV Demon. Prog. for Children, Adolescents & Women	93.153		132,013
Duke University:			
Allergy, Immunology and Transplantation Research	93.855		540,969
Educational Development Center, Inc:			
Nursing Research	93.361	50,043	
Lung Diseases Research	93.838	<u>43,565</u>	
Total Educational Development Center, Inc			93,608
Emmes Corporation:			
Allergy, Immunology and Transplantation Research	93.855		(5,417)
Emory University:			
Vision Research	93.867		40,275
Enson, Inc.:			
Heart and Vascular Diseases Research	93.837		28,747
Harvard Medical School:			
Biomedical Imaging Research	93.286	40,382	
Research Infrastructure	93.389	3,093,313	
ARRA - Trans-NIH Recovery Act Research Support	93.701	2,461	
Heart and Vascular Diseases Research	93.837	80,587	
Blood Diseases and Resources Research	93.839	94,063	
Clinical Research Related to Neurological Disorders	93.853	(1,794)	
Allergy, Immunology and Transplantation Research	93.855	377,427	
Microbiology and Infectious Diseases Research	93.856	101,533	
Biomedical Research and Research Training	93.859	<u>44,065</u>	
Total Harvard Medical School			3,832,036
Harvard Pilgrim Health Care:			
Innovations in Applied Public Health Research	93.061	557,755	
Heart and Vascular Diseases Research	93.113	59,274	
Allergy, Immunology and Transplantation Research	93.855	<u>25,863</u>	
Total Harvard Pilgrim Health Care			642,892
Harvard School of Dental Medicine:			
Arthritis, Musculoskeletal & Skin Diseases Research	93.846		42,756

Children's Medical Center

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures	
Pass Through Programs (by Prime Recipient) (continued):			
Harvard School of Public Health:			
Heart and Vascular Diseases Research	93.113	\$ 93,195	
Mental Health Research Grants	93.242	3,233	
Mental Health National Research Service Awards for Research Training	93.282	53,670	
Cancer Cause and Prevention Research	93.393	52,838	
Cancer Biology Research	93.396	(5,318)	
Cancer Research Manpower	93.398	15,025	
Lung Diseases Research	93.838	208,627	
Child Health and Human Development Extramural Research	93.865	<u>588,543</u>	
Total Harvard School of Public Health			1,009,812
Harvard University:			
Mathematical and Physical Sciences	47.049	(18,807)	
Heart and Vascular Diseases Research	93.113	219,924	
Senior International Fellowships	93.989	<u>11,997</u>	
Total Harvard University			213,114
Hospital for Sick Children:			
Diabetes, Endocrinology and Metabolism Research	93.847	165,055	
Child Health and Human Development Extramural Research	93.865	<u>(59,493)</u>	
Total Hospital for Sick Children			105,562
Immunodeficiency Research Consortium Inc.	Contracts		144
Indiana University:			
Arthritis, Musculoskeletal and Skin Diseases Research	93.846	69,350	
Clinical Research Related to Neurological Disorders	93.853	58,280	
	Contracts	<u>356,913</u>	
Total Indiana University			484,543
Infoscitex:			
Military Medical Research and Development	12.420	111,422	
Heart and Vascular Diseases Research	93.113	175,468	
Child Health and Human Development Extramural Research	93.865	<u>249,195</u>	
Total Infoscitex			536,084
Johns Hopkins University/School of Medicine:			
Lung Diseases Research	93.838	13,365	
Digestive Diseases and Nutrition Research	93.848	12,987	
Allergy, Immunology and Transplantation Research	93.855	<u>29,725</u>	
Total Johns Hopkins University/School of Medicine			56,077
Joslin Diabetes Center:			
Diabetes, Endocrinology and Metabolism Research	93.847		65,529
Latino Health Institute:			
University Centers for Excellence in Developmental Disabilities Education, Research, and Service	93.632		75,801
Magnascensors, Inc.:			
Allergy, Immunology and Transplantation Research	93.855		(18,031)
Massachusetts Eye & Ear Infirmary:			
Vision Research	93.867		14,625
Massachusetts General Hospital:			
Military Medical Research and Development	12.420	29,305	
Heart and Vascular Diseases Research	93.837	28,976	
Digestive Diseases and Nutrition Research	93.848	28,262	
Clinical Research Related to Neurological Disorders	93.853	(9,399)	
Allergy, Immunology and Transplantation Research	93.855	(187,986)	
Child Health and Human Development Extramural Research	93.865	<u>279,676</u>	
Total Massachusetts General Hospital			168,834
Massachusetts Institute of Technology:			
Cancer Control	93.399	123,974	
Heart and Vascular Diseases Research	93.837	260,376	
Medical Library Assistance	93.879	<u>49,217</u>	
Total Massachusetts Institute of Technology			433,567
Mayo Clinic:			
Mental Health Research Grants	93.242		20,589
Michigan State University:			
Microbiology and Infectious Diseases Research	93.856		61,523
Mt. Sinai School of Medicine:			
Allergy, Immunology and Transplantation Research	93.855		18,631
National Childhood Cancer Foundation:			
Cancer Treatment Research	93.395		87,857
National Jewish Medical and Research Center	Contracts		226,608
Neighborhood Health Plan:			
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		2,405

