

This Document is Dated as of October 30, 2009.

SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS:

Certain of the discussions included in the Management Report section of the following document may include certain “forward-looking statements” which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. Actual actions or results may differ materially from those discussed below. Specific factors that might cause such differences include competition from other healthcare facilities in the service areas of Good Shepherd’s facilities, federal and state regulation of healthcare providers, and reimbursement policies of the state and federal governments and managed care organizations. In particular, statements preceded by, followed by or that include the words “believes,” “estimates,” “expects,” “anticipates,” “plans,” “intends,” “scheduled,” or other similar expressions are or may constitute forward-looking statements.

Annual Report

Concerning

**Good Shepherd Rehabilitation Network
And Controlled Entities**

The information in this report
has been provided by

Good Shepherd Rehabilitation Network
and Controlled Entities

**Good Shepherd Rehabilitation Network
And Controlled Entities
Reporting Package**

**As of and for the Twelve Month Periods Ended
June 30, 2009 and 2008**

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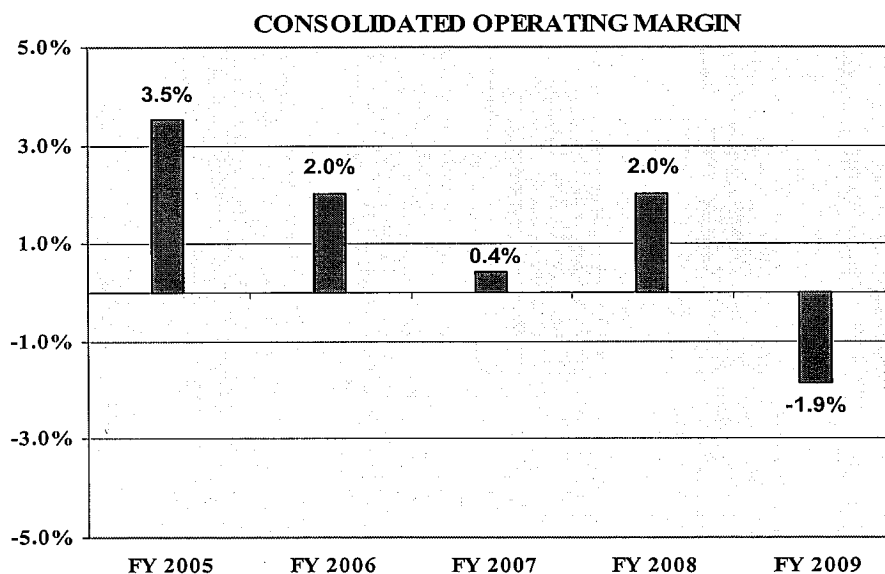
Good Shepherd Rehabilitation Network and Controlled Entities
Management Discussion and Analysis
As of and for the Twelve Month Periods Ended June 30, 2009 and 2008

Introduction

***SPECIAL NOTE CONCERNING FORWARD-LOOKING STATEMENTS:** Certain of the discussions included in the Management Report section of the following document may include certain “forward-looking statements” which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. Actual actions or results may differ materially from those discussed below. Specific factors that might cause such differences include competition from other healthcare facilities in the service areas of Good Shepherd’s facilities, federal and state regulation of healthcare providers, and reimbursement policies of the state and federal governments and managed care organizations. In particular, statements preceded by, followed by or that include the words “believes,” “estimates,” “expects,” “anticipates,” “plans,” “intends,” “scheduled” or other similar expressions are or may constitute forward-looking statements.*

This Management Discussion and Analysis compares financial and volume data on a fiscal year basis for Good Shepherd Rehabilitation Network and Controlled Entities (Good Shepherd). Certain matters are discussed and graphically presented in order to highlight trends occurring during the past five fiscal years.

For the twelve-month period ended June 30, 2009, Good Shepherd’s operating margin loss was (\$1,967,000) or (1.9%), compared to an operating margin of \$2,057,000 or 2.0% during the preceding fiscal year.

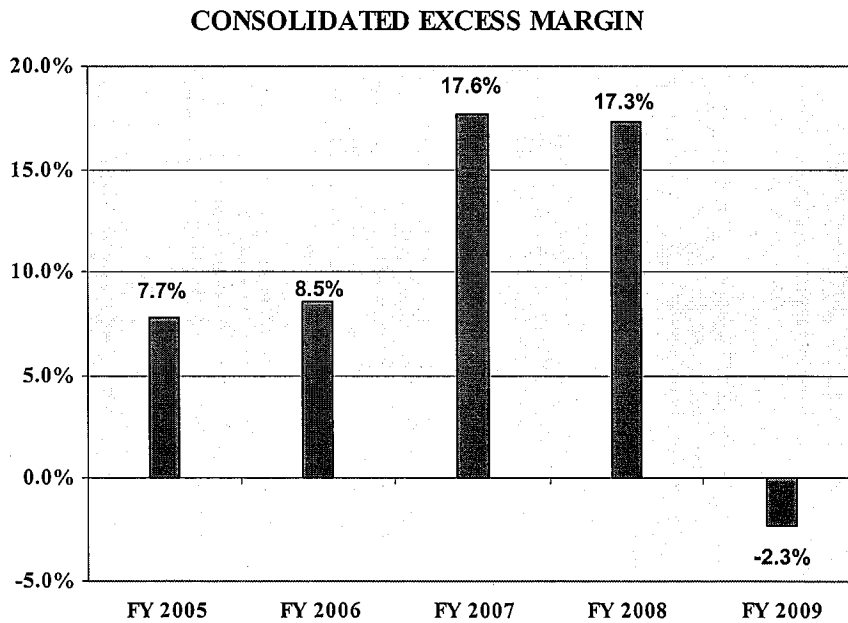


The fiscal year ended June 30, 2009 was a very financially challenging year for Good Shepherd Rehabilitation Network. The audited results show an operating loss of \$1.97 million (negative 1.9% margin) compared to a \$2.1 million profit (2.0% margin) in the fiscal year ended June 30, 2008. This is the first loss experienced by Good Shepherd since 2002. The operating loss includes a first-year start-up loss at Good Shepherd Penn Partners of \$1.0 million. This represents Good Shepherd’s 70% stake in the joint venture with The University of Pennsylvania

Health System. Looking at performance from a cash flow perspective, cash flow from operations (defined as earnings before interest, depreciation and amortization (EBIDA)) still produced an 11% cash flow which was similar to last year.

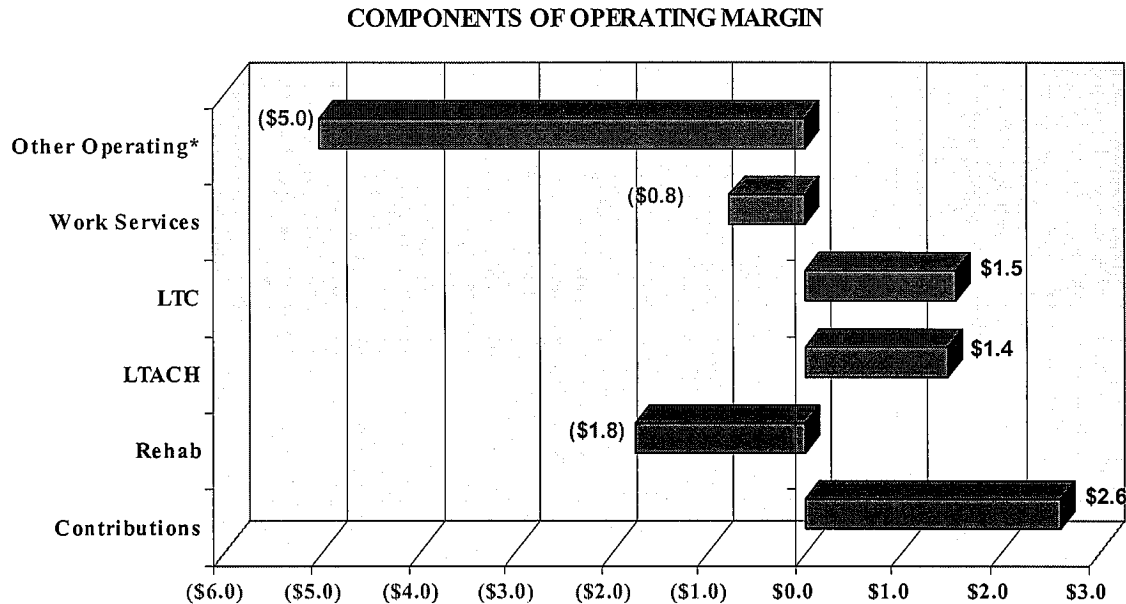
In terms of patient utilization, there was a growth in inpatient business for both the Rehab Hospital and the LTCH. The Rehab Hospital experienced an 11% admissions growth from prior year and the LTCH had a 2% growth. The outpatient business experienced same store growth and start-up growth at two new sites during the year achieving 204,000 outpatient visits in fiscal year 2009. The Long Term care division remained at near full capacity at both locations. Work Services was impacted by the downturn in the economy and did experience less business volume than prior year.

As a result of the significant capital market and liquidity issues in the marketplace, investment income declined compared to the previous fiscal year. Specifically, for the twelve-month periods ended June 30, 2009 and 2008, investment income was \$706,000, and \$21,385,000, respectively. Additionally related to the economy and impacting the P&L was a \$1.1 million charge taken for the decrease in the value of the two swaps that were put in place for the two variable rate bonds. The charge relates to a significant difference in the anticipated interest rate environment comparing the swap dates to the current market conditions. This investment performance decline, coupled with Good Shepherd's decline in operating margin performance, yielded a decline in Revenue in Excess of Expenses of approximately \$24 million between periods. Therefore excess margin percentages have declined significantly, as illustrated on an annual basis below.



Statement of Operations

The components of Good Shepherd's operating margin, for the twelve-month period ended June 30, 2009, are delineated within the following summary:



*Other Operating includes Corporate, Institutional Advancement, and the Loss from Unconsolidated Affiliate

Net Patient Service Revenue increased between twelve-month periods by \$2,258,000 or 2.5% as the Rehabilitation Hospital posted a Net Patient Service Revenue growth of \$3.9 million, offset by a (\$951,000) Net Patient Service Revenue decline at the Specialty Hospital and a (\$727,000) Net Patient Service Revenue decline at Long-Term Care. Professional Services Revenues increased \$903,000 between twelve months periods. As previously indicated, the current twelve-month period reflects a Loss on Investment in Unconsolidated Affiliate of (\$1) million, \$300,000 lower than the prior year end. As a result, Total Unrestricted Revenues, Gains and Other Support increased between periods by \$3.1 million, or 3%.

Salaries and Benefits represent the largest component of Total Expenses, at \$66.4 million or 61.9% for the twelve-month period ended June 30, 2009 and \$61.3 million or 61.4% in the previous year. Salary and Benefits have increased by 8% between periods, while FTE's only increased by 2% (from 1,025 to 1,045). Between periods, there was a decline in client FTE's within the Work Services division (approximately 30 FTE's), primarily because of less production orders and the discontinuation of the Thrift Store business line effective July 1, 2008. These client FTE's generally are paid a wage rate that is on the lower end of Good Shepherd's wage scale. The impact of competitive salary and market rate adjustments (approximately \$1 million) also contributed heavily to the increase in Salaries and Benefits between periods.

Supplies and Other Expenses remained relatively flat, decreasing only (\$170,000) between periods and remained at approximately 27-28% of Net Patient Service Revenue.

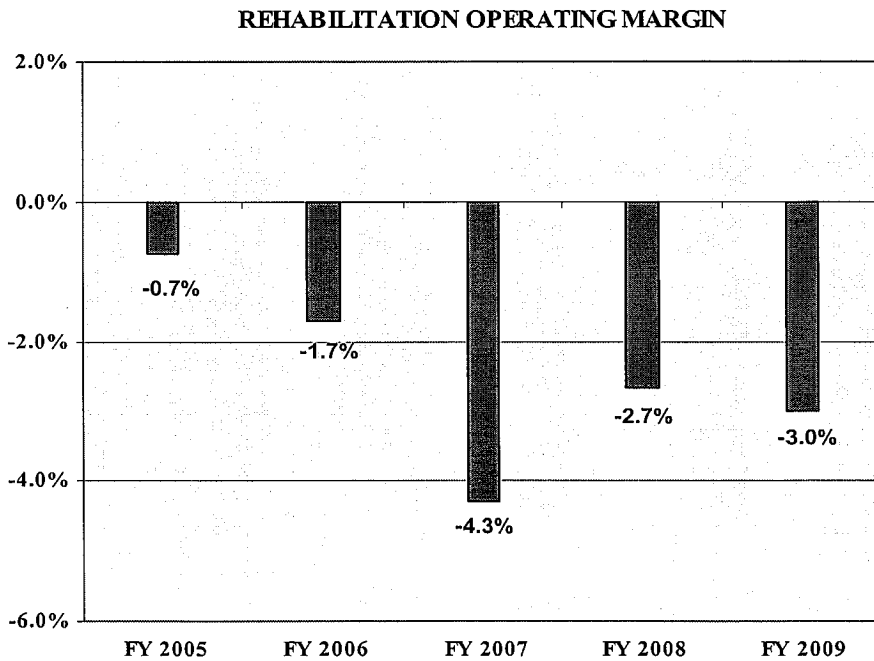
Interest expense increased from \$3,989,000 to \$6,054,000 between periods for a few reasons. First, Good Shepherd floated approximately \$52 million of Revenue Bonds in November 2007, primarily to fund and finance the capital investment requirements at Good Shepherd Penn Partners. In addition, in FY 2008 Good Shepherd was able to capitalize \$1 million of interest incurred during the construction of those capital assets. Finally, for a portion of the twelve-month period, interest rates on Variable Rate Debt Obligations increased significantly in reaction to the overall capital market and liquidity issues in the marketplace.

Bad debt expense declined between periods by \$309,000 due to a general improvement in collections rates and several significant bad debt recoveries, primarily at the Rehabilitation Hospital.

Divisional Review

Rehabilitation

The rehabilitation services division includes all of the inpatient and outpatient rehabilitation sites, the Psychology, Psychiatry and Developmental Pediatrics physicians, the Fitness Center and the Imaging Center service lines. Operating margin comparisons, by fiscal year, appear as follows:



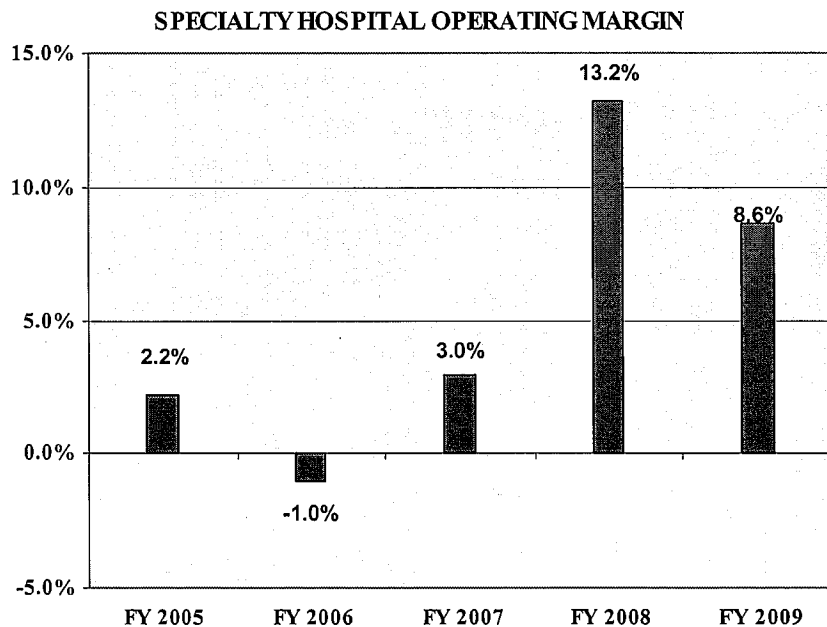
In total the division experienced an operating loss of \$1.8 million compared to a loss of \$1.5 million in FY 08. When comparing the two years FY 08 included a \$1.2 million loss from the now closed operations of Lifestyles Products. This removed, the FY 09 loss was driven by a significant swing in performance at the inpatient Allentown Rehab hospital. The Allentown site went from a \$1.4 million profit in FY 08 to a loss of \$1 million in FY 09. As noted, although admissions grew by 11% year to year, the revenue base, particularly the Medicare revenue base,

was negatively impacted in FY 09 creating much of the loss. In FY 09 the Medicare cases were impacted by a high level of early transfer cases that result in a much lower Medicare payment. In response to the commencement of federal government proliferation of Recovery Audit Contractor's (RAC's) additional reserves were taken in FY 09 in anticipation of the potential for future revenue adjustments. Fortunately the outpatient business performance improved by \$407,000 from FY 08 and helped offset the decline in the inpatient margin. Additionally the loss associated with the Physician Group was reduced by \$500,000 in FY 09, to a loss of \$1.8 million compared to \$2.3 million in FY 08. This also helped offset the decline in the inpatient rehab hospital performance.