Children's Medical Center

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures	
Pass Through Programs (by Prime Recipient) (continued):			
New England Genetics and Newborn Screening: Maternal and Child Health Fed'l Consolidated Programs	93.110		(1,991)
New England Research Institutes, Inc.:			
Heart and Vascular Diseases Research	93.837	\$ 534,697	
Blood Diseases and Resources Research	93.839	<u>47,981</u>	
Total New England Research Institutes, Inc.			582,678
PPD Development, LP	Contracts		26
Rand Corporation:			
Research on Healthcare Costs, Quality and Outcomes	93.226	63,322	
Minority Health and Health Disparities Research	93.307	(56,050)	
Kidney Diseases, Urology and Hematology Research	93.849	<u>23,219</u>	
Total Rand Corporation			30,492
Research Foundation of State University of New York:			
Heart and Vascular Diseases Research	93.837	211	
Kidney Diseases, Urology and Hematology Research	93.849	<u>41,246</u>	
Total Research Foundation of State University of New York			41,457
Rho Federal Systems Division, Inc.:			
Heart and Vascular Diseases Research	93.837	1,097	
Blood Diseases and Resources Research	93.839	<u>12,063</u>	
Total Rho Federal Systems Division, Inc.			13,159
Rhode Island Hospital:			
Arthritis, Musculoskeletal and Skin Diseases Research	93.846		21,801
Seattle Children's Hospital:			
Arthritis, Musculoskeletal and Skin Diseases Research	93.846		36,931
St. Elizabeth's Hospital	Contracts		(105,449)
St. Jude Children's Research Hospital:			
Cancer Treatment Research	93.395	229,915	
Blood Diseases and Resources Research	93.839	<u>61,896</u>	
Total St. Jude Children's Research Hospital			291,811
Stowers Institute for Medical Research:			
Biomedical Research and Research Training	93.859		15,724
Texas Tech University:			
Allergy, Immunology and Transplantation Research	93.855		4,506
The Regents of the Univ. of California:			
Injury Prevention and Control Research and State and Community Based Programs	93.136		1,016
The Schepens Eye Research Institute:			
Research Infrastructure	93.389		78,728
Thomas Jefferson University:			
Blood Diseases and Resources Research	93.839		67,793
TKC Integration Services	Contracts		147,426
Tufts University:			
Oral Diseases and Disorders Research	93.121		50,834
University of Alabama:			
Military Medical Research and Development	12.420		112,626
University of California, San Diego:			
Heart and Vascular Diseases Research	93.837		207
University of California, San Francisco:			
Clinical Research Related to Neurological Disorders	93.853	(8,421)	
	Contracts	<u>38,125</u>	
Total Univ. of California, San Francisco			29,704
University of California, Los Angeles:			
Centers for Disease Control and Prevention Investigations and Technical Assistance	93.283	486,773	
Allergy, Immunology and Transplantation Research	93.855	<u>(23,960)</u>	
Total Univ. of California, Los Angeles			462,813
University of Florida:			
Heart and Vascular Diseases Research	93.837		65,653