In late FY 09, the decision was made to move forward with the planning and opening of an 18-bed inpatient pediatric unit located on the Bethlehem campus. Hiring of staff for the July 1 opening all occurred in FY 09 resulting in about \$50,000 in losses in FY 09.

Specialty Hospital

The long term acute care hospital division also experienced a decrease in performance from year to year. In FY 09 the specialty hospital reported an operating margin of \$1.4 million compared to a FY 08 margin of \$2.6 million. A couple of revenue issues impacted the performance in 09; some months had high short stay outliers, and the month of December had a significant census drop which resulted in an excessive loss. In response to the commencement of federal government proliferation of Recovery Audit Contractor's (RAC's) additional reserves were taken in FY 09 in anticipation of the potential for future revenue adjustments. A comparison of LTACH fiscal year operating margin performance appears as follows:

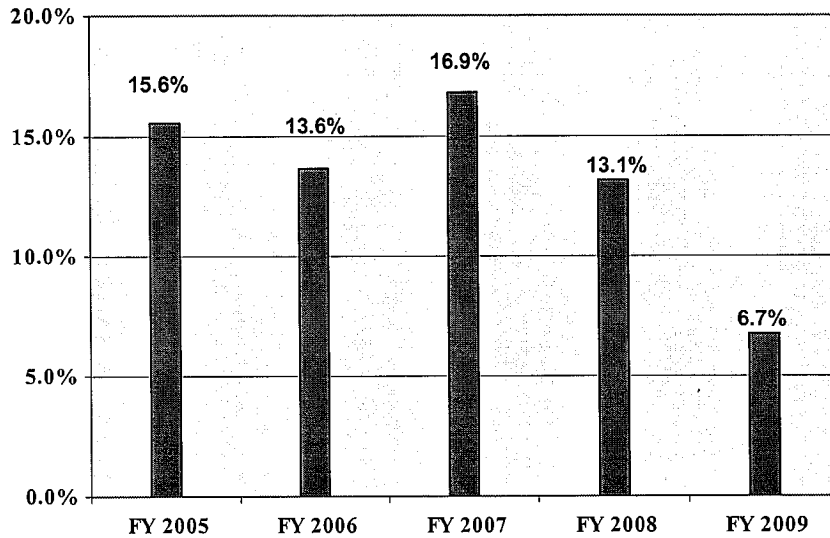


Long Term Care

The Long Term Care/Special Rehab division includes the Raker Center, Bethlehem Home and the Supported Independent Living apartments. The Long Term Care division continues to operate at almost 100% capacity at the two sites. Profitability decreased from FY 08 by \$1.5 million as the MA rates paid to Peer Group 13 have continued to decline. Additionally during the year management provided a market adjustment of up to \$2 per hour to the care providers and support staff throughout the network. The bulk of the care givers and support staff receiving the increase are staff to the two long term care facilities which added a fairly significant additional layer of operating costs to the division in FY 09. The combination of lower MA rates and higher costs created the decrease in performance.

The Raker Center and the Bethlehem Home, along with two other providers, were historically grouped into the highest peer group for Medical Assistance reimbursement purposes, based upon the types of patients that were treated at these facilities. However, over the last few years, other providers have been added to this peer group thereby lowering the overall cost base that is the starting point for the peer group rate setting process. The Commonwealth has also implemented budget neutrality adjustments to the rates. It is anticipated that the Long Term Care division will continue to see further rate reductions in the future. A comparison of the division's annual operating margin performance appears as follows:

LONG TERM CARE OPERATING MARGIN

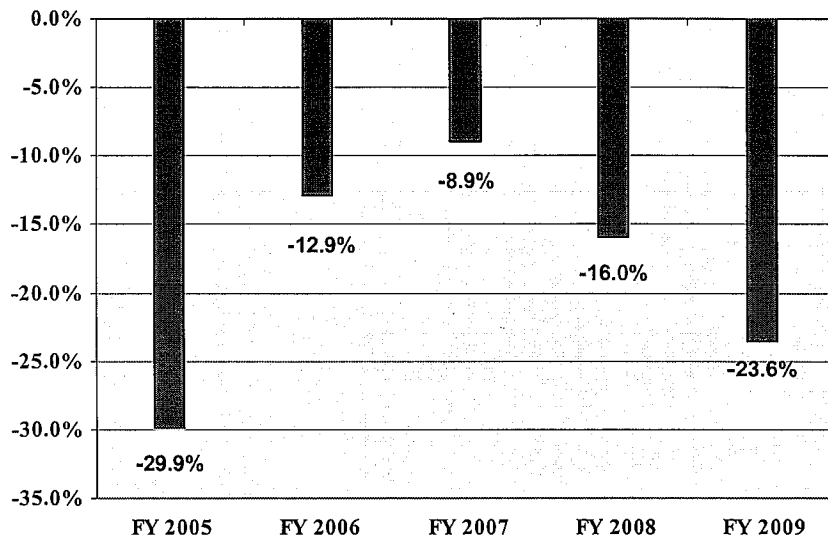


Work Services

The Work Services division encompasses a variety of services including Vocational Services, Clubhouse and Production. The Thrift Store service line was discontinued effective July 1, 2008. In total operating performance from year to year didn't change significantly. In FY 09 there was a loss of \$781,000 compared to a FY 08 loss of \$723,000. The losses from Thrift Stores were eliminated in FY 09 as the business was transferred to VIA. That eliminated about \$240,000 of losses but in FY 09 additional losses were incurred by Production and Vocational Services to the

same level. The RePlace building is still on the market for sale and will have continuing operating expenses of about \$100,000 per year for depreciation and utilities until it is sold.

WORK SERVICES OPERATING MARGIN



Good Shepherd Penn Partners

In FY 09 GSPP incurred an operating loss of \$1.5 million. Of this 70% is recognized in the GSRN financial statements as a loss on investment in unconsolidated affiliate. FY 09 was the first full year of operations of GSPP. During the year the LTCH went through the Medicare demonstration period and became certified as an LTCH effective for discharges after April 1, 2009. During the demonstration period census was kept low and losses were realized as anticipated. The management contract for the IRF also had its challenges as the ramp-up of census was an issue immediately. The anticipated census to be transferred from the two former rehab units at the UPHS hospitals was much lower than anticipated. Fortunately the outpatient business from the 8 sites transferred to GSPP had exceptional margins that more than offset the significant losses from the inpatient business. The outpatient performance gains were mainly a result of favorable managed care rates for services that had been contracted by UPHS before the transition.

Balance Sheet

The Balance Sheet took a pretty significant hit during the year as investments decreased by \$24 million from \$162 million to \$138 million. The decrease was not the result of liquidation of any funds for operations; rather, the decrease was entirely related to the overall downturn in the equity markets. Fortunately there was a late fiscal year surge in the market which helped bring unrestricted days cash on hand up to 465 by June 30, 2009. This is compared to 595 days in FY 08 and a high of 700 days in FY 07. The investment performance for the year was a negative return of 19%.

This decrease in investments also carried through to the Net Assets. Unrestricted Net Assets decreased \$34 million from prior year. As noted, \$24 million was from the decrease in value of the investments, \$2 million came from the loss incurred during the year, and another \$7 million was related to the change in the defined benefit pension liability. The pension liability adjustment recognizes the funded status of the plan which is the difference between the market value of the plan assets and the projected benefit liability. The market value of the plan assets decreased about \$4 million from prior year while the projected benefits increased about \$2 million. The pension assets had the same market performance issues noted above for the operating portfolio.

Some of the more significant Balance Sheet ratios were impacted by the loss in operating performance and the decrease in market value of the investments and net assets. The table below notes the ratio changes.

Selected Ratios	FY 09	FY 08
UR Days Cash	465	595
UR Cash to Debt	104%	121%
Debt to Capitalization	49%	44%

The ratios do show a general weakening in the Balance Sheet mostly a result of the downturn in the value of investments.

Good Shepherd Rehabilitation Network and Controlled Entities, through the Obligated Group, as defined, are required to meet certain financial covenants under their various Long-Term Debt Agreements. One of the covenants requires the Obligated Group to maintain a Debt Service Coverage ratio of 1.25. The calculation compares Maximum Annual Debt Service to Revenue in Excess of Expenses, adjusted for Depreciation, Amortization and Interest Expense. The calculation also provides that certain items, such as the Loss on Extinguishment of Debt and Unrealized Losses on Securities are excluded from the Debt Service Coverage calculation. During the current fiscal year, management needed to interpret two matters with respect to the Debt Service Coverage calculation. Management excluded the Loss on Investment in Unconsolidated Affiliate from the calculation because GSPP is not a member of the Obligated Group. Also, unrealized gains and losses relating to an alternative investment (Walter Scott Global Fund) and the ineffectiveness of certain financial instruments are required to be included as part of Revenue in Excess of Expenses, per recent accounting guidance. Since Unrealized Losses on Securities represent a specific exclusion from the Debt Service Coverage calculation, they were excluded.

FY 2009 Debt Covenants	Required	Actual Performance
Debt Service Coverage	Min 1.25 x	2.02 x
UR Days Cash	Min. 120 days	546 days
Debt to Capital	Max. 67%	50.5%

Outlook

The imperfect storm between a major downturn in the economy, the first-year start-up of operations at GSPP, and challenging Medicare regulations all came together at the same time in FY 09. Fortunately the damage was not that significant and the strong Balance Sheet, although a bit more fragile, is still in good shape from a liquidity perspective.

The financial challenges in FY 09 carry into the FY 2010 Budget. In terms of FY 10 the challenges have not diminished of any significant proportion and the financial performance will need to be watched closely. The budget for FY 10 is very thin with a 1.1% margin. The FY 10 Budget includes two assumptions that had a significant impact on the operating margin. First, as a result of the pension plan assets decrease in value, the FAS87 pension expense increased by \$2 million. Second, as a result of the decreased value of the endowment portfolio, the budget does not include \$1 million of endowment income used for operations. The budget also does not include any salary increases because of the low margin. The second year of operations at GSPP is also critical and the budgeted margin of 11.7% will go a long way towards an upswing in performance.

Good Shepherd Rehabilitation Network and Controlled Entities
Obligated Group and Consolidated Balance Sheet
As of June 30, 2009 and 2008

	<u>Obligated Group</u>		<u>Consolidated</u>	
	Audited as of 06/30/09	Audited as of 06/30/08	Audited as of 06/30/09	Audited as of 06/30/08
<u>Assets</u>				
CURRENT ASSETS:				
Cash and cash equivalents	3,079,496	4,450,043	3,504,107	4,755,785
Resident funds	178,540	183,240	178,540	183,240
Assets whose use is limited	56,605	51,107	2,316,021	2,023,899
Accounts receivable, patients	9,834,044	10,944,342	12,375,457	13,870,809
Other receivables	633,994	697,289	968,994	1,020,200
Estimated third-party payor settlements	406,117	561,927	406,117	561,927
Inventories of drugs and supplies	407,119	347,377	407,119	347,377
Prepaid expenses and other current assets	1,045,483	882,035	1,173,317	976,877
Amount due from affiliates	1,309,905	0	1,309,908	0
Total current assets	16,951,303	18,117,360	22,639,580	23,740,114
ASSETS WHOSE USE IS LIMITED	11,442,137	26,700,923	11,442,137	26,700,923
INVESTMENTS				
Unrestricted	123,985,581	145,980,667	122,860,581	144,855,667
Temporarily Restricted	1,573,607	4,064,733	1,573,607	4,064,733
Permanently restricted	13,428,746	12,774,159	13,428,746	12,774,159
Total investments	138,987,934	162,819,559	137,862,934	161,694,559
INVESTMENTS IN AND OTHER ASSETS PERTAINING TO UNCONSOLIDATED SUBSIDIARY	34,909,450	24,513,854	34,909,450	24,513,854
ASSETS HELD FOR SALE	0	1,363,133	0	1,363,133
PROPERTY AND EQUIPMENT, Net	77,234,317	74,947,751	80,570,762	78,660,167
BENEFICIAL INTEREST IN:				
Perpetual trusts	8,096,351	10,718,249	8,096,351	10,718,249
Charitable remainder trusts	9,314,183	11,674,639	9,314,183	11,674,639
PLEDGES RECEIVABLE, Net	2,001,309	2,659,289	2,001,309	2,659,289
DEFERRED FINANCING COSTS, Net	3,318,417	3,418,945	3,318,417	3,418,945
PREPAID PENSION COST	0	0	0	0
INTANGIBLE ASSETS, Net	452,129	491,683	473,843	503,467
CONTRIBUTIONS RECEIVABLE	390,000	0	390,000	0
DERIVATIVE FINANCIAL INSTRUMENTS	0	0	0	0
TOTAL	<u>303,097,530</u>	<u>337,425,385</u>	<u>311,018,966</u>	<u>345,647,339</u>

Good Shepherd Rehabilitation Network and Controlled Entities
Obligated Group and Consolidated Balance Sheet
As of June 30, 2009 and 2008

	Obligated Group		Consolidated	
	Unaudited	Unaudited	Unaudited	Unaudited
	as of	as of	as of	as of
	06/30/09	06/30/08	06/30/09	06/30/08
<u>Liabilities and Net Assets</u>				
CURRENT LIABILITIES				
Demand note payable	2,186,000	0	2,186,000	0
Current portion of long-term debt	2,665,000	1,825,000	2,665,000	1,825,000
Accounts payable, trade	4,089,681	2,368,919	4,888,423	3,475,648
Estimated third-party payor settlements	651,668	2,464,046	1,038,153	2,512,242
Advance from third party payor	277,900	277,900	277,900	277,900
Accrued expenses	4,877,705	6,274,065	5,072,644	6,531,996
Resident funds	178,540	183,240	178,540	183,240
Amount due to affiliates	3,281,742	2,030,767	0	0
	<u>18,208,236</u>	<u>15,423,937</u>	<u>16,306,660</u>	<u>14,806,026</u>
Total current liabilities				
LONG-TERM DEBT:				
Revenue bonds	119,729,823	122,346,009	119,729,823	122,346,009
Mortgages payable	0	0	1,675,500	1,675,500
	<u>119,729,823</u>	<u>122,346,009</u>	<u>121,405,323</u>	<u>124,021,509</u>
Total long-term debt				
DERIVATIVE FINANCIAL INSTRUMENTS				
	3,347,297	1,192,937	3,347,297	1,192,937
ACCRUED PENSION COST				
	8,497,500	1,895,530	8,497,500	1,895,530
OTHER LIABILITIES				
	5,297,619	6,529,951	5,505,610	6,855,024
Total liabilities	<u>155,080,475</u>	<u>147,388,364</u>	<u>155,062,390</u>	<u>148,771,026</u>
NET ASSETS				
Unrestricted	117,373,808	152,988,971	125,313,326	159,828,263
Temporarily restricted	7,545,007	11,823,242	7,545,007	11,823,242
Permanently restricted	23,098,240	25,224,808	23,098,240	25,224,808
Total net assets	<u>148,017,055</u>	<u>190,037,021</u>	<u>155,956,573</u>	<u>196,876,313</u>
TOTAL	<u><u>303,097,530</u></u>	<u><u>337,425,385</u></u>	<u><u>311,018,963</u></u>	<u><u>345,647,339</u></u>

**Good Shepherd Rehabilitation Network and Controlled Entities
Obligated Group and Consolidated Statement of Operations
For the Twelve Month Period Ended June 30, 2009 and 2008**