Children's Medical Center

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures	
Pass Through Programs (by Prime Recipient) (continued):			
University of Iowa:			
Heart and Vascular Diseases Research	93.837	\$ 11,499	
Arthritis, Musculoskeletal and Skin Diseases Research	93.846	10,659	
	Contracts	<u>250,849</u>	
Total University of Iowa			273,007
University of Kentucky Research Foundation:			
Allergy, Immunology and Transplantation Research	93.855		195,332
University of Massachusetts Worcester/Amherst/Boston:			
Maternal and Child Health Fed'l Consolidated Programs	93.110	50,000	
Minority Health and Health Disparities Research	93.307	21,103	
Centers for Disease Control and Prevention Investigations and Technical Assistance	93.283	13,784	
AIDS Education and Training Centers	93.145	24,860	
Cancer Biology Research	93.396	72,735	
Allergy, Immunology and Transplantation Research	93.855	58,391	
Child Health and Human Development Extramural Research	93.865	<u>24,488</u>	
Total Univ. of Massachusetts, Worcester			265,362
University of Medicine & Dentistry of New Jersey:			
Allergy, Immunology and Transplantation Research	93.855		12,402
University of Miami:			
Heart and Vascular Diseases Research	93.837		65,886
University of Michigan:			
Biological Response to Environmental Health Hazards	93.113	122,114	
Blood Diseases and Resources Research	93.839	<u>117,322</u>	
Total University of Michigan			239,436
University of Minnesota:			
Mental Health Research Grants	93.242	23,560	
Allergy, Immunology and Transplantation Research	93.855	116,426	
Child Health and Human Development Extramural Research	93.865	<u>19,277</u>	
Total University of Minnesota			159,263
University of New Hampshire:			
Maternal and Child Health Fed'l Consolidated Programs	93.110		5,639
University of North Carolina:			
Allergy, Immunology and Transplantation Research	93.855		7,873
University of Pennsylvania:			
Kidney Diseases, Urology and Hematology Research	93.849	193,038	
Allergy, Immunology and Transplantation Research	93.855	<u>58,439</u>	
Total University of Pennsylvania			251,477
University of Pittsburgh:			
Mental Health Research Grants	93.242	302,338	
Heart and Vascular Diseases Research	93.837	368,084	
	Contracts	<u>41,532</u>	
Total University of Pittsburgh			711,954
University of Texas Health Science Center:			
Vision Research	93.867		10,698
University of Texas Southwestern Medical Center:			
Emergency Medical Services for Children	93.127	5,596	
Digestive Diseases and Nutrition Research	93.848	<u>(1,678)</u>	
Total University of Texas Southwestern Medical Center			3,918
University of Texas MD Anderson Cancer Center:			
Cancer Biology Research	93.396		7,569
University of Wisconsin:			
Kidney Diseases, Urology and Hematology Research	93.849		51,711
US Immunodeficiency Network	Contracts		(16,848)
Washington University:			
Lung Diseases Research	93.838		23,345
Wayne State University:			
Biometry and Risk Estimation-Health Risks from Environmental Exposures	93.115		(2,648)
Westat, Inc	Contracts		1,170,940
Whitehead Institute for Biomedical Research:			
Cancer Biology Research	93.396		6,411
Wildlife Conservation Society	Contracts		9