	<u>Obligated Group</u>		<u>Consolidated</u>	
	<u>Audited Period Ending 06/30/09</u>	<u>Audited Period Ending 06/30/08</u>	<u>Audited Period Ending 06/30/09</u>	<u>Audited Period Ending 06/30/08</u>
UNRESTRICTED REVENUE, GAINS, AND OTHER SUPPORT:				
Net patient service revenues	74,852,815	71,643,107	91,614,262	89,356,295
Other operating revenues	5,188,506	5,839,896	5,620,095	6,105,958
Professional services revenue	4,621,967	3,977,811	4,863,559	3,959,811
Contributions	2,610,293	2,806,502	2,610,293	2,806,502
Management Fees	5,594,473	4,534,378	0	0
Equity in (loss) on investment in unconsolidated subsidiary	(1,045,456)	(1,349,449)	(1,045,456)	(1,349,449)
Gains (losses) on disposal of property and equipment	(11,539)	6,004	(42,995)	6,004
Net assets released from restrictions for operations	1,656,577	1,331,851	1,659,234	1,332,351
Total unrestricted revenues, gains, and other support	93,467,636	88,790,100	105,278,992	102,217,472
EXPENSES:				
Salaries and wages	48,750,747	44,592,597	54,199,310	50,050,951
Supplies and other expenses	20,474,104	20,383,799	24,630,807	24,800,519
Employee benefits	11,823,293	10,890,734	12,228,739	11,288,730
Depreciation and amortization	7,139,845	6,782,561	7,582,348	7,256,226
Interest	6,053,810	3,989,339	6,053,810	3,989,339
Professional fees	1,883,884	1,567,847	2,147,392	1,825,349
Provision for doubtful collections	408,938	615,971	403,345	712,458
Total	96,534,621	88,822,848	107,245,751	99,923,572
OPERATING INCOME (LOSS) BEFORE LOSS ON ABANDONMENT OF CAPITAL PROJECTS	(3,066,985)	(32,748)	(1,966,759)	2,293,900
LOSS ON ABANDONMENT ON CAPITAL PROJECTS	0	0	0	236,925
OPERATING INCOME (LOSS)	(3,066,985)	(32,748)	(1,966,759)	2,056,975
OTHER INCOME (EXPENSE):				
Loss on extinguishment of debt	0	(2,111,926)	0	(2,111,926)
Investment income	705,793	21,384,957	705,793	21,384,957
Ineffectiveness of Derivative Financial Instrument	(1,116,772)	0	(1,116,772)	0
REVENUE IN EXCESS OF EXPENSES	(3,477,964)	19,240,283	(2,377,738)	21,330,006
CHANGE IN NET UNREALIZED GAINS AND LOSSES ON INVESTMENTS OTHER THAN TRADING SECURITIES	(23,215,460)	(33,421,928)	(23,215,460)	(33,421,928)
CHANGE IN FAIR VALUE OF DERIVATIVE FINANCIAL INSTRUMENTS	(1,037,588)	(2,407,818)	(1,037,588)	(2,407,818)
PENSION LIABILITY ADJUSTMENT	(6,611,574)	(6,542,724)	(6,611,574)	(6,542,724)
PENSION LIABILITY ADJUSTMENT - UNCONSOLIDATED AFFILIATE	(910,271)	0	(910,274)	0
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASE OF PROPERTY AND EQUIPMENT	444,368	5,034,128	444,368	5,034,446
OTHER CHANGES	(593,703)	29,605	(593,703)	36,605
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS BEFORE EFFECT OF ADOPTION OF FASB STATEMENT No. 158	(35,402,192)	(18,068,454)	(34,301,969)	(15,971,413)
EFFECT OF ADOPTION OF FASB STATEMENT NO. 158	(212,971)	0	(212,971)	0
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	(35,615,163)	(18,068,454)	(34,514,940)	(15,971,413)

Good Shepherd Rehabilitation Network and Controlled Entities
Consolidated Statement of Cash Flows
For the Twelve Month Period Ended June 30, 2009 and 2008

	Audited Period Ending 06/30/09	Audited Period Ending 06/30/08
CASH FLOWS FROM OPERATING ACTIVITIES		
(Decrease) increase in net assets	(40,919,740)	(19,444,789)
Adjustments to reconcile (decrease) increase in net assets to net cash provided by (used for) operating activities:		
Depreciation and amortization	7,582,348	7,256,226
Losses (gains) on disposal of property and equipment	42,995	(6,004)
Loss on abandonment of capital projects	0	236,925
Provision for doubtful collections	403,345	712,458
Other changes	0	(36,605)
Net realized and unrealized losses (gains) on investments	29,412,422	18,906,507
Restricted contributions and investment income	(1,415,680)	(5,660,541)
Change in fair value of derivative financial instruments	2,154,360	2,407,818
Valuation adjustments - permanently and temporarily restricted net assets	3,804,929	1,645,135
Loss on extinguishment of debt	0	2,111,926
Equity in loss of unconsolidated affiliate	1,045,456	1,349,449
Pension liability adjustment - The Good Shepherd Rehabilitation Hospital	6,611,574	6,542,724
Pension liability adjustment - unconsolidated affiliate	910,271	0
Effect of adoption of measurement date provisions of FASB Statement No.158	212,971	0
Changes in assets and liabilities:		
Accounts receivable, patients	1,092,007	249,829
Other receivables	51,206	(78,124)
Estimated third-party payor settlements	(1,318,279)	(1,021,128)
Inventories of drugs and supplies	(59,742)	137,150
Prepaid expenses and other current assets	(586,440)	89,546
Account payable, trade	1,412,775	(1,033,439)
Accrued expenses and other liabilities	(1,913,456)	852,261
Net cash provided by (used for) operating activities	<u>8,523,322</u>	<u>15,217,324</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
(Increase) Decrease in investments	9,452,296	(30,139,359)
Investment in and other assets pertaining to unconsolidated subsidiary	(13,654,228)	(25,863,303)
Proceeds from sale of property and equipment	0	7,500
Purchase of property and equipment	(7,955,560)	(10,269,489)
Purchase of intangible assets	(27,929)	(18,395)
Net cash used in investing activities	<u>(12,185,421)</u>	<u>(66,283,046)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from (repayment of) demand note payable	2,186,000	(1,764,000)
Restricted contributions and investment income	2,103,602	6,366,797
Repayment of long-term debt	(1,825,000)	(42,946,800)
Proceeds from issuance of long-term debt, net	0	93,777,938
Other changes	0	36,605
Decrease in annuities payable and trusts	(36,831)	(90,977)
Payment of financing costs	(17,350)	(2,813,938)
Net cash provided by financing activities	<u>2,410,421</u>	<u>52,565,625</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,251,678)	1,499,903
CASH AND CASH EQUIVALENTS, BEGINNING	<u>4,755,785</u>	<u>3,255,882</u>
CASH AND CASH EQUIVALENTS, ENDING	<u>3,504,107</u>	<u>4,755,785</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest (net of amounts capitalized)	<u>6,102,046</u>	<u>5,172,900</u>

Good Shepherd Rehabilitation Network Obligated Group
Selected Financial Ratios

		Fiscal Year Ended June 30						
		2003	2004	2005	2006	2007	2008	2009
Operating Cash Flow Margin	(1)	13.6%	12.2%	13.5%	12.9%	13.7%	12.1%	10.8%
Long-Term Debt to Capitalization	(2)	32.6%	41.0%	37.8%	34.0%	29.5%	44.4%	50.5%
Debt Service Coverage	(3)	2.95	2.62	2.89	3.38	6.33	3.93	2.02
Operating Margin Ratio	(4)	4.83%	3.85%	3.98%	2.76%	2.35%	-0.04%	-3.28%
Return on Equity Ratio	(5)	2.4%	6.4%	6.0%	6.4%	12.4%	12.6%	-3.0%
Cushion Ratio	(6)	30.0	20.7	23.2	25.0	29.6	16.9	16.0
Days Cash on Hand	(7)	497	548	596	625	704	676	521
Days in Accounts Receivable	(8)	54	51	45	59	55	53	46
Obligated Group % of Total Assets	(9)	99.6%	97.2%	97.3%	97.3%	97.5%	97.6%	97.5%
Obligated Group % of NPSR	(10)	86.6%	85.2%	83.9%	81.7%	81.5%	80.2%	88.8%
Obligated Group % of Total Expenses	(11)	91.7%	91.7%	90.5%	89.4%	89.3%	88.9%	90.0%
Cash to Debt	(12)	1.99	1.42	1.62	1.79	2.16	1.23	1.06
Debt to Operating Cash Flow	(13)	4.42	7.76	6.78	6.69	5.88	11.39	11.82

(1) Defined as the sum of Operating Income (Loss) before Abandonment of Capital Project, Interest Expense and Depreciation and Amortization Expense divided by Total Operating Revenue.

(2) Defined as Non-Current Portion of Long-Term Debt divided by the sum of Non-Current Portion of Long-Term Debt and Unrestricted Net Assets.

(3) Defined as the sum of Revenue in Excess of Expenses Adjusted for Interest Expense, Depreciation and Amortization Expense, Loss on Investment in Unconsolidated Subsidiary, Loss on Extinguishment of Debt and Unrealized Gains and Losses on Alternative Investments divided by Maximum Annual Debt Service.

(4) Defined as Operating Income (Loss) before Abandonment of Capital Project divided by Total Operating Revenue.

(5) Defined as Revenue in Excess of Expenses divided by Unrestricted Net Assets.

(6) Defined as the sum of Cash and Unrestricted Investments divided by Maximum Annual Debt Service.

(7) Defined as the sum of Cash and Unrestricted Investments divided by the quotient of the sum of Total Expenses less Provision for Doubtful Accounts and Depreciation and Amortization Expense divided by 365 days.

(8) Defined as Total Net Patient Accounts Receivable and Work Services Accounts Receivable multiplied by 365 days divided by Net Patient Service Revenues and Work Services Revenue.

(9) Defined as Obligated Group's Total Assets divided by Total Consolidated Assets.

(10) Defined as Obligated Group's NPSR divided by Total Consolidated NPSR.

(11) Defined as Obligated Group's Total Expenses divided by Total Consolidated Expenses.

(12) Defined as the sum of Unrestricted Cash and Investments divided by Long Term Debt net of Current Portion.

(13) Defined as Long Term Debt net of Current portion divided by the sum of Operating Income (Loss) before Abandonment of Capital Project, Depreciation and Amortization Expense and Interest Expense.

Good Shepherd Rehabilitation Network and Controlled Entities
The Good Shepherd Rehabilitation Hospital - Utilization of Services

The following table sets forth historical inpatient utilization statistics for the Rehabilitation Hospitals:

Inpatient Utilization	Fiscal Year Ended June 30						
	2003	2004	2005	2006	2007	2008	2009
Number of Licensed Beds	104	104	93	82	82	82	82
Average Beds in Service	86	104	93	82	82	82	82
Admissions	2,843	2,903	1,721	1,553	1,449	1,571	1,738
Patient Days	25,509	27,577	21,960	19,570	18,415	20,905	22,386
Percent Occupancy	82.63%	72.65%	64.69%	65.39%	61.53%	69.66%	74.79%
Average Length of Stay	8.98	9.46	12.67	12.73	12.71	13.30	12.88

The following table sets forth historical outpatient visit statistics for the Rehabilitation Hospitals and their satellites:

Outpatient Visits	Fiscal Year Ended June 30						
	2003	2004	2005	2006	2007	2008	2009
Hospital	63,164	63,089	63,260	66,566	71,805	70,594	78,139
Satellites	80,031	64,936	76,787	87,948	89,286	91,305	105,311
Contracted Services	27,983	37,974	37,869	29,490	28,594	22,194	21,145
Total	171,178	165,999	177,916	184,004	189,685	184,093	204,595

The following table delineates the payor mix based on gross revenues for the Rehabilitation Hospitals' business line:

Payor Mix	Fiscal Year Ended June 30						
	2003	2004	2005	2006	2007	2008	2009
Medicare	45.1%	43.3%	39.2%	38.9%	38.0%	37.9%	39.0%
Medical Assistance	7.2%	10.5%	12.4%	11.6%	11.4%	12.0%	11.1%
Blue Cross	20.7%	19.1%	18.5%	15.4%	12.2%	13.6%	10.4%
Commercial/Auto	8.1%	8.7%	9.3%	10.9%	10.3%	7.7%	7.3%
Managed Care	8.9%	9.3%	10.7%	13.9%	17.3%	18.4%	23.0%
Workers' Compensation	4.4%	3.9%	4.7%	4.5%	5.1%	4.3%	3.9%
Self Pay	0.5%	0.6%	1.0%	0.7%	0.7%	0.6%	0.6%
Other	5.2%	4.7%	4.2%	4.1%	5.1%	5.4%	4.7%

**Good Shepherd Rehabilitation Network and Controlled Entities
The Good Shepherd Home Long Term Care Facility, Inc. - Utilization**

	Fiscal Year Ended June 30						
	2003	2004	2005	2006	2007	2008	2009
Beds Available	159	159	159	159	159	159	159
Days Available	58,035	58,035	58,035	58,035	58,035	58,194	58,035
Percentage Occupancy	99.89%	99.91%	99.51%	99.81%	99.67%	99.55%	99.59%
Inpatient Days	57,972	57,985	57,748	57,923	57,841	57,934	57,795

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

**CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2009 AND 2008
&
INDEPENDENT AUDITORS' REPORT
&
ADDITIONAL INFORMATION**

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Good Shepherd Rehabilitation Network:

We have audited the accompanying consolidated balance sheet of Good Shepherd Rehabilitation Network and controlled entities (collectively "Good Shepherd") as of June 30, 2009 and 2008, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Good Shepherd's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Good Shepherd Rehabilitation Network and controlled entities as of June 30, 2009 and 2008, and the results of their operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 2 to the consolidated financial statements, Good Shepherd adopted the provisions of Statement of Financial Accounting Standards ("SFAS") Nos. 157 and 159 in 2009. Good Shepherd also adopted the measurement date provisions of SFAS No. 158 in 2009 (Note 2).

Parente Randolph, LLC

Philadelphia, Pennsylvania
September 22, 2009

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

**CONSOLIDATED BALANCE SHEET
JUNE 30, 2009 AND 2008**

	2009	2008	2009	2008
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 3,504,107	\$ 4,755,785	\$ 2,186,000	\$ 1,825,000
Resident funds	178,540	183,240	2,665,000	3,475,648
Assets whose use is limited	2,316,021	2,023,899	4,888,423	2,512,242
Accounts receivable, patients (net of estimated allowance for doubtful collections of \$1,158,000 in 2009 and \$1,242,000 in 2008)	12,375,457	13,870,809	1,038,153	277,900
Other receivables	968,994	1,020,200	5,072,644	6,531,996
Amounts due from and other assets pertaining to unconsolidated subsidiary	1,309,905	-	178,540	183,240
Estimated third-party payor settlements	406,117	561,927		
Inventories of drugs and supplies	407,119	347,377		
Prepaid expenses and other current assets	1,173,317	976,877		
Total current assets	22,639,577	23,740,114	16,306,660	14,806,026
ASSETS WHOSE USE IS LIMITED				
	11,442,137	26,700,923	119,729,823	122,346,009
BOARD DESIGNATED FUNDS	3,000,000	3,269,019	1,675,500	1,675,500
INVESTMENTS	134,862,934	158,425,540	121,405,323	124,021,509
INVESTMENTS IN AND OTHER ASSETS PERTAINING TO UNCONSOLIDATED SUBSIDIARY	34,909,450	24,513,854	3,347,297	1,192,937
ASSETS HELD FOR SALE		1,363,133	8,497,500	1,895,530
PROPERTY AND EQUIPMENT, Net	80,570,762	78,660,167	5,505,610	6,855,024
BENEFICIAL INTEREST IN:			155,062,390	148,771,026
Perpetual trusts	8,096,351	10,718,249		
Charitable remainder trusts	9,314,183	11,674,639	125,313,326	159,828,263
PLEDGES RECEIVABLE, Net	2,001,309	2,659,289	7,545,007	11,823,242
DEFERRED FINANCING COSTS, Net	3,318,417	3,418,945	23,098,240	25,224,808
INTANGIBLE ASSETS, Net	473,843	503,467	155,956,573	196,976,313
OTHER ASSETS	390,000	-		
TOTAL	\$311,018,963	\$345,647,339	\$311,018,963	\$345,647,339
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Demand note payable			\$ 2,186,000	\$ 1,825,000
Current portion of long-term debt			2,665,000	3,475,648
Accounts payable, trade			4,888,423	2,512,242
Estimated third-party payor settlements			1,038,153	277,900
Advance from third-party payor			5,072,644	6,531,996
Accrued expenses			178,540	183,240
Resident funds				
Total current liabilities			16,306,660	14,806,026
LONG-TERM DEBT:				
Revenue bonds			119,729,823	122,346,009
Mortgages payable			1,675,500	1,675,500
Total long-term debt			121,405,323	124,021,509
DERIVATIVE FINANCIAL INSTRUMENTS			3,347,297	1,192,937
ACCRUED PENSION COST			8,497,500	1,895,530
OTHER LIABILITIES			5,505,610	6,855,024
Total liabilities			155,062,390	148,771,026
NET ASSETS:				
Unrestricted			125,313,326	159,828,263
Temporarily restricted			7,545,007	11,823,242
Permanently restricted			23,098,240	25,224,808
Total net assets			155,956,573	196,976,313
TOTAL	\$311,018,963	\$345,647,339	\$311,018,963	\$345,647,339

See Notes to Consolidated Financial Statements

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

**CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	2009	2008
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:		
Net patient service revenues	\$ 91,614,262	\$ 89,356,295
Other operating revenues	5,620,095	6,105,958
Professional services revenue	4,863,559	3,959,811
Contributions	2,610,293	2,806,502
Loss on investment in unconsolidated subsidiary	(1,045,456)	(1,349,449)
(Loss) gain on disposal of equipment	(42,995)	6,004
Net assets released from restrictions for operations	<u>1,659,234</u>	<u>1,332,351</u>
Total unrestricted revenues, gains, and other support	<u>105,278,992</u>	<u>102,217,472</u>
EXPENSES:		
Salaries and wages	54,199,310	50,050,951
Supplies and other expenses	24,630,807	24,800,519
Employee benefits	12,228,739	11,288,730
Depreciation and amortization	7,582,348	7,256,226
Interest	6,053,810	3,989,339
Professional fees	2,147,392	1,825,349
Provision for doubtful collections	<u>403,345</u>	<u>712,458</u>
Total	<u>107,245,751</u>	<u>99,923,572</u>
OPERATING (LOSS) INCOME BEFORE LOSS ON ABANDONMENT OF CAPITAL PROJECTS	(1,966,759)	2,293,900
LOSS ON ABANDONMENT OF CAPITAL PROJECTS	<u>-</u>	<u>236,925</u>
OPERATING (LOSS) INCOME	(1,966,759)	2,056,975
OTHER INCOME (EXPENSE):		
Loss on extinguishment of debt	-	(2,111,926)
Investment income	705,793	21,384,957
Ineffectiveness of derivative financial instrument	<u>(1,116,772)</u>	<u>-</u>
REVENUES (LESS THAN) IN EXCESS OF EXPENSES	(2,377,738)	21,330,006
CHANGE IN NET UNREALIZED GAINS AND LOSSES ON INVESTMENTS OTHER THAN TRADING SECURITIES	(23,215,460)	(33,421,928)
CHANGE IN FAIR VALUE OF DERIVATIVE FINANCIAL INSTRUMENTS	(1,037,588)	(2,407,818)
PENSION LIABILITY ADJUSTMENT THE GOOD SHEPHERD REHABILITATION HOSPITAL	(6,611,574)	(6,542,724)
PENSION LIABILITY ADJUSTMENT - UNCONSOLIDATED SUBSIDIARY	(910,271)	-
OTHER CHANGES IN UNRESTRICTED NET ASSETS	(593,703)	36,605
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASE OF PROPERTY AND EQUIPMENT	<u>444,368</u>	<u>5,034,446</u>
DECREASE IN UNRESTRICTED NET ASSETS BEFORE EFFECT OF ADOPTION OF MEASUREMENT DATE PROVISIONS OF FASB STATEMENT NO. 158	(34,301,966)	(15,971,413)
EFFECT OF ADOPTION OF MEASUREMENT DATE PROVISIONS OF FASB STATEMENT NO. 158	<u>(212,971)</u>	<u>-</u>
DECREASE IN UNRESTRICTED NET ASSETS	<u>\$ (34,514,937)</u>	<u>\$ (15,971,413)</u>

See Notes to Consolidated Financial Statements

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

**CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	2009	2008
UNRESTRICTED NET ASSETS:		
Revenues (less than) in excess of expenses	\$ (2,377,738)	\$ 21,330,006
Change in net unrealized gains and losses on investments other than trading securities	(23,215,460)	(33,421,928)
Change in fair value of derivative financial instruments	(1,037,588)	(2,407,818)
Pension liability adjustment - The Good Shepherd Rehabilitation Hospital	(6,611,574)	(6,542,724)
Pension liability adjustment - unconsolidated subsidiary	(910,271)	-
Other changes in unrestricted net assets	(593,703)	36,605
Net assets released from restrictions for purchase of property and equipment	<u>444,368</u>	<u>5,034,446</u>
Decrease in unrestricted net assets before effect of adoption of measurement date provisions of FASB Statement No. 158	(34,301,966)	(15,971,413)
Effect of adoption of measurement date provisions of FASB Statement No. 158	<u>(212,971)</u>	<u>-</u>
Decrease in unrestricted net assets	<u>(34,514,937)</u>	<u>(15,971,413)</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions	696,609	5,052,536
Net realized and unrealized (losses) gains on investments	(2,636,953)	(1,121,985)
Investment income	322,846	450,858
Other changes in temporarily restricted net assets	729,083	-
Change in value of split-interest agreements	(1,286,218)	(374,740)
Net assets released from restrictions for operations	(1,659,234)	(1,332,351)
Net assets released from restrictions for purchase of property and equipment	<u>(444,368)</u>	<u>(5,034,446)</u>
Decrease in temporarily restricted net assets	<u>(4,278,235)</u>	<u>(2,360,128)</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Contributions	396,225	157,147
Valuation loss, beneficial interest in perpetual trusts	<u>(2,522,793)</u>	<u>(1,270,395)</u>
Decrease in permanently restricted net assets	<u>(2,126,568)</u>	<u>(1,113,248)</u>
DECREASE IN NET ASSETS	(40,919,740)	(19,444,789)
NET ASSETS, BEGINNING	<u>196,876,313</u>	<u>216,321,102</u>
NET ASSETS, ENDING	<u>\$ 155,956,573</u>	<u>\$ 196,876,313</u>

See Notes to Consolidated Financial Statements

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009 AND 2008**

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Decrease in net assets	\$(40,919,740)	\$(19,444,789)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation and amortization	7,582,348	7,256,226
Loss (gain) on disposal of property and equipment	42,995	(6,004)
Loss on abandonment of capital projects	-	236,925
Provision for doubtful collections	403,345	712,458
Other changes	-	(36,605)
Net realized and unrealized losses on investments	29,412,422	18,906,507
Restricted contributions and investment income	(1,415,680)	(5,660,541)
Change in fair value of derivative financial instruments	2,154,360	2,407,818
Valuation adjustments - permanently and temporarily restricted net assets	3,804,929	1,645,135
Loss on extinguishment of debt	-	2,111,926
Equity in loss of unconsolidated subsidiary	1,045,456	1,349,449
Pension liability adjustment - The Good Shepherd Rehabilitation Hospital	6,611,574	6,542,724
Pension liability adjustment - unconsolidated subsidiary	910,271	-
Effect of adoption of measurement date provisions of FASB Statement No. 158	212,971	-
Changes in assets and liabilities:		
Accounts receivable, patients	1,092,007	249,829
Other receivables	51,206	(78,124)
Estimated third-party payor settlements	(1,318,279)	(1,021,128)
Inventories of drugs and supplies	(59,742)	137,150
Prepaid expenses and other current assets	(586,440)	89,546
Accounts payable, trade	1,412,775	(1,033,439)
Accrued expenses and other liabilities	(1,913,456)	852,261
Net cash provided by operating activities	<u>8,523,322</u>	<u>15,217,324</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease (increase) in investments	9,452,296	(30,139,359)
Increase in investment in and other assets pertaining to unconsolidated subsidiary	(13,654,228)	(25,863,303)
Proceeds from sale of property and equipment	-	7,500
Purchase of property and equipment	(7,955,560)	(10,269,489)
Purchase of intangible assets	(27,929)	(18,395)
Net cash used in investing activities	<u>(12,185,421)</u>	<u>(66,283,046)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from (repayment of) demand note payable	2,186,000	(1,764,000)
Restricted contributions and investment income	2,103,602	6,366,797
Repayment of long-term debt	(1,825,000)	(42,946,800)
Proceeds from issuance of long-term debt, net	-	93,777,938
Other changes	-	36,605
Decrease in annuities payable and trusts	(36,831)	(90,977)
Payment of financing costs	(17,350)	(2,813,938)
Net cash provided by financing activities	<u>2,410,421</u>	<u>52,565,625</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,251,678)	1,499,903
CASH AND CASH EQUIVALENTS, BEGINNING	<u>4,755,785</u>	<u>3,255,882</u>
CASH AND CASH EQUIVALENTS, ENDING	<u>\$ 3,504,107</u>	<u>\$ 4,755,785</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION,		
Cash paid for interest (net of amounts capitalized)	<u>\$ 6,102,046</u>	<u>\$ 5,172,900</u>

See Notes to Consolidated Financial Statements

**GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. NATURE OF OPERATIONS AND SUMMARY OF
SIGNIFICANT ACCOUNTING POLICIES**

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the following:

- Good Shepherd Rehabilitation Network (the "GSRN"), the controlling parent, formerly Good Shepherd Home
- Good Shepherd Rehabilitation Hospital (the "Hospital")
- Good Shepherd Home Long-Term Care Facility, Inc. (the "LTC")
- Good Shepherd Workshop/Vocational Services, Inc. ("Work Services")
- Good Shepherd Long-Term Acute Care Services, Inc. (the "LTACH")
- Good Shepherd Reciprocal Risk Retention Group (the "RRG")
- Good Shepherd Housing Development Corporation ("SUPPIL")
- Good Shepherd Group, LLC (the "GS Group")

All significant intercompany transactions and balances between the GSRN, the Hospital, the LTC, Work Services, the LTACH, the RRG, SUPPIL, and the GS Group (collectively "Good Shepherd") have been eliminated.

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
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NATURE OF OPERATIONS

Good Shepherd's primary operations are conducted within the Hospital, which provides comprehensive inpatient rehabilitation services and outpatient rehabilitation services at several locations. The LTC operates two skilled nursing facilities which service the needs of severely disabled adults. Work Services specializes in employment and development programs for persons with physical, emotional and intellectual disabilities, hearing and sight impairments, and industrial injuries by providing subcontracting services. The LTACH provides services that represent the first step in the post acute care process of recovery. The RRG is a self insurance company that provides primary liability insurance and risk management services. SUPPIL provides supportive independent housing to persons with disabilities under Section 811 of the Department of Housing and Urban Development. GS Group was established to develop a wheelchair device to assist rehabilitation patients. Good Shepherd's primary service area includes Allentown and Bethlehem and surrounding communities in Lehigh, Northampton, Berks and Montgomery counties, Pennsylvania.

Good Shepherd evaluated subsequent events for recognition or disclosure through September 22, 2009 the date the financial statements were issued.

USE OF ESTIMATES

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

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include investments in highly liquid debt instruments purchased with an original maturity of three months or less, excluding assets whose use is limited and investments.

ACCOUNTS RECEIVABLE, PATIENTS

Accounts receivable, patients are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. The allowance for doubtful collections is estimated based upon a periodic review of the accounts receivable aging, payor classifications, and application of historical write-off percentages.

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RESIDENT FUNDS

Resident funds are accounted for as trust funds and are separately maintained from other funds.

ASSETS WHOSE USE IS LIMITED

Assets whose use is limited includes assets held by a bond trustee under trust indenture agreements, escrowed funds under a mortgage agreement, and assets held by the RRG to meet state funding requirements for self-insurance. Amounts available to meet current liabilities of Good Shepherd have been reclassified as current assets in the accompanying consolidated balance sheet.

INVENTORIES

Inventories of drugs and medical supplies are valued at the lower of cost or market. Cost is determined on a first-in, first-out basis.

INVESTMENTS AND INVESTMENT RISK

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Cash and cash equivalents and guaranteed income investment contract are carried at cost which approximates fair value. Good Shepherd currently has two alternative investment agreements, one of which represents an ownership interest in a managed fund that invests in equity securities of companies throughout the world, and the other investment represents an ownership interest in a fund that holds primarily real estate investments. Good Shepherd's investment in the managed fund that invests in equity securities is accounted for under the equity method as Good Shepherd's ownership interest is greater than 5%. Good Shepherd's investment in the fund that invests primarily in real estate investments is accounted for under the cost method as Good Shepherd's ownership interest is less than 5%. Investment income or loss (including realized gains and losses on investments, interest, dividends, and unrealized gains and losses on Good Shepherd's alternative investment accounted for under the equity method) are included in the determination of revenues (less than) in excess of expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the determination of revenues (less than) in excess of expenses unless the investments are trading securities.

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Good Shepherd's investments are comprised of a variety of financial instruments and are managed by third-party investment advisors. The fair values reported in the consolidated balance sheet are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying consolidated financial statements could change materially in the near term.

Investments, in general, are exposed to various risks such as interest rate, credit, and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheet and the consolidated statements of operations and changes in net assets.

PROPERTY AND EQUIPMENT

Property and equipment acquisitions are recorded at cost. Depreciation is computed using the straight-line method based upon the estimated useful life of each class of depreciable asset. Depreciation was \$7,358,103 in 2009 and \$7,041,090 in 2008.

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest incurred was \$5,035,698 in 2008, of which \$1,046,359 was capitalized in 2008 and \$3,989,339 was charged to operations in 2008. Investment earnings of \$474,039 in 2008 were offset against the capitalized interest. Interest incurred was \$6,053,810 in 2009, all of which charged to operations as there was no capitalized interest.

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

IMPAIRMENT OF PROPERTY AND EQUIPMENT

Property and equipment are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If expected cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the assets. No such losses were recognized in 2009 and 2008.

DEFERRED FINANCING COSTS

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the term of the debt using an effective interest method. Amortization amounted to \$140,514 in 2009 and \$137,309 in 2008.

INTANGIBLE ASSETS

Costs incurred with the acquisition of physical therapy businesses exceeded the fair value of the net assets acquired. These excesses were allocated to intangible assets and are being amortized on a straight-line basis over periods ranging from 5 to 15 years. Amortization was \$57,554 in 2009 and \$54,726 in 2008.

DERIVATIVE FINANCIAL INSTRUMENTS

Good Shepherd has entered into two interest rate swap agreements, which are considered derivative financial instruments, to manage its interest rate exposure on certain long-term debt. The interest rate swap agreements are reported at fair value in the consolidated balance sheet and related changes in fair value are reported in the consolidated statement of operations as unrealized gain on derivative financial instruments.

SPLIT-INTEREST AGREEMENTS

GSRN received as contributions various types of split-interest agreements, including perpetual and charitable remainder trusts.

Under GSRN's charitable remainder trust arrangements, GSRN recorded the asset and recognized temporarily restricted contributions at the fair market value of GSRN's beneficial interest in the trust assets. Subsequent to certain events, GSRN may be entitled to a portion of the principal and income remaining in the trust. Subsequent changes in fair values are recorded as a change in value of split-interest agreements in temporarily restricted net assets.

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Under perpetual trust arrangements, GSRN recorded the asset and recognized permanently restricted contributions at the fair market value of GSRN's beneficial interest in the trust assets. Income earned on the trust assets and distributed to GSRN is recorded as unrestricted contributions in the accompanying consolidated statement of operations, unless otherwise restricted by the donor. Subsequent changes in fair values are recorded as valuation (loss) gain, beneficial interest in perpetual trusts in permanently restricted net assets.

TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are those whose use by Good Shepherd has been limited by donors to a specific purpose or time periods. Permanently restricted net assets have been restricted by donors to be maintained by Good Shepherd in perpetuity.

ENDOWMENT SPENDING POLICY

Commonwealth of Pennsylvania law permits Good Shepherd to allocate to income each year a portion of endowment return. The law allows non-profit organizations to spend a percentage of the market value of their endowment funds, including realized and unrealized gains. The percentage, which by law must be between 2% and 7%, is elected annually by the Board of Trustees. The endowment market value is determined based on an average spanning three years. Good Shepherd's policy for fiscal years 2009 and 2008 allowed for a payout of up to 5% of the three-year average of the fair market value of permanently restricted investments as stipulated by the Board of Trustees.

REVENUES (LESS THAN) IN EXCESS OF EXPENSES

The consolidated statements of operations include the determination of revenues (less than) in excess of expenses. Changes in unrestricted net assets which are excluded from the determination of revenues (less than) in excess of expenses, consistent with industry practice, include change in net unrealized gains and losses on investments other than trading securities, unrealized gain (loss) on derivative financial instruments, pension liability adjustments, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such long-lived assets).

NET PATIENT SERVICE REVENUES

Good Shepherd has agreements with third-party payors that provide for payments to Good Shepherd at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and contracted amounts. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. It is reasonably possible that the estimates used could change in the near term.

CHARITY CARE

Good Shepherd provides a significant amount of charity care to patients who meet certain criteria regardless of their ability to pay. The criteria for charity considers family size, sources of income, living expenses, net worth, ongoing healthcare needs, as well as other pertinent information. Because Good Shepherd does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenues. The amount of charity care provided to patients for the years ended June 30, 2009 and 2008, measured at charges, was \$2,026,000 and \$2,184,000, respectively. These amounts do not include doubtful accounts.

DONOR-RESTRICTED GIFTS

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statement of operations as net assets released from restrictions.

ADVERTISING COSTS

Advertising costs are expensed as incurred. Advertising expense was \$840,567 in 2009 and \$1,003,727 in 2008.

INCOME TAXES

GSRN, the Hospital, the LTC, Work Services, the LTACH, and SUPPIL are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on their exempt income under Section 501(a) of the Internal Revenue Code. The RRG is a taxable corporation that is subject to federal and state income taxes.

In 2008, Good Shepherd applied the guidance in FASB Staff Position FAB 126-1, "Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities" ("FSP 126-1"). FSP 126-1 amended certain accounting literature to include conduit debt obligors in the definition of a public entity or enterprise. As a result, Good Shepherd adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48") effective July 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. Management has determined that the adoption of FIN 48 did not have an effect on the consolidated financial statements.

Good Shepherd's policy is to recognize interest related to unrecognized tax benefits in interest expense and penalties in operating expenses.

Good Shepherd's federal Exempt Organization Business Income Tax Returns for 2006, 2007, and 2008 remain subject to examination by the Internal Revenue Service.

ESTIMATED MEDICAL MALPRACTICE COSTS

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

RECLASSIFICATIONS

Certain items relating to 2008 have been reclassified to conform to the 2009 reporting format.

2. NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 157

Effective July 1, 2008, Good Shepherd adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America, and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or the price that would be paid to dispose of a liability in an orderly transaction between market participants at the measurement date. The framework that SFAS No. 157 establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 – Fair value is based on unadjusted quoted prices in active markets that are accessible to Good Shepherd for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 – Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 – Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

The adoption of SFAS 157 did not have a material effect on Good Shepherd's consolidated financial statements but expanded disclosure with respect to fair value measurements.