Children's Medical Center

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Federal Expenditures
Yale University:		
Child Health and Human Development Extramural Research	93.865	216,287
Total Pass Through Programs:		<u>21,631,587</u>
Total Federal Research and Development Expenditures		<u>136,719,823</u>
OTHER PROGRAMS		
Pass Through Programs (by Prime Recipient):		
Action for Boston Community Development:		
Family Planning Services	93.217	\$ 57,893
Head Start	93.600	<u>98,562</u>
Total Action for Boston Community Development		156,454
Boston Public Health Commission:		
Rehabilitation Services/Vocational Rehabilitation Grants to States	84.126	36,419
Biometry and Risk Estimation-Health Risks from Environmental Exposures	93.915	<u>110,630</u>
Total Boston Public Health Commission		147,049
Commonwealth of Massachusetts, Commission for the Deaf:		
Assistive Technology	84.224	(216)
Commonwealth of Massachusetts, Dept. of Public Health:		
AIDS Activity	93.118	161,513
HIV Dem. Prog. for Children, Adolescents & Women	93.153	14,648
National Bioterrorism Hospital Preparedness Program	93.889	66,072
Maternal and Child Health Services Block Grant to States	93.994	<u>96,809</u>
Total Massachusetts Dept. of Public Health		339,042
Commonwealth of Massachusetts, Dept. of Social Services:		
Children's Justice Grants to States	93.643	66,143
Commonwealth of Massachusetts, Poison Control:		
Maternal and Child Health Services Block Grant to States	93.994	462,259
Commonwealth of Massachusetts, Office for Victim Assistance:		
Crime Victim Assistance	16.575	108,132
Commonwealth of Massachusetts, Rehabilitation Commission:		
Rehabilitation Services/Vocational Rehabilitation Grants to States	84.126	(154,331)
Rhode Island Department of Health:		
Medical Assistance Program (Medicaid; Title XIX)	93.778	167,153
Total Other Program Expenditures		<u>1,291,685</u>
TOTAL FEDERAL EXPENDITURES		<u>\$ 138,011,508</u>

See accompanying notes.

Children's Medical Center

Notes to Schedule of Expenditures of Federal Awards

Year Ended September 30, 2009

1. Basis of Accounting

The schedule of expenditures of federal awards for the year ended September 30, 2009 is prepared on the accrual basis of accounting. Consequently, expenditures are recognized when the obligation is incurred.

The schedule of expenditures of federal awards for the year ended September 30, 2009 reflects the integration of the Immune Disease Institute, Inc. (IDI), which became a wholly owned subsidiary of the Medical Center in February 2009 in a business combination that was accounted for under the pooling of interests method. The schedule of expenditures of federal awards includes the expenditures of federal awards for IDI from July 1, 2009 through September 30, 2009. Any awards between Children's Hospital, a Medical Center subsidiary, and the IDI containing expenditures during 2009 have been eliminated at the sub recipient level and the expenditures are only shown as direct awards.

2. Categorization of Expenditures

The categorization of expenditures by program included in the schedule of expenditures of federal awards is based upon the grant documents. Changes in the categorization of expenditures occur based upon revisions to the Catalog of Federal Domestic Assistance (CFDA), which are issued in June and December of each year. The schedule of expenditures of federal awards for the year ended September 30, 2009 reflects CFDA changes issued through December 2009.

3. Subrecipients

Certain funds are passed through to subgrantee organizations by the Medical Center. Of the federal expenditures presented in the schedule, the Medical Center provided \$14,401,404 of federal awards to subrecipients in the Research and Development Program as follows:

Anylam Pharmaceuticals	\$ 26,344
Baylor College of Medicine	172,745
Benaroya Research Institute at Virginia Mason	142,585
Beth Israel Deaconess Medical Center	923,276
Boston Medical Center	710,460
Boston Public Health Commission	30,119
Boston University	251,372
Brigham & Women's Hospital	2,495,304
Broad Institute	213,464
Cambridge Health Alliance	67,687
Capital Region Family Health Center	19,118

Children's Medical Center

Notes to Schedule of Expenditures of Federal Awards (continued)