SFAS No. 158

Good Shepherd adopted the measurement date provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" in its June 30, 2009 consolidated financial statements, which change the measurement date for its defined benefit pension plan from April 30 to June 30. The adoption of the measurement date provisions increased accrued pension cost and decreased unrestricted net assets by \$212,971 for 2009.

SFAS No. 159

Effective July 1, 2008, Good Shepherd adopted SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 permits entities to make an irrevocable election to value certain financial assets and liabilities, on an instrument-by-instrument basis, at fair value and include the change in fair value within the performance indicator. Good Shepherd did not elect to measure any eligible items at fair value. As a result, the adoption of SFAS 159 did not have an effect on Good Shepherd's consolidated financial statements.

SFAS No. 165

As of June 30, 2009, Good Shepherd adopted Statement of Financial Accounting Standards No. 165 "Subsequent Events" ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The adoption of SFAS 165 did not have an effect on Good Shepherd's consolidated financial statements.

FSP 117-1

In 2009, Good Shepherd adopted FSP FAS 117-1, 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 ("FSP 117-1"). FSP 117-1 requires an organization subject to an enacted version of the 2006 uniform Prudent Management of Institutional Funds Act ("UPMIFA") to classify a portion of a perpetual donor-restricted endowment fund as permanently restricted net assets (UPMIFA is not applicable to the state of Pennsylvania not-for-profits as of June 30, 2009). FSP 117-1 also requires all not-for-profit organizations with donor-restricted or board-restricted endowment funds to make extensive new disclosures about such funds regardless of whether an organization is subject to an enacted version of UPMIFA. FSP 117-1 did not have a material effect on Good Shepherd's consolidated financial statements.

3. NET PATIENT SERVICE REVENUES

Certain members of Good Shepherd have agreements with third-party payors that provide for payments at amounts different from their established rates. A significant portion of Good Shepherd's net patient service revenues is derived from those third-party payor programs. A summary of the principal payment arrangements with major third-party payors follows:

- **Medicare:** Inpatient rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services are paid at prospectively determined amounts based upon a published fee schedule. Inpatient post acute services for patients with an average patient stay longer than 25 days are paid at prospectively determined rates per discharge. Skilled nursing services are paid at prospectively determined rates per day and services to Medicare Part B beneficiaries are paid at the lesser of a published fee schedule or actual charges, subject to an annual limitation. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Reimbursements for cost reimbursable expenditures are received at tentative interim rates, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medicare cost reports have been settled by the Medicare fiscal intermediary through June 30, 2007.
- **Medical Assistance:** Inpatient rehabilitation services and skilled nursing services rendered to Medical Assistance program beneficiaries are paid at prospectively determined per diem rates. Outpatient services are paid based on a published fee schedule.
- **Blue Cross:** Inpatient rehabilitation services rendered to Blue Cross subscribers are paid at prospectively determined per diem rates. Outpatient services are paid based on a cost reimbursement methodology subject to a limitation.

Net patient service revenues decreased approximately \$113,000 in 2009 and increased approximately \$724,000 in 2008 due to settlement of prior years' activity with third-party payors.

Certain members of Good Shepherd also have entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations, and other organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined daily rates, or published fee schedules.

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4. INVESTMENTS

ASSETS WHOSE USE IS LIMITED

The composition of assets whose use is limited at June 30, 2009 and 2008 is set forth in the following table:

	<u>2009</u>	<u>2008</u>
Under trust indenture, held by trustee:		
Guaranteed income investment contract	\$ 2,240,558	\$ 2,240,558
Cash and cash equivalents	9,243,172	24,401,413
Accrued interest receivable	<u>15,012</u>	<u>110,059</u>
Subtotal	11,498,742	26,752,030
Under self-insurance program, held to meet state funding requirements,		
Cash and cash equivalents	1,985,353	1,668,296
Under mortgage agreement,		
Cash and cash equivalents	<u>274,063</u>	<u>304,496</u>
Total	13,758,158	28,724,822
Less funds held for current liabilities	<u>2,316,021</u>	<u>2,023,899</u>
Noncurrent portion of assets whose use is limited	<u>\$11,442,137</u>	<u>\$26,700,923</u>

BOARD DESIGNATED FUNDS AND INVESTMENTS

The composition of board designated funds and investments at June 30, 2009 and 2008 is set forth in the following table:

	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	\$ 58,719	\$ 1,279,718
Mutual funds	97,582,109	113,891,756
Marketable equity securities	5,024,832	6,224,401
Other bonds	-	168,009
Alternative investment, managed fund	18,525,018	23,423,509
Alternative investment, at cost	<u>16,672,256</u>	<u>16,707,166</u>
Total	<u>\$137,862,934</u>	<u>\$161,694,559</u>

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Investment income and gains and losses for assets whose use is limited, investments, and cash and cash equivalents are comprised of the following in 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Other operating revenues,		
Interest and dividend income	\$ <u>229,601</u>	\$ <u>458,188</u>
Investment income:		
Interest and dividend income	4,658,633	6,236,249
Realized gains on sale of securities, net	1,709,093	17,316,433
Write-down of the cost basis of investments due to an other-than-temporary decline in fair value	(703,779)	-
Change in unrealized (loss) gain on alternative investment recorded under the equity method	(4,565,323)	(1,679,027)
Investment expenses	<u>(392,831)</u>	<u>(488,698)</u>
Investment income	<u>705,793</u>	<u>21,384,957</u>
Total	<u>\$ 935,394</u>	<u>\$21,843,145</u>
Other changes in unrestricted net assets,		
Change in net unrealized gains and losses on investments other than trading securities	<u>\$(23,215,460)</u>	<u>\$(33,421,928)</u>

GOOD SHEPHERD REHABILITATION NETWORK
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5. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

FAIR VALUE MEASUREMENTS

Good Shepherd measures its assets whose use is limited, investments, beneficial interest in trusts, and derivative financial instruments on a recurring basis in accordance with SFAS No. 157. The financial instruments were measured with the following inputs at June 30, 2009:

	QUOTED PRICES IN ACTIVE MARKETS (LEVEL 1)	OTHER OBSERVABLE INPUTS (LEVEL 2)	UNOBSERVABLE INPUTS (LEVEL 3)
Assets:			
Cash and cash equivalents	\$ 11,088,110	\$ -	\$ -
Certificates of deposit	488,207	-	-
Guaranteed income investment contract	-	-	2,240,558
Marketable securities	5,024,833	-	-
Mutual funds	97,582,199	-	-
Alternative investment, managed fund	-	18,525,018	-
Beneficial interest in perpetual trusts	-	-	8,096,351
Beneficial interest in charitable remainder trusts	-	-	9,314,183
Total	<u>\$114,183,349</u>	<u>\$18,525,018</u>	<u>\$19,651,092</u>
Liabilities:			
Derivative financial instruments	\$ -	\$ 3,347,297	\$ -

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Changes in the beneficial interest in perpetual trusts and charitable remainder trusts in 2009 are as follows:

	BENEFICIAL INTEREST IN PERPETUAL TRUSTS	BENEFICIAL INTEREST IN CHARITABLE REMAINDER TRUSTS
Beginning balance	\$10,718,249	\$11,674,639
Trust interests added in the current year	94,816	-
Trust interests terminated during the current year	(187,106)	-
Change in unrealized gains and losses	<u>(2,529,608)</u>	<u>(2,360,456)</u>
Ending balance	<u>\$ 8,096,351</u>	<u>\$ 9,314,183</u>

Beneficial interest in perpetual and charitable remainder trusts are valued at fair value, which are the amounts reported in the consolidated balance sheet. The fair value takes into consideration the underlying principal for these assets and Good Shepherd's interest in the trusts. In accordance with SFAS No. 157, these assets are to be valued based on discounted cash flows and as such are determined to be measured with Level 3 inputs as disclosed above.

Guaranteed investment contracts are valued based on unobservable inputs, as observable inputs are not available, using valuation methodologies to determine fair value to include discounted cash flows and other similar techniques. There were no changes in the guaranteed income investment contract during the current year.

Level 1 assets whose use is limited and investments are valued at fair value, which are the amounts reported in the consolidated balance sheet, based on quoted market prices. Mutual fund securities are valued based on the net asset value ("NAV") of the shares held by Good Shepherd at year end.

Good Shepherd measures its alternative investment-managed fund above at fair value based on the net asset value of the fund held at the end of the year. The fair value is based on the fund's underlying investments using observable inputs (Level 2) in accordance with SFAS No. 157.

Good Shepherd did not have any financial assets or financial liabilities measured at fair value on a non-recurring basis.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, accounts payable and accrued expenses, accrued compensation and related items, and estimated third-party payor settlements approximate their related fair values due to the short-term nature of these instruments. The fair value of Good Shepherd's alternative investment accounted for under the cost method was approximately \$10,400,000 at June 30, 2009. At June 30, 2008 the carrying value of this investment approximated fair value. Management has determined that its investment is not other-than-temporarily impaired as of June 30, 2009. This determination was based on several factors, including the financial condition and prospects of the fund, the fact that the decline in fair value of the investment occurred in fiscal 2009, and management's intent and ability to retain its investment for a sufficient period of time to recover its cost basis in the investment.

The carrying amounts reported in the consolidated balance sheets for Good Shepherd's variable rate long-term debt and HUD mortgages payable approximate their fair value. The fair value of Good Shepherd's remaining long-term obligations was approximately \$77,459,000 and \$83,197,000 as of June 30, 2009 and 2008, respectively, and are estimated based on market data provided by Good Shepherd's financial consultants.

The fair value of the interest rate swap derivative financial instruments is determined by an independent third party valuation specialist based on proprietary models of discounted cash flows. The fair value takes into consideration the prevailing interest rate environment and the specific terms and conditions of the derivative financial instrument, and considers the credit risk of Good Shepherd and the counterparty. The method used to determine the fair value calculates the estimated future payments required by the derivative financial instrument and discounts these payments using an appropriate discount rate. The value represents the estimated exit price Good Shepherd would pay to terminate the agreement.

**6. INVESTMENT IN AND OTHER ASSETS PERTAINING TO
UNCONSOLIDATED SUBSIDIARY**

On January 23, 2007, GSRN entered into a joint venture agreement with the Trustees of the University of Pennsylvania (the "University") to create Philadelphia Post-Acute Care Partners, LLC D/B/A Good Shepherd Penn Partners ("GSPP"). GSPP was created to establish and operate a new long-term acute care hospital, to assume the ownership of and continue to operate all of the outpatient rehabilitation operations of the University, to carry out, the day-to-day operations of the Hospital of the University of Pennsylvania's ("HUP") inpatient rehabilitation unit, and to provide the University and its Affiliates with certain clinical and/or staffing service relating to rehabilitation. GSRN is a seventy percent owner of GSPP; however, the operations of GSPP are not consolidated in the accompanying consolidated financial statements as GSRN is not deemed to have control over GSPP. As a result, GSRN records their investment in GSPP under the equity method in the accompanying consolidated financial statements. The operations of GSPP commenced on July 1, 2008.

As a result of this joint venture, GSRN entered into two lease agreements with the University. The first lease relates to an inpatient rehabilitation facility ("IRF") in which GSRN leases space in a building owned by the University. This space is then subleased to the University from GSRN for the operations of the IRF. The second lease relates to a long-term acute care hospital ("GSPP LTACH") which GSRN leased from the University until the commencement of the joint venture at which time GSRN's interest in this lease was assigned to GSPP and the Fixed Rent Amounts (see discussion below) were assigned to GSPP as a capital contribution. The commencement date of both of the leases referred to above was June 23, 2008.

Through the payment to the University of the "Fixed Rent Amounts" as defined in the lease agreements, GSRN was required to fund the IRF and GSPP LTACH project renovation and construction costs. GSRN financed these costs through the issuance of the Series 2007A Bonds (See Note 10). The total fixed rent payments that GSRN made on behalf of the IRF space totaled \$20,879,369 and are being amortized based on the monthly rental amounts due to GSRN from the University per the terms of the sublease. The total fixed rent payments that GSRN made on behalf of the GSPP LTACH space totaled \$17,815,704 were transferred to GSPP during fiscal 2009 and represent GSRN's capital contribution to GSPP. This amount is included in GSRN's investment in GSPP balance at June 30, 2009.

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GSRN's investment in and other assets pertaining to GSPP are comprised of the following components:

	<u>2009</u>	<u>2008</u>
Fixed rent amounts paid related to the IRF lease	\$20,774,297	\$13,194,427
Fixed rent amounts paid related to the GSPP LTACH lease	-	11,147,652
Due from GSPP	953,155	1,514,224
Investment in GSPP	<u>14,491,903</u>	<u>(1,342,449)</u>
Investment in and other assets pertaining to GSPP	36,219,355	24,513,854
Less: current portion	<u>(1,309,905)</u>	-
Investment in and other assets pertaining to GSPP, non-current portion	<u>\$34,909,450</u>	<u>\$24,513,854</u>

GSRN recognized a loss of \$1,045,456 in 2009 and \$1,349,449 in 2008 as its share of GSPP's loss in the accompanying consolidated statement of operations. In addition, GSRN recognized its share of GSPP's pension liability adjustment of \$910,271 in 2009 which is included in other changes in unrestricted net assets in the 2009 consolidated statement of operations.

7. PROPERTY AND EQUIPMENT AND ACCUMULATED DEPRECIATION

Property and equipment and accumulated depreciation at June 30, 2009 and 2008 consists of the following:

	<u>2009</u>	<u>2008</u>
Land and land improvements	\$ 9,267,391	\$ 8,981,144
Buildings	76,659,395	74,781,042
Leasehold improvements	5,878,796	5,120,797
Equipment	69,062,259	65,623,338
Construction-in-progress	<u>3,883,875</u>	<u>46,905</u>
Total	164,751,716	154,553,226
Less accumulated depreciation	<u>84,180,954</u>	<u>75,893,059</u>
Property and equipment, net	<u>\$ 80,570,762</u>	<u>\$ 78,660,167</u>

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Good Shepherd recognized a loss of \$236,925 in 2008 associated with the write off of certain renovation costs associated with its long-term acute care hospital.

In 2008, Good Shepherd marketed to sell a parcel of land and the related building. A sales contract was signed for the property and the sale was scheduled to be completed in 2009. The property was recorded at the lower of carrying value or fair value, which was \$1,363,133 at June 30, 2008. The sale was subsequently cancelled and no other such activity occurred. The property was classified as assets held for sale in the 2008 consolidated balance sheet; however, due to the cancellation of the sales contract in 2009 it has been reclassified to property and equipment at June 30, 2009.

8. PLEDGES RECEIVABLE

GSRN has undertaken a capital pledge campaign to raise funds in connection with various construction and renovation projects. Pledges and grants related to this campaign have been recorded as temporarily restricted contributions.

Pledges receivable are recorded as follows at June 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Capital campaign pledges before unamortized discount and allowance for uncollectible pledges	\$2,281,385	\$3,078,838
Less unamortized discount	<u>57,708</u>	<u>124,072</u>
Subtotal	2,223,677	2,954,766
Less allowance for uncollectible pledges	<u>222,368</u>	<u>295,477</u>
Pledges receivable, net	<u>\$2,001,309</u>	<u>\$2,659,289</u>
Amounts due in:		
Less than one year	\$ 589,450	\$ 886,905
One to five years	612,455	1,259,433
Five to ten years	<u>1,079,480</u>	<u>932,500</u>
Total	<u>\$2,281,385</u>	<u>\$3,078,838</u>

The discount rate used was approximately 2.5% at June 30, 2009.

9. DEMAND NOTE PAYABLE

GSRN, the Hospital, the LTC, and Work Services have a \$12,000,000 unsecured bank line of credit agreement with interest at LIBOR plus 1%, and an availability fee of .5% of the unused balance. The line of credit expires on December 31, 2009. Borrowings at June 30, 2009 were \$2,186,000. There were no borrowings as of June 30, 2008.

10. REVENUE BONDS

In June 2004, the Lehigh County General Purpose Authority (the "Authority") issued \$32,520,000 of its tax-exempt revenue bonds (the "2004 Bonds") to provide funds to finance the cost of various capital projects of Good Shepherd, establish a debt service reserve fund, and pay costs of the 2004 Bonds.

In November 2007, the Authority issued \$51,645,000 of its tax-exempt revenue bonds (the "2007A Bonds") to provide funds to finance the capital investment requirements associated with the GSPP's development of a long-term acute care hospital and inpatient rehabilitation unit through prepaid lease arrangements (See Note 6). The Series 2007A Bonds also provided funds to finance the cost of various capital projects of Good Shepherd, establish a debt service reserve fund, and pay costs of the 2007A Bonds.

In November 2007, the Authority also issued \$29,395,000 of its tax-exempt revenue bonds (the "2007B Bonds") to provide funds to refund the 1997 Bonds, establish a debt service reserve, and pay costs of the 2007B Bonds. In April 2008, GSRN converted the 2007B Bonds from auction rate securities to variable rate demand bonds.

In April 2008, the Authority issued \$13,015,000 of its tax-exempt revenue bonds (the "2008 Bonds") to currently refund the 2000 Bonds and pay costs of the 2008 Bonds.

The 2004 Bonds, the 2007 Bonds, and the 2008 Bonds (collectively, the "Revenue Bonds") were issued pursuant to a Loan and Trust Agreement, as amended and supplemented by Supplemental Loan and Trust Agreements (collectively, the "Agreements"). In connection with the Agreements, GSRN, the Hospital, the LTC, and Work Services (collectively, the "Obligated Group") have agreed to be jointly and severally liable for the repayment of the Revenue Bonds.

GOOD SHEPHERD REHABILITATION NETWORK
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The Obligated Group is obligated for the payments under the terms of the Agreements which are structured to meet the Authority's principal and interest requirements on the Revenue Bonds. At June 30, 2009 and 2008, the Revenue Bonds are as follows:

	<u>2009</u>	<u>2008</u>
<u>2004 Bonds:</u>		
<u>Term Bonds</u>		
Bonds due on November 1, 2009, plus interest at 4.0%. Beginning on November 1, 2005, bonds to be selected by lot will be redeemed in varying installments through 2009	\$ 565,000	\$ 1,105,000
<u>Term Bonds</u>		
Bonds due on November 1, 2014, plus interest at 5.25%. Beginning on November 1, 2010, bonds to be selected by lot will be redeemed in varying installments through 2014	3,255,000	3,255,000
<u>Term Bonds</u>		
Bonds due on November 1, 2024, plus interest at 5.50%. Beginning on November 1, 2015, bonds to be selected by lot will be redeemed in varying installments through 2024	9,745,000	9,745,000
<u>Term Bonds</u>		
Bonds due on November 1, 2034, plus interest at 5.625%. Beginning on November 1, 2025, bonds to be selected by lot will be redeemed in varying installments through 2034	16,745,000	16,745,000
<u>2007A Bonds:</u>		
<u>Serial Bonds</u>		
Bonds due in varying installments through November 1, 2019, plus interest at rates ranging from 4.00% to 4.50%	10,105,000	10,105,000
<u>Term Bonds</u>		
Bonds due on November 1, 2022, plus interest at 4.50%. Beginning on November 1, 2020, bonds to be selected by lot will be redeemed in varying installments through 2022	3,660,000	3,660,000

GOOD SHEPHERD REHABILITATION NETWORK
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	<u>2009</u>	<u>2008</u>
<u>Term Bonds</u>		
Bonds due on November 1, 2030, plus interest at 5.00%. Beginning on November 1, 2023, bonds to be selected by lot will be redeemed in varying installments through 2030.	\$ 9,850,000	\$ 9,850,000
<u>Term Bonds</u>		
Bonds due on November 1, 2037, plus interest at 5.00%. Beginning on November 1, 2031, bonds to be selected by lot will be redeemed in varying installments through 2037.	28,030,000	28,030,000
<u>2007B Bonds:</u>		
<u>Serial Bonds</u>		
Bonds due in varying installments through November 1, 2028, plus interest at a variable rate (a)	28,380,000	29,395,000
<u>2008 Bonds:</u>		
<u>Serial Bonds</u>		
Bonds due in varying installments through November 1, 2029, plus interest at a variable rates (b)	<u>12,745,000</u>	<u>13,015,000</u>
Total	123,080,000	124,905,000
Less current maturities	2,665,000	1,825,000
Less bond discounts	<u>685,177</u>	<u>733,991</u>
Long-term debt	<u>\$119,729,823</u>	<u>\$122,346,009</u>

GOOD SHEPHERD REHABILITATION NETWORK
 AND CONTROLLED ENTITIES
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Scheduled principal repayments on the Revenue Bonds at June 30, 2009 are as follows:

YEARS ENDING JUNE 30

2010	\$ 2,665,000
2011	2,775,000
2012	2,875,000
2013	2,995,000
2014	3,115,000
Thereafter	<u>108,655,000</u>
Total	<u>\$123,080,000</u>

- (a) The 2007B Bonds bear interest at a variable rate, adjusted on a weekly basis as defined under the Series 2007 Bond Agreements. The 2007B Bonds may be converted to bear interest at Auction Period Rates, Daily Rates, Short-Term Rates, Long-Term Rates, or Fixed Rates as defined under the bond agreements. Under no circumstances shall the interest rate exceed 12%. The interest rate at June 30, 2009 was .28%. Good Shepherd has an interest rate swap agreement for the term of these bonds whereby Good Shepherd agreed to swap its variable interest payments for a fixed interest rate of 3.644% including related costs. (See Note 15)
- (b) The 2008 Bonds bear interest at the Variable Rate as defined under the Series 2008 Bond Agreements. Under no circumstances shall the interest rate exceed an annual rate of 12%. The interest rate at June 30, 2009 was .32%. Good Shepherd has an interest rate swap agreement for the term of these bonds whereby Good Shepherd agreed to swap its variable interest payments for a fixed interest rate of 3.315% including related costs. (See Note 15)

The Obligated Group executed loan and trust agreements to secure their payment obligations and collateralized their repayment obligations with a pledge of their gross revenues. Further, a trustee for the Authority holds certain deposits for the benefit of the holders of the bonds. Such deposits are included with assets whose use is limited in the accompanying consolidated balance sheet.

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The scheduled payments of principal and interest on the Series 2007A and 2007B Bonds when due are guaranteed under a financial guaranty insurance policy (the "Bond Insurance Policy") issued by Assured Guaranty Corp. As long as the Bond Insurance Policy is in effect, the Obligated Group is required to maintain a ratio of Aggregate Income Available for Debt Service to Maximum Annual Debt Service (the "Debt Service Ratio") of at least 1.15. The 2008 Bonds are secured by a Letter of Credit issued by Wachovia Bank, National Association ("Wachovia") pursuant to a Reimbursement, Credit and Security Agreement (the "Reimbursement Agreement") among the Obligated Group Members and Wachovia, which Reimbursement Agreement requires the maintenance of a Debt Service Ratio of 1.25. For purposes of these Debt Service Ratio calculations, Aggregate Income Available for Debt Service is determined by the addition of Obligated Group Depreciation and Amortization Expense, Interest Expense, and other non-cash charges as permitted under the bond agreements, to Revenues (Less Than) in Excess of Expenses of the Obligated Group. The Equity in Loss on Investment in Unconsolidated Subsidiary is excluded from Aggregate Income Available for Debt Service as the unconsolidated subsidiary is not an Obligated Group member.

As long as the Bond Insurance Policy is in effect, the Obligated Group also must maintain a liquidity ratio of at least 90 days of operating expenses in unrestricted cash and investments. This requirement is 120 days under the Reimbursement Agreement. Additionally, as long as the Bond Insurance Policy is in effect, the Obligated Group is required to maintain a debt to capitalization ratio of less than 67% and the documents relating to the Bonds establish limits on the incurrence of additional indebtedness and on the permitted transfer of assets to nonobligated group members as long as the Bonds are outstanding.

The above financial covenants are measured at June 30 of each year pursuant to the provisions of the documents relating to the Bonds and at both December 31 and June 30 of each year pursuant to the provisions of the Reimbursement Agreement.

A loss on extinguishment of debt of \$2,111,926 was recognized in fiscal 2008 related to the refunding of the 1997 and 2000 Bonds. The principal components of the loss included the write-off of unamortized deferred financing costs and a call premium paid on the 1997 Bonds.

Good Shepherd, along with the University, has guaranteed certain third-party debt of GSPP in relation to their ownership interests. The guarantee term is for the term of the underlying loan agreement which expires June 27, 2012. Should Good Shepherd be obligated to perform under the guarantee arrangement, Good Shepherd may seek reimbursement from GSPP. At June 30, 2009, the total outstanding balance of the loan was \$9,000,000.

11. MORTGAGES PAYABLE

Mortgages payable at June 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Mortgage payable, United States Department of Housing and Urban Development ("HUD"), under Section 811 of the National Affordable Housing Act. The mortgage bears no interest and repayment is not required as long as housing remains available for very low-income persons through the maturity date of June 1, 2043. Failure to keep the housing available for persons would result in HUD's billing SUPPIL for the entire capital advance outstanding plus interest since the date of the first advance. The mortgage grants HUD a security interest in substantially all SUPPIL's property and equipment and gross revenues	\$1,495,500	\$1,495,500
Mortgage payable, National Penn Bank ("NPB"), recipient of a direct subsidy through the Affordable Housing Program of Federal Home Loan Bank of Pittsburgh ("FHLB"). The mortgage bears no interest and repayment is not required as long as housing remains available for very low-income persons through the maturity date of July 15, 2017. Failure to keep the housing available for persons would result in FHLB's billing SUPPIL for the entire mortgage outstanding plus interest since the date of the first advance. The mortgage grants NPB a second mortgage in substantially all SUPPIL's property and equipment and gross revenues	<u>180,000</u>	<u>180,000</u>
Long-term debt	<u>\$1,675,500</u>	<u>\$1,675,500</u>

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
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12. ACCRUED EXPENSES

Accrued expenses at June 30, 2009 and 2008 consist of the following:

	<u>2009</u>	<u>2008</u>
Salaries and wages and payroll taxes	\$1,565,658	\$3,054,571
Paid time off	2,679,474	2,378,178
Interest	278,266	326,502
Employee benefits	331,071	288,000
Other	<u>218,175</u>	<u>484,745</u>
Total	<u>\$5,072,644</u>	<u>\$6,531,996</u>

13. OTHER LIABILITIES

Other liabilities at June 30, 2009 and 2008 consist of the following:

	<u>2009</u>	<u>2008</u>
Charitable gift annuities	\$3,771,078	\$4,852,132
Workers' compensation	1,123,477	1,211,523
Annuities payable	253,274	290,105
Estimated medical malpractice claims liability	276,929	421,459
Defined contribution plan liability	<u>80,852</u>	<u>79,805</u>
Total	<u>\$5,505,610</u>	<u>\$6,855,024</u>

14. PENSION PLANS

DEFINED BENEFIT PENSION PLAN

Good Shepherd sponsors a defined benefit pension plan for its employees. The plan provides benefits based on years of service and final average salary.

In accordance with SFAS No. 158, Good Shepherd recognizes the funded status of its defined benefit pension plan in its consolidated balance sheet. The funded status is measured as the difference between plan assets at fair value and the projected benefit obligation.

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
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Changes in the funded status will be recognized through a change in unrestricted net assets in the year in which the change occurs. Amounts recognized in the balance sheet, including the gains or losses, prior service costs or credits, and the transition asset or obligation remaining from the initial application of SFAS No. 87, "Employers' Accounting for Pension," are adjusted as they are subsequently recognized as components of net periodic pension cost pursuant to the recognition and measurement provisions of SFAS No. 158.

The following table sets forth the change in benefit obligation, the fair value of plan assets, and the amounts recognized in the consolidated balance sheet at June 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Change in projected benefit obligation:		
Benefit obligation, beginning of year	\$40,401,214	\$34,365,430
Service cost	1,891,107	1,945,641
Interest cost	2,400,304	2,161,159
Actuarial (gain) loss	(1,704,854)	1,185,610
Benefits paid	(705,336)	(635,380)
Adjustment to reflect measurement date change	593,880	-
Change in plan provisions and assumptions	-	<u>1,378,754</u>
Projected benefit obligation, end of year	<u>42,876,315</u>	<u>40,401,214</u>
Change in plan assets:		
Fair value of plan assets, beginning of year	\$ 38,505,684	\$39,010,292
Actual return on plan assets (net of expense)	(5,316,728)	(879,208)
Employer contributions	1,500,400	1,009,980
Benefits paid	(705,336)	(635,380)
Adjustment to reflect measurement date change	<u>394,795</u>	-
Fair value of plan assets, end of year	<u>34,378,815</u>	<u>38,505,684</u>
Funded status of the plan at end of year	<u>\$ (8,497,500)</u>	<u>\$ (1,895,530)</u>
Accumulated benefit obligation	<u>\$37,064,130</u>	<u>\$35,501,071</u>

GOOD SHEPHERD REHABILITATION NETWORK
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	<u>2009</u>	<u>2008</u>
Net amount recognized in consolidated balance sheets consist of,		
Accrued pension cost	<u>\$ 8,497,500</u>	<u>\$1,895,530</u>
Amounts recognized in accumulated unrestricted net assets consist of:		
Actuarial loss	\$11,089,271	\$4,416,986
Prior service cost	<u>374,276</u>	<u>434,987</u>
	<u>\$11,463,547</u>	<u>\$4,851,973</u>

The following table sets forth the components of net periodic pension cost in 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Service cost	\$ 1,891,107	\$ 1,945,641
Interest cost	2,400,304	2,161,159
Expected return on plan assets	(3,096,900)	(3,131,793)
Amortization of unrecognized prior service cost	<u>83,314</u>	<u>32,641</u>
Net periodic pension cost	<u>\$ 1,277,825</u>	<u>\$ 1,007,648</u>

The Hospital intends to contribute approximately \$2,338,000 to the plan in 2010.

The measurement dates used to determine the pension plan asset and benefit obligation information were June 30, 2009 and April 30, 2008.

A net loss of \$11,089,271 and net prior service cost of \$374,276 represent the unrecognized components of net periodic pension cost included in unrestricted net assets at June 30, 2009.

Amortization of the net loss expected to be recognized in net periodic pension cost in 2010 is \$579,000.

GOOD SHEPHERD REHABILITATION NETWORK
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The weighted-average assumptions used in computing the benefit obligation at June 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.25%	6.00%
Rate of compensation increase	3.25%	3.00%

The weighted-average assumptions used in the measurement of the net periodic pension cost in 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	3.00%	2.75%

The expected long-term rate of return on the assets of the plans assumption was developed based on historical returns for the major asset classes. This review also considered both current market conditions and projected future conditions. Adjustments are made to the expected long-term rate of return assumption when deemed necessary based upon revised expectations of future investment performance of the overall capital markets.

The following table sets forth the actual asset allocation and target asset allocation for plan assets at June 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>	TARGET ASSET ALLOCATION <u>2009</u>	TARGET ASSET ALLOCATION <u>2008</u>
Equity securities	51%	55%	50%	60%
Debt securities	42%	45%	40%	40%
Real Estate	7%	0%	10%	0%

The assets of the plan are invested among and within various asset classes in order to achieve sufficient diversification in accordance with Good Shepherd's investment objectives. This is achieved through the utilization of asset managers and systematic allocation to investment management styles, providing a broad exposure to different segments of the fixed income and equity markets.

GOOD SHEPHERD REHABILITATION NETWORK
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The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

YEARS ENDING JUNE 30

2010	\$ 777,000
2011	859,000
2012	961,000
2013	1,368,000
2014	1,575,000
2015-2019	12,079,000

DEFINED CONTRIBUTION PENSION PLAN

Good Shepherd established a defined contribution plan in 2007 that is available to substantially all employees. Pension expense was \$828,800 in 2009 and \$532,850 in 2008.

15. INTEREST RATE SWAP AGREEMENTS

Good Shepherd has entered into two interest rate swap agreements, which are considered derivative financial instruments, to hedge variable rate interest rate payments due on certain long-term debt (See Note 10). Good Shepherd documents its risk management strategy and hedge effectiveness at the inception of and during the term of the hedge. The objective of the swap agreements is to minimize the risks associated with financing activities by reducing the impact of changes in the interest rate on variable rate debt. The swap agreements are contracts to exchange variable rate for fixed rate payments over the term of the swap agreement without the exchange of the underlying notional amount. The notional amount of the swap agreements are used to measure the interest to be paid or received and does not represent the amount of exposure to credit loss. Exposure to credit loss is limited to the receivable, if any, which may be generated as a result of the swap agreements. Management believes that losses related to credit risk are remote. The net cash paid or received under the swap agreements are recognized as an adjustment to interest expense. As a result of these swap agreements, interest expense was increased by \$1,306,751 in 2009 and \$308,546 in 2008. Good Shepherd does not utilize interest rate swap agreements or other financial instruments for trading or other speculative purposes.

GOOD SHEPHERD REHABILITATION NETWORK
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At June 30, 2009, Good Shepherd has the following interest rate swaps in effect:

Notional amount at June 30, 2009	\$12,525,000
Notional amount at June 30, 2008	\$12,760,000
Fixed rate	3.315%
Variable rate	Weekly auction
Maturity date	November 2029

Notional amount at June 30, 2009	\$28,380,000
Notional amount at June 30, 2008	\$29,395,000
Fixed rate	3.644%
Variable rate	Weekly auction
Maturity date	November 2027

A reconciliation of the beginning and ending balances of the Fair Value of the Derivative Financial Instruments is as follows:

	<u>2009</u>	<u>2008</u>
Fair value of Derivative Financial Instruments, beginning of year	\$(1,192,937)	\$ 1,214,881
Change in fair value of Derivative Financial Instruments, effective portion	(1,037,588)	(2,407,818)
Change in fair value of Derivative Financial Instruments, ineffective portion	<u>(1,116,772)</u>	<u> </u>
Fair Value of Derivative Financial Instruments, end of year	<u>\$(3,347,297)</u>	<u>\$(1,192,937)</u>

Good Shepherd does not anticipate that any significant gains or losses excluded from revenues (less than) in excess of expenses will be reclassified into revenues (less than) in excess of expenses within the next twelve months.

16. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes at June 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Healthcare coordination and outreach	\$6,332,337	\$ 9,996,081
Purchase of property and equipment	<u>1,212,670</u>	<u>1,827,161</u>
Total	<u>\$7,545,007</u>	<u>\$11,823,242</u>

During 2009 and 2008, net assets were released from donor restrictions by satisfying their restricted purpose in the amount of \$2,103,602 and \$6,366,797, respectively.

PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of GSRN's beneficial interest in several perpetual trusts and annuities which are held by outside organizations serving as trustee. It also includes endowments that have been established with GSRN to be held in perpetuity. These funds are included in the investment portfolio. The terms of the trusts are such that GSRN receives a portion of the income earned on the trust assets. Trust assets consist primarily of marketable equity securities, debt securities, and cash and cash equivalents recorded at their fair value as of June 30, 2009 and 2008 and consist of the following:

	<u>2009</u>	<u>2008</u>
Investment to be held in perpetuity, the income from which is generally available for rehab services and programs	\$14,841,284	\$14,352,769
Lifetime endowment trusts held in perpetuity	8,096,351	10,718,249
Annuity funds held in perpetuity	<u>160,605</u>	<u>153,790</u>
Total	<u>\$23,098,240</u>	<u>\$25,224,808</u>

17. ENDOWMENT FUNDS

GSRN's endowment funds consist of funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds at the current time. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

GSRN has interpreted relevant Pennsylvania law governing the net asset classification of endowment funds as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, GSRN classifies as permanently restricted net assets (a) the original value of gifts donated as permanent endowments; (b) the original value of subsequent gifts to the permanent endowments, 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 not classified in permanently restricted net assets is classified as either unrestricted or temporarily restricted net assets, based on the existence of donor restriction or by law.

GSRN has adopted investment and spending policies for its endowment assets that attempt to preserve the capital and achieve sufficient total return to fund the annual operating and capital expenditures in accordance with the donor restrictions. To achieve this overall goal, the primary objective of the investment policy is the long-term growth of capital. A real rate of return over capital is required to preserve the purchasing power of the endowment funds. The secondary objective of the investment policy is the preservation of capital, including the protection of capital in declining markets. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. GSRN expects its endowment funds, over time, to provide an average return of approximately 8% annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, GSRN 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). GSRN targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

GOOD SHEPHERD REHABILITATION NETWORK
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GSRN has a policy of appropriating for distribution each year 5 percent of the three-year average of the fair market value of permanently restricted investments as stipulated by the Board of Trustees, in accordance with Pennsylvania Trust Fund Law. In establishing this policy, GSRN considered the long-term expected return on its endowments, which has been estimated (after inflation) at 8% of investment assets after all investment related fees and costs have been paid. Accordingly, over the long term, GSRN expects the current spending policy to allow its endowment funds to preserve the fair value of the original gifts. This is consistent with the GSRN's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

Endowment net asset composition by type of fund as of June 30, 2008:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Donor-restricted endowment funds	\$ -	\$2,965,254	\$14,352,769	\$17,318,023
Board-designated endowment funds	<u>3,269,019</u>	-	-	<u>3,269,019</u>
Total funds	<u>\$3,269,019</u>	<u>\$2,965,254</u>	<u>\$14,352,769</u>	<u>\$20,587,042</u>

GOOD SHEPHERD REHABILITATION NETWORK
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Changes in endowment net assets for the year ended June 30, 2008 is as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, beginning of year	<u>\$3,000,000</u>	<u>\$ 4,582,394</u>	<u>\$14,195,623</u>	<u>\$21,778,017</u>
Investment return:				
Investment income		426,393		426,393
Net appreciation (depreciation) (realized and unrealized)	<u>269,019</u>	<u>(1,121,985)</u>	_____	<u>(852,966)</u>
Total investment return	269,019	(695,592)	-	(426,573)
Contributions			590,068	590,068
Appropriation of endowment assets for expenditure	_____	<u>(921,548)</u>	<u>(432,922)</u>	<u>(1,354,470)</u>
Endowment net assets, end of year	<u>\$3,269,019</u>	<u>\$ 2,965,254</u>	<u>\$14,352,769</u>	<u>\$20,587,042</u>

Endowment net asset composition by type of fund as of June 30, 2009:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Donor-restricted endowment funds	\$ (593,703)	\$652,751	\$14,841,284	\$14,900,332
Board-designated endowment funds	<u>3,000,000</u>	_____	_____	<u>3,000,000</u>
Total funds	<u>\$2,406,297</u>	<u>\$652,751</u>	<u>\$14,841,284</u>	<u>\$17,900,332</u>

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Changes in endowment net assets for the year ended June 30, 2009 is as follows:

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, beginning of year	\$3,269,019	\$2,965,254	\$14,352,769	\$20,587,042
Investment return:				
Investment income		322,846		322,846
Net depreciation (realized and unrealized)	<u>(269,019)</u>	<u>(2,636,953)</u>	<u> </u>	<u>(2,905,972)</u>
Total investment return	(269,019)	(2,314,107)		(2,583,126)
Contributions			654,587	654,587
Appropriation of endowment assets for expenditure		(592,099)	(166,072)	(758,171)
Other changes	<u>(593,703)</u>	<u>593,703</u>	<u> </u>	<u> </u>
Endowment net assets, end of year	<u>\$2,406,297</u>	<u>\$ 652,751</u>	<u>\$14,841,284</u>	<u>\$17,900,332</u>

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or law requires GSRN to retain as a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature that are reported in unrestricted net assets were \$593,703 as of June 30, 2009. There were no such deficiencies as of June 30, 2008.

18. MEDICAL MALPRACTICE CLAIMS COVERAGE

PRIMARY COVERAGE

Effective February 3, 2006, primary medical and professional liability coverage for Good Shepherd is being provided through the RRG. The RRG is a separate legal entity established for the payment of medical malpractice claim settlements and expenses. Good Shepherd was required to deposit an initial capital investment of \$1,125,000 into the RRG. Good Shepherd's annual funding requirements and capital investment were determined by an actuary based upon an evaluation of Good Shepherd's past claims history.

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The coverage limits for medical malpractice claims under the RRG are \$500,000 per occurrence and either \$1,500,000 or \$2,500,000, depending on the applicable entity, in the aggregate per year. The medical malpractice coverage is funded on a mature claims-made basis with retroactive coverage.

Previously, Good Shepherd insured medical malpractice coverage on a claims-made basis.

MCARE FUND COVERAGE

The Pennsylvania Medical Care Availability and Reduction of Error Fund ("MCARE Fund") provides excess coverage per the Pennsylvania law governing the MCARE Fund. Pursuant to the per occurrence and aggregate limits set forth in the controlling Pennsylvania statutes, the MCARE Fund provides coverage for losses in excess of the primary coverage that was in effect on the date of the incident. The cost of MCARE Fund coverage is recognized as expense in the period incurred. Increases in annual surcharges and concerns over the MCARE Fund's ability to manage and pay claims continue to result in proposals to reform or restructure the MCARE Fund. MCARE Fund coverage is currently scheduled to be reduced in 2010, unless the State Insurance Commissioner determines that additional primary insurance capacity is not available at that time, and eliminated three years after such reduction Good Shepherd will be required to purchase additional primary insurance to take the place of the MCARE Fund coverage as it phases out. Depending upon the ultimate resolution of this matter, Good Shepherd may incur additional insurance costs.

UMBRELLA OR EXCESS COVERAGE

Umbrella liability insurance coverage insures against losses in excess of the primary or MCARE Fund coverage reported during the period the contract is in force.

Good Shepherd believes it has adequate insurance coverages for all asserted claims and it has no knowledge of unasserted claims which would exceed its insurance coverages.

Good Shepherd's estimated medical malpractice claims liability for both asserted and unasserted claims was \$276,929 and \$421,459 at June 30, 2009 and 2008, respectively. The discount rate used in determining these liabilities was 4% at June 30, 2009 and 8% at June 30, 2008. It is reasonably possible that the estimates used could change materially in the near term.

19. SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Good Shepherd's primary operations and service area includes most communities of Lehigh, Northampton, and Monroe Counties, Pennsylvania. Good Shepherd grants credit without collateral to its patients, who are insured under third-party payor arrangements, primarily with Medicare, Medical Assistance, Blue Cross, and various commercial insurance companies.

Good Shepherd maintains its cash and cash equivalents with several financial institutions. Cash and cash equivalents on deposit with any one financial institution are insured to \$250,000.

20. LEASE AND OTHER COMMITMENTS

Certain members of Good Shepherd are committed under the terms of operating leases for future minimum rental payments on real property and equipment as follows:

YEARS ENDING JUNE 30

2010	\$2,659,022
2011	2,074,003
2012	1,703,276
2013	1,046,921
2014	<u>604,845</u>
Total	<u>\$8,088,067</u>

Rental expense for these operating leases was \$2,719,183 in 2009 and \$2,536,609 in 2008.

21. SELF-FUNDED PLAN

Good Shepherd maintains a self-insurance program for its workers' compensation costs. Estimated self-insurance costs are accrued based upon actuarial determinations, data provided by the third-party administrator of the program, and historical claims experience. Self-insurance costs incurred under this program were \$808,772 and \$1,062,374 in 2009 and 2008, respectively, and are included in employee benefits in the consolidated statements of operations. Good Shepherd's estimated self-insured workers' compensation liability at June 30, 2009 and 2008 was included in other liabilities in the consolidated balance sheets.

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

22. CONTINGENCIES

As not-for-profit corporations in the Commonwealth of Pennsylvania, certain members of Good Shepherd presently qualify for an exemption from real estate taxes. A number of cities, municipalities, and school districts in the Commonwealth of Pennsylvania have challenged the real estate tax exemption of not-for-profit corporations. The possible future effects of this matter on Good Shepherd, if any, are not presently determinable.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance; however, the possible future financial effects of this matter on Good Shepherd, if any, are not presently determinable.

23. FUNCTIONAL EXPENSES

Good Shepherd provides post acute care and related services to individuals within its geographic location. Expenses related to providing these services in 2009 and 2008 approximate the following:

	<u>2009</u>	<u>2008</u>
Healthcare and other related services	\$ 76,089,000	\$ 72,642,000
General and administrative	28,589,000	24,933,000
Fund raising	2,568,000	2,348,000
Loss on abandonment of capital projects	<u>-</u>	<u>237,000</u>
Total expenses	<u>\$107,246,000</u>	<u>\$100,160,000</u>

PARENTERANDOLPH

The Power of Ideas

**INDEPENDENT AUDITORS' REPORT
ON ADDITIONAL INFORMATION**

Board of Trustees
Good Shepherd Rehabilitation Network:

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information presented on pages 47 through 54 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual entities. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Parente Randolph, LLC

Philadelphia, Pennsylvania
September 22, 2009

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES

SCHEDULE OF CONSOLIDATING INFORMATION, BALANCE SHEET
JUNE 30, 2009

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME LONG-TERM CARE FACILITY, INC.	GOOD SHEPHERD WORKSHOP VOCATIONAL SERVICES, INC.	GOOD SHEPHERD OBLIGATED GROUP ELIMINATIONS	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS CONSOLIDATED
ASSETS										
CURRENT ASSETS:										
Cash and cash equivalents	\$ 3,072,729	\$ 10,763	\$ 1,400	\$ (5,368)	\$ 3,079,496	\$ 2,541,413	\$ 51,019	\$ 373,592		\$ 3,504,107
Resident funds	56,605		178,540		178,540					178,540
Assets whose use is limited					56,006					2,316,021
Accounts receivable, patients (net of estimated allowance for doubtful collections of \$1,158,000)	53,109	7,714,591	1,795,757	323,696	9,834,044					12,375,457
Other receivables		580,352	533		663,994					988,994
Amounts due from and other assets pertaining to unconsolidated subsidiary	1,312,410	(2,505)	406,117		1,309,905					1,309,905
Estimated third-party payor settlements		407,119			407,119					407,119
Inventories of drugs and supplies	259,119	784,164	24,431,722	23,210	1,045,483	90,596		28,163	\$ 8,085	407,119
Prepaid expenses and other current assets						4,524,783				1,173,317
Amounts due from affiliates										
Total current assets	4,752,972	9,474,464	26,814,069	341,520	16,951,303	7,156,792	325,082	2,723,088	8,085	22,639,577
ASSETS WHOSE USE IS LIMITED	11,442,137				11,442,137					11,442,137
BOARD DESIGNATED FUNDS	3,000,000				3,000,000					3,000,000
INVESTMENTS	135,897,934				135,897,934					134,862,934
INVESTMENT IN AND OTHER ASSETS PERTAINING TO UNCONSOLIDATED SUBSIDIARY	34,909,450				34,909,450					34,909,450
PROPERTY AND EQUIPMENT, Net	10,654,254	52,213,647	11,312,692	3,053,724	77,234,317	803,398	2,425,147		7,900	80,570,762
BENEFICIAL INTEREST IN:										
Perpetual trusts	8,096,351				8,096,351					8,096,351
Charitable remainder trusts	9,314,183				9,314,183					9,314,183
PLEDGES RECEIVABLE, Net	2,001,309				2,001,309					2,001,309
DEFERRED FINANCING COSTS, Net	3,318,417				3,318,417			21,714		3,318,417
INTANGIBLE ASSETS, Net		452,129			452,129					473,843
OTHER ASSETS		390,000			390,000					390,000
TOTAL	\$223,477,007	\$62,530,240	\$38,126,761	\$3,395,244	\$303,097,530	\$8,060,190	\$2,750,229	\$2,744,812	\$15,985	\$311,016,963
					\$24,451,722					\$5,649,783
					(24,451,722)					(1,125,000)
										(4,524,783)
										8,085
										8,085

GOOD SHEPHERD REHABILITATION NETWORK AND CONTROLLED ENTITIES
 SCHEDULE OF CONSOLIDATING INFORMATION, BALANCE SHEET
 JUNE 30, 2009

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME LONG-TERM CARE FACILITY, INC.	GOOD SHEPHERD WORKSHOP/ VOCATIONAL SERVICES, INC.	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS CONSOLIDATED
LIABILITIES AND NET ASSETS									
CURRENT LIABILITIES:									
Demand note payable	\$ 2,186,000								\$ 2,186,000
Current portion of long-term debt	2,665,000								2,665,000
Accounts payable, trade	3,426,100	\$ 572,638	\$ 84,682	\$ 6,075	\$ 175,229	\$ 8,964	\$ 614,569		4,086,923
Estimated third-party payor settlements		651,688			386,465				1,038,153
Advance from third-party payor	2,024,150	277,900	349,815	117,122	192,904				2,777,900
Accrued expenses		2,366,618	178,540						5,072,844
Resident funds	596,599	24,877,588	178,540	2,239,277		342,320	797,282		178,540
Amounts due to affiliates				2,362,474	754,619	351,274	1,411,821		
Total current liabilities	10,697,655	28,786,612	613,017	2,362,474	18,209,236	351,274	1,411,821	105,494	(4,524,783)
LONG-TERM DEBT:									
Revenue bonds	119,729,823					1,675,500			119,729,823
Mortgages payable						1,675,500			1,675,500
Total long-term debt	119,729,823					1,675,500			121,405,323
DERIVATIVE FINANCIAL INSTRUMENT									
Accrued pension costs	3,347,297								3,347,297
OTHER LIABILITIES									
Total liabilities	5,228,680	68,939	613,017	2,362,474	155,080,475	2,026,774	207,991	105,494	(4,524,783)
NET ASSETS:									
Unrestricted	53,630,105	25,197,189	37,513,744	1,032,770	117,373,906	723,455	1,125,000	(89,509)	125,313,326
Temporarily restricted	7,545,007				7,545,007				7,545,007
Permanently restricted	23,098,240				23,098,240				23,098,240
Total net assets	84,273,352	25,197,189	37,513,744	1,032,770	148,017,055	723,455	1,125,000	(89,509)	155,956,573
TOTAL	\$223,477,007	\$62,630,240	\$38,126,761	\$3,395,244	\$303,057,530	\$2,750,229	\$2,744,812	\$15,985	\$311,018,953