3. Subrecipients (continued)

Cepros, O.P.S.	\$ 154,346
Children's Hospital Anesthesia Foundation	58,500
Children's Healthcare of Atlanta	35,221
Children's Hospitals and Clinics of Minnesota	500
Children's Hospital Oakland	26,500
Children's Hospital of Philadelphia	97,319
Children's Hospital and Regional Medical Center	28,369
Cincinnati Children's Hospital Medical Center	30,000
Clemson University	90,293
Connecticut Children's Medical Center	14,500
Creighton University	3,754
Dana-Farber Cancer Institute	702,136
Dartmouth College	826,027
Dell Children's Medical Center	500
Dominican University of California	8,176
East Carolina University	13,344
Emory University	30,098
Fallon Clinic Inc.	44,270
Families First Parenting Program	10,000
Harvard Medical School	904,900
Harvard School of Public Health	151,502
Harvard University	635,791
Helmholtz Zentrum Munchen	88,118
IHC Health Services, Inc.	18,438
International Computer Science Institute	166,238
Joslin Diabetes Center	9,286
LaJolla Institute for Allergy & Immunology	107,948
Louisiana State University	5,430
Loyola University of Chicago	61,317
Massachusetts General Hospital	565,218
Massachusetts Institute of Technology	115,743
Medical College of Wisconsin	8,500
Miami Children's Hospital Research Institute	500
Montefiore Medical Center	6,500
National Jewish Medical and Research Center	98,233
Nationwide Children's Hospital	10,500
Pacer Center	38,977
Pennsylvania State University	10,500
Philips Medical Systems	133,546
Rand Corporation	901,856

Children's Medical Center

Notes to Schedule of Expenditures of Federal Awards (continued)

3. Subrecipients (continued)

Regents of University of California	\$ 59,700
Rhode Island Hospital	174,048
Royal Victorian Eye and Ear Hospital	26,000
Stanford University	4,517
St. George's University of London	117,169
The Children's Hospital Association – Colorado	10,500
The Jackson Laboratory	229,055
The Regents of the University of Minnesota	202,766
The Scripps Research Institute	63,372
Third Sector New England	49,553
Trustees of Dartmouth College	500
Tufts New England Medical Center	4,655
Tufts University	2,288
Tulane University	78,936
University of Alabama	10,676
University of California	70,292
University of California Los Angeles	37,423
University of California Regents – San Francisco	83,996
University of Chicago	31,134
University of Florida	28,456
University of Illinois	43,784
University of Iowa	14,873
University of Maryland	75,397
University of Massachusetts	742,356
University of Massachusetts Medical School	225
University of Miami	4,500
University of Michigan	28,169
University of Montreal	19,500
University of Nebraska Medical Center	6,500
University of Southern California	5,905
University of Utah	500
University of Vermont	10,190
University of Virginia Health System	15,000
University of Western Australia	28,037
Vanderbilt University Medical Center	8,099
Wake Forest University	111,213
Whitehead Institute	496,188
Yale University	240,564
Grand Total	\$14,401,404

Children's Medical Center

Schedule of Findings and Questioned Costs

Year Ended September 30, 2009

Part I – Summary of Auditors' Results

Financial Statement Section

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? _____ Yes X No

Significant deficiency(ies) identified that are not considered to be material weaknesses? _____ Yes X None Reported

Non-compliance material to financial statements noted? _____ Yes X No

Federal Awards Section

Internal control over major programs:

Material weakness(es) identified? _____ Yes X No

Significant deficiency(ies) identified that are not considered to be material weakness(es)? _____ Yes X None Reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133? X Yes ___ No

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part I – Summary of Auditors' Results (continued)

Federal Awards Section (continued)

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
Various	Research and Development

Dollar threshold used to distinguish between
Type A and Type B programs: \$3,000,000

Auditee qualified as low-risk auditee? X Yes No

Part II – Schedule of Financial Statement Findings

There were no significant deficiencies, material weaknesses, or instances of non-compliance related to the financial statements.

Children’s Medical Center

Schedule of Findings and Questioned Costs (continued)

Part III – Schedule of Federal Award Findings and Questioned Costs

<u>Finding 2009-01</u>	<u>Allowable Costs</u>
CFDA No. 93.113 CFDA No. 93.118 CFDA No. 93.243	Environmental Health Acquired Immunodeficiency Syndrome (AIDS) Activity Substance Abuse and Mental Health Services_ Projects of Regional and National Significance
CFDA No. 93.839 CFDA No. 93.847	Blood Diseases and Resources Research Diabetes, Digestive, and Kidney Diseases Extramural Research
Criteria or Specific Requirement	Department of Health and Human Services Appendix E of Title 45 Code of Federal Regulations, Part 74 Section IX A Paragraph 7c states, “Charges for salaries and wages of individuals other than members of the professional staff will be supported by daily time and attendance and payroll distribution records. For members of the professional staff, current and reasonable estimates of the percentage distribution of their total effort may be used as support in the absence of actual time records. In order to qualify as current and reasonable, estimates must be made no later than one month after the month in which the services were performed.”
Condition	Of 68 effort reports tested, 8 were not signed and dated within one month of the actual activity. However, all effort reports selected for testing were ultimately signed.
Questioned Costs	None. All the time and effort reports were ultimately signed.

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part III – Schedule of Federal Award Findings and Questioned Costs (continued)

<u>Finding 2009-01</u>	<u>Allowable Costs</u>
Cause	While the Medical Center has implemented a process to continually monitor the timeliness of effort reporting, there still remains an opportunity to further improve compliance.
Effect	Untimely effort reporting increases the likelihood of inaccuracies in reporting actual effort.
Recommendation	We recommend the Medical Center continue to focus on monitoring of effort reporting compliance and reinforce the need to submit all required time and effort reports timely.
Views of Responsible Officials and Planned Corrective Actions	During 2009, we have provided additional training to department staff and PIs on the principles of effort reporting. We will continue to focus on this area, and will continue to provide lists of late or outstanding reports to the department administrator and the Dept/Div Chief.

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part III – Schedule of Federal Award Findings and Questioned Costs (continued)

<u>Finding 2009-02</u>	<u>Allowable Costs</u>
CFDA No. 93.242 CFDA No. 93.243 CFDA No. 93.632	Mental Health Research Grants Substance Abuse and Mental Health Services, Projects of Regional and National Significance University Centers for Excellence in Developmental Disabilities Education, Research, and Service
Criteria or Specific Requirement	Each year, Congress legislatively mandates a provision limiting the direct salary that an individual may receive under an NIH grant. For FY 2009, Public Law 111-8: <i>Omnibus Appropriations Act, 2009</i> restricts the amount of direct salary to Executive Level I of the Federal Executive Pay scale. Effective January 1, 2009, the Executive Level I salary level was \$196,700.
Condition	Of the 33 salaries tested that were applied to NIH grants, one individual's salary exceeded the Executive Level I annual salary rate of \$196,700 by \$5,500.
Questioned Costs	Approximately \$5,500.
Cause	The salary for one individual was not limited to Executive Level I annual salary rate prior to allocating the costs to research grants.
Effect	Salary costs applied to NIH grants were higher than the amount allowed.
Recommendation	We recommend the Medical Center implement a control in order to monitor and review the actual salaries allocated to NIH grants on a timely basis.

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part III – Schedule of Federal Award Findings and Questioned Costs (continued)

Finding 2009-02

Allowable Costs

Views of Responsible Officials and
Planned Corrective Actions

We have investigated the circumstances surrounding the instance noted above and have determined that it was the result of an honest calculation error. The department administrator who made the error had thorough knowledge and understanding of the federal salary cap restriction and how it is implemented. As an additional control, we will review the actual salaries allocated to federal grants, on a quarterly basis.

Children’s Medical Center

Schedule of Findings and Questioned Costs (continued)

Part IV – Schedule of Prior Audit Findings

<u>Finding 2008-01</u>	<u>Allowable Costs</u>
CFDA No. 93.225	National Research Service Awards – Health Services Research Training
CFDA No. 93.283	Center for Disease Control and Prevention Investigations and Technical Assistance
CFDA No. 93.839	Blood Diseases and Resources Research
CFDA No. 93.847	Diabetes, Digestive, and Kidney Diseases Extramural Research
CFDA No. 93.849	Kidney Diseases, Urology, and Hematology Research
CFDA No. 93.855	Allergy, Immunology, and Transplantation Research
CFDA No. 93.865	Child Health and Human Development Extramural Research
Criteria or Specific Requirement	Department of Health and Human Services Appendix E of Title 45 Code of Federal Regulations, Part 74 Section IX A Paragraph 7c states, “Charges for salaries and wages of individuals other than members of the professional staff will be supported by daily time and attendance and payroll distribution records. For members of the professional staff, current and reasonable estimates of the percentage distribution of their total effort may be used as support in the absence of actual time records. In order to qualify as current and reasonable, estimates must be made no later than one month after the month in which the services were performed.”
Condition	Of 77 effort reports tested, 6 were not signed and dated within one month of the actual activity. However, all effort reports selected for testing were ultimately signed.
Questioned Costs	None. All the time and effort reports were ultimately signed.

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part IV – Schedule of Prior Audit Findings (continued)

<u>Finding 2008-01</u>	<u>Allowable Costs</u>
Cause	During the period under audit, internal monitoring of the timeliness and completion of effort reporting improved significantly from the prior year. However, there remains an opportunity to further improve compliance.
Effect	Untimely effort reporting increases the likelihood of inaccuracies in reporting actual effort.
Recommendation	We recommend the Hospital continue to focus on monitoring of effort reporting compliance and reinforce the need to submit all required time and effort reports timely.
Views of Responsible Officials and Planned Corrective Actions	During 2008, the significant drop in untimely submission of effort certifications forms is a direct result of the new compliance coordinator's efforts to train department staff and continually monitor the process. We will continue to focus on this area, and are in the process of developing additional training for PIs and administrators on the principles of effort reporting.

Children’s Medical Center

Schedule of Findings and Questioned Costs (continued)

Part IV – Schedule of Prior Audit Findings (continued)

<u>Finding 2008-02</u>	<u>Allowable Costs</u>
CFDA No. 93.853	Extramural Research Programs in the Neurosciences and Neurological Disorders
Criteria or Specific Requirement	Department of Health and Human Services Appendix E of Title 45 Code of Federal Regulations, Part 74 Section IX A Paragraph 7d states, “estimates of effort spent by a member of the professional staff on each research agreement should be prepared by the individual who performed the services or by a responsible individual such as a department head or supervisor having first-hand knowledge of the services performed on each research agreement.”
Condition	Of 77 effort reports tested, 1 was not signed by either the individual who performed the services, or by someone with first-hand knowledge of the actual effort spent on the grant.
Questioned Costs	None. The individual who performed the services eventually signed the time and effort report after notification of non-compliance. In addition, we verified that the costs related to the time and effort report were appropriately allocated to the grant.
Cause	Management should reinforce the need for individuals with first-hand knowledge to sign effort reports.
Effect	Signing of time and effort reports by personnel who do not have first-hand knowledge of the effort performed increases the likelihood of inaccuracies in reporting actual effort.

Children's Medical Center

Schedule of Findings and Questioned Costs (continued)

Part IV – Schedule of Prior Audit Findings (continued)

<u>Finding 2008-02</u>	<u>Allowable Costs</u>
Recommendation	We recommend the Hospital continue to improve its monitoring of effort reporting to ensure that only those personnel with first-hand knowledge of the researcher's effort are signing effort reports.
Views of Responsible Officials and Planned Corrective Actions	We will continue to monitor for errors such as this one, and will strive to increase compliance from 99% to 100%.