See Notes to Consolidated Financial Statements

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES

SCHEDULE OF CONSOLIDATING INFORMATION, STATEMENT OF OPERATIONS
FOR THE YEAR ENDED JUNE 30, 2009

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME CARE FACILITY, INC.	GOOD SHEPHERD HOME CARE VOCATIONAL SERVICES, INC.	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS CONSOLIDATED
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:									
Net patient service revenues	\$ 1,538,464	\$ 52,883,722	\$ 221,169,093	\$ 3,245,725	\$ 16,761,447	\$ 172,864	\$ 25,000	\$ (89,127)	\$ 91,614,262
Other operating revenues	39,167,473	443,125	40	(33,703,665)	2,352			(6,352,881)	5,620,095
Professional services revenue	2,610,293	4,752,822							4,883,559
Contributions	(1,045,459)								2,610,293
Loss on investment in unconsolidated subsidiary	(11,539)								(1,045,459)
Loss on disposal of equipment									(42,995)
Net assets released from restrictions for operations	40,000	941,700	608,349	66,528	1,650,577				1,659,234
Total unrestricted revenues, gains, and other support	42,299,295	58,821,169	227,777,482	3,312,253	16,766,356	141,408	25,000	(6,442,009)	105,278,992
EXPENSES:									
Salaries and wages	14,410,437	23,356,378	8,951,216	2,002,716	5,370,770	9,533	68,260	(4,492,643)	54,198,310
Supplies and other expenses	11,172,438	27,657,757	8,541,151	1,497,154	8,357,990	113,501	24,824	(9,511,165)	24,938,707
Employee benefit expenses	9,513,780	5,390,292	1,956,735	371,593	1,329,912	1,571	5,928	(9,511,165)	17,553,348
Depreciation and amortization	1,930,388	3,637,088	1,332,871	238,398	188,466	243,535	900	(18,000)	6,053,810
Interest	6,053,810	262,445	67,133	(17,723)	66,460	41,532	5,817	(18,000)	2,147,392
Professional fees	1,554,306	375,257	50,404		(6,293)				403,345
Provision (credit) for doubtful collections									
Total expenses	44,635,159	60,580,217	20,988,910	4,093,136	15,318,037	410,072	104,429	(5,442,009)	107,245,751
OPERATING (LOSS) INCOME BEFORE LOSS ON ABANDONMENT OF CAPITAL PROJECT	(2,335,924)	(1,759,048)	1,808,872	(780,895)	1,448,319	(268,664)	(79,429)		(1,968,759)
LOSS ON ABANDONMENT OF CAPITAL PROJECT									
OPERATING (LOSS) INCOME	(2,335,924)	(1,759,048)	1,808,872	(780,895)	1,448,319	(268,664)	(79,429)		(1,968,759)
NONOPERATING GAINS (LOSSES):									
Investment income	705,783								705,783
Ineffectiveness of Derivative Financial Instrument	(1,116,772)								(1,116,772)
REVENUES (LESS THAN) IN EXCESS OF EXPENSES	(2,746,903)	(1,759,048)	1,808,872	(780,895)	1,448,319	(268,664)	(79,429)		(2,377,738)
CHANGE IN NET UNREALIZED GAINS AND LOSSES ON INVESTMENTS OTHER THAN TRADING SECURITIES	(23,215,460)								(23,215,460)
CHANGE IN NET UNREALIZED GAIN ON DERIVATIVE FINANCIAL INSTRUMENTS	(1,037,588)								(1,037,588)
PENSION LIABILITY ADJUSTMENT - THE GOOD SHEPHERD REHABILITATION HOSPITAL		(6,611,574)							(6,611,574)
PENSION LIABILITY ADJUSTMENT - UNCONSOLIDATED SUBSIDIARY	(910,271)								(910,271)
OTHER CHANGES IN UNRESTRICTED NET ASSETS	(593,703)								(593,703)
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASE OF PROPERTY AND EQUIPMENT		419,835		24,533					444,368
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS BEFORE EFFECT OF ADOPTION OF MEASUREMENT DATE PROVISIONS OF FASB STATEMENT NO. 158	(28,503,925)	(7,950,797)	1,808,872	(756,352)	1,448,319	(268,664)	(79,429)		(34,301,966)
EFFECT OF MEASUREMENT DATE PROVISIONS OF FASB STATEMENT NO. 158		(212,971)							(212,971)
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	\$ (28,503,925)	\$ (8,163,768)	\$ 1,808,872	\$ (756,352)	\$ 1,448,319	\$ (268,664)	\$ (79,429)	\$	\$ (34,514,937)

See Notes to Consolidated Financial Statements

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES

SCHEDULE OF CONSOLIDATING INFORMATION, STATEMENT OF CHANGES IN NET ASSETS (DEFICIT)
FOR THE YEAR ENDED JUNE 30, 2009

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME LONG-TERM CARE FACILITY, INC.	GOOD SHEPHERD WORKSHOP/ VOCATIONAL SERVICES, INC.	GOOD OBLIGATED GROUP ELIMINATIONS	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS	CONSOLIDATED
UNRESTRICTED NET ASSETS:											
Revenues (less than) in excess of expenses	\$ (2,746,903)	\$ (1,759,046)	\$ 1,608,872	\$ (780,885)	\$ (3,477,964)	\$ 1,448,319	\$ (268,664)	\$ -	\$ (79,429)	\$ -	\$ (2,377,739)
Change in net unrealized gains and losses on investments other than trading securities	(23,215,460)				(23,215,460)						(23,215,460)
Change in net unrealized gain on derivative financial instruments	(1,037,668)				(1,037,668)						(1,037,668)
Pension liability adjustment - The Good Shepherd Rehabilitation Hospital	(910,271)	(6,611,574)			(6,611,574)						(6,611,574)
Pension liability adjustment - unconsolidated subsidiary	(593,703)				(593,703)						(593,703)
Other changes in unrestricted net assets		419,835		24,533	444,368						444,368
Net assets released from restrictions for purchase of property and equipment											
(Decrease) increase in unrestricted net assets before effect of measurement date provisions of FASB Statement No. 158	(26,503,925)	(7,950,787)	1,608,872	(756,352)	(35,402,192)	1,448,319	(268,664)		(79,429)		(34,301,966)
Effect of adoption of measurement date provisions of FASB Statement No. 158	(28,503,925)	(8,163,758)	1,608,872	(756,352)	(35,615,163)	1,448,319	(268,664)		(79,429)		(34,514,937)
(Decrease) increase in unrestricted net assets	693,952	1,361,535	608,349	91,001	(2,060,845)	2,657					696,609
TEMPORARILY RESTRICTED NET ASSETS:											
Contributions	(2,636,953)				(2,636,953)						(2,636,953)
Net realized and unrealized losses on investments	322,846				322,846						322,846
Investment income	729,083				729,083						729,083
Other changes in temporarily restricted net assets	(1,266,218)				(1,266,218)						(1,266,218)
Change in value of split-interest agreements	(1,656,577)	(941,700)	(608,349)	(66,528)	(1,656,577)	(2,657)					(1,659,234)
Net assets released from restrictions for operations	(444,368)	(419,835)		(24,533)	444,368						(444,368)
Net assets released from restrictions for purchase of property and equipment											
Decrease in temporarily restricted net assets	(4,278,235)				(4,278,235)						(4,278,235)
PERMANENTLY RESTRICTED NET ASSETS:											
Contributions	396,225				396,225						396,225
Valuation gain, beneficial interest in Perpetual Trusts	(2,522,793)				(2,522,793)						(2,522,793)
Decrease in permanently restricted net assets	(2,126,568)				(2,126,568)						(2,126,568)
(DECREASE) INCREASE IN NET ASSETS	(34,908,728)	(6,163,769)	1,608,872	(756,352)	(42,019,966)	1,448,319	(268,664)		(79,429)		(40,919,740)
NET ASSETS, BEGINNING	119,182,080	33,960,947	35,704,872	1,789,122	180,037,021	5,657,253	992,119		(10,080)		196,878,313
NET ASSETS, ENDING	\$ 84,273,352	\$ 25,197,189	\$ 37,513,744	\$ 1,032,770	\$ 148,017,055	\$ 7,305,572	\$ 723,455	\$ 1,125,000	\$ (89,509)	\$ (1,125,000)	\$ 155,956,573

See Notes to Consolidated Financial Statements

GOOD SHEPHERD REHABILITATION NETWORK AND CONTROLLED ENTITIES
 SCHEDULE OF CONSOLIDATING INFORMATION, BALANCE SHEET
 JUNE 30, 2008

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME LONG-TERM CARE FACILITY, INC.	GOOD SHEPHERD VOCATIONAL SERVICES, INC.	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS CONSOLIDATED
LIABILITIES AND NET ASSETS									
CURRENT LIABILITIES:									
Current portion of long-term debt	\$ 1,825,000	\$ 614,110	\$ 74,385	\$ 25,281	\$ 826,850	\$ 8,700	\$ 271,179		\$ 1,825,000
Accounts payable, trade	1,855,163	2,464,046			48,188				3,475,648
Estimated third-party payor settlements		277,900		108,533	257,931				2,512,242
Advances from third-party payor	2,576,646	3,247,579	343,107	1,773,636					277,900
Accrued expenses		19,897,553	183,240	1,905,450					6,531,986
Resident funds	671,366						402,864		183,240
Amounts due to affiliates								18,158	\$2,889,785
Total current liabilities	6,728,975	26,501,188	600,712	1,905,450	1,132,977	446,588	674,143	18,158	14,806,028
LONG-TERM DEBT:									
Revenue bonds	122,346,009					1,675,500			122,346,009
Mortgages payable									1,675,500
Total long-term debt	122,346,009					1,675,500			124,021,509
DERIVATIVE FINANCIAL INSTRUMENT									
ACCRUED PENSION COSTS	1,192,937								1,192,937
OTHER LIABILITIES									
Total liabilities	6,433,565	1,895,630					325,073		6,855,024
	135,700,886	28,493,104	600,712	1,905,450	1,132,977	2,122,056	999,216	18,158	148,771,026
NET ASSETS:									
Unrestricted	82,134,030	33,390,947	35,704,672	1,789,122	5,857,253	982,119	1,125,000	(10,080)	159,828,263
Temporarily restricted	11,823,242								11,823,242
Permanently restricted	25,224,808				25,224,808				25,224,808
Total net assets	119,182,080	33,390,947	35,704,672	1,789,122	5,857,253	982,119	1,125,000	(10,080)	196,876,313
TOTAL	\$ 255,862,965	\$ 61,854,051	\$ 36,305,564	\$ 3,694,572	\$ 6,990,230	\$ 3,114,215	\$ 2,124,216	\$ 8,078	\$ 345,647,339

See Notes to Consolidated Financial Statements

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES

SCHEDULE OF CONSOLIDATING INFORMATION, STATEMENT OF OPERATIONS
FOR THE YEAR ENDED JUNE 30, 2008

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME LONG-TERM CARE FACILITY, INC.	GOOD SHEPHERD WORKSHOP/ VOCATIONAL SERVICES, INC.	GOOD SHEPHERD OBLIGATED GROUP ELIMINATIONS	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECIPROCAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	CONSOLIDATION ELIMINATIONS CONSOLIDATED
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:										
Net patient service revenues	\$ 717,457	\$48,747,095	\$2,895,012	\$4,454,461	\$ (70,451)	\$17,713,188	\$ 175,778	\$307,362	\$ 20,000	\$ (238,727)
Other operating revenues	36,050,800	795,087	2,322	5,933,998	(31,607,428)	1,649				6,105,958
Professional services revenue	2,806,502	4,068,818		8,512,189						3,959,811
Contributions	(1,349,449)			(1,848,449)						2,806,502
Loss on investment in unconsolidated subsidiary				6,004						(1,349,449)
Gain on disposal of equipment										6,004
Net assets released from restrictions for operations	54,939	695,631	517,875	62,406	1,331,851	500				1,332,351
Total unrestricted revenues, gains, and other support	38,280,249	54,246,631	23,415,209	4,522,891	(31,677,880)	17,715,337	175,778	307,362	20,000	102,217,472
EXPENSES:										
Salaries and wages	12,481,163	21,103,952	8,465,950	2,861,532	44,592,597	5,434,433	10,987	150,000	12,934	50,050,951
Supplies and other expenses	11,064,338	25,480,512	8,327,022	2,009,817	20,363,799	8,109,203	77,136		16,157	24,800,519
Employee benefits	8,757,757	4,995,560	1,529,068	408,341	10,690,734	1,233,389	950		989	11,288,730
Depreciation and amortization	1,906,491	3,322,497	1,302,273	251,300	6,782,561	182,667	280,898			7,256,228
Interest	3,888,338	202,377	63,094	14,991	3,969,339	67,187	50,953	157,362		3,989,339
Professional fees	1,302,376	614,509	(19,529)		1,597,617	95,187				1,825,349
Provision (credit) for doubtful collections					619,971					712,458
Total expenses	39,481,462	55,699,507	20,073,878	5,245,681	(31,677,880)	15,133,393	421,024	307,362	30,080	99,923,572
OPERATING INCOME (LOSS) BEFORE LOSS ON ABANDONMENT OF CAPITAL PROJECT	(1,201,213)	(1,450,876)	3,342,331	(722,960)	(32,748)	2,581,974	(245,246)		(10,080)	2,293,900
LOSS ON ABANDONMENT OF CAPITAL PROJECT	(1,201,213)	(1,450,876)	3,342,331	(722,960)	(32,748)	2,345,049	(245,246)		(10,080)	2,056,975
OPERATING INCOME (LOSS)	(2,111,926)	(1,450,876)	3,342,331	(722,960)	(32,748)	2,345,049	(245,246)		(10,080)	(2,111,926)
NONOPERATING GAINS (LOSSES):										
Loss on extinguishment of debt	21,384,957					236,925				21,384,957
Investment income										
REVENUES IN EXCESS OF (LESS THAN) EXPENSES	18,071,818	(1,450,876)	3,342,331	(722,960)	19,240,283	2,345,049	(245,246)		(10,080)	21,330,008
CHANGE IN NET UNREALIZED GAINS AND LOSSES ON INVESTMENTS OTHER THAN TRADING SECURITIES	(33,421,928)				(33,421,928)					(33,421,928)
CHANGE IN NET UNREALIZED GAIN ON DERIVATIVE FINANCIAL INSTRUMENTS	(2,407,818)	(6,542,724)			(2,407,818)					(2,407,818)
PENSION LIABILITY ADJUSTMENT	29,605				(6,542,724)	29,605		7,000		36,605
OTHER CHANGES IN UNRESTRICTED NET ASSETS										
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASE OF PROPERTY AND EQUIPMENT		5,018,732	10,841	4,555	5,034,128	318				5,034,446
(DECREASE) INCREASE IN UNRESTRICTED NET ASSETS	\$(17,728,323)	\$(2,974,866)	\$ 3,353,172	\$(718,435)	\$(18,068,454)	\$ 2,345,367	\$(245,246)	\$ -	\$(10,080)	\$(15,971,413)

See Notes to Consolidated Financial Statements

GOOD SHEPHERD REHABILITATION NETWORK
AND CONTROLLED ENTITIES

SCHEDULE OF CONSOLIDATING INFORMATION, STATEMENT OF CHANGES IN NET ASSETS (DEFICIT)
FOR THE YEAR ENDED JUNE 30, 2008

	GOOD SHEPHERD REHABILITATION NETWORK	GOOD SHEPHERD REHABILITATION HOSPITAL	GOOD SHEPHERD HOME FACILITY, INC.	GOOD SHEPHERD WORKSHOP/ VOCATIONAL SERVICES, INC.	ELIMINATIONS	COMBINED	GOOD SHEPHERD LONG-TERM ACUTE CARE SERVICES, INC.	GOOD SHEPHERD HOUSING DEVELOPMENT CORPORATION	GOOD SHEPHERD RECREATIONAL RISK RETENTION GROUP	GOOD SHEPHERD GROUP, LLC	ELIMINATIONS	CONSOLIDATED
UNRESTRICTED NET ASSETS:												
Revenues in excess of (less than) expenses	\$ 18,071,818	\$ (1,450,876)	\$ 3,342,331	\$ (722,990)		\$ 19,240,283	\$ 2,345,049	\$ (245,246)		\$ (10,080)		\$ 21,300,008
Change in net unrealized gains and losses on investments other than trading securities	(33,421,928)					(33,421,928)						(33,421,928)
Change in net unrealized gain on derivative financial instruments	(2,407,818)	(6,542,724)				(2,407,818)						(2,407,818)
Pension liability adjustment	29,605					(6,542,724)					\$ 7,000	(6,542,724)
Other changes in unrestricted net assets			10,841	4,555		29,605	318					36,605
Net assets released from restrictions for purchase of property and equipment		5,018,732				5,034,128						5,034,448
(Decrease) Increase in unrestricted net assets	(17,728,323)	(2,974,869)	3,953,172	(718,435)		(18,068,454)	2,345,367	(245,246)		(10,080)	7,000	(15,971,413)
TEMPORARILY RESTRICTED NET ASSETS:												
Contributions	5,052,036	5,715,363	528,716	66,861		5,051,718	818					5,052,538
Net realized and unrealized gains on investments	(1,121,985)					(1,121,985)						(1,121,985)
Investment income	450,858					450,858						450,858
Change in value of split-interest agreements	(374,740)					(374,740)						(374,740)
Net assets released from restrictions for operations	(1,331,851)	(686,631)	(57,875)	(82,406)		(1,331,851)	(500)					(1,332,351)
Net assets released from restrictions for purchase of property and equipment	(5,034,446)	(5,018,732)	(10,841)	(4,555)		(5,034,128)	(318)					(5,034,446)
Decrease in temporarily restricted net assets	(2,360,128)					(2,360,128)						(2,360,128)
PERMANENTLY RESTRICTED NET ASSETS:												
Contributions	157,147					157,147						157,147
Valuation gain, beneficial interest in, perpetual trusts	(1,270,395)					(1,270,395)						(1,270,395)
Decrease in permanently restricted net assets	(1,113,248)					(1,113,248)						(1,113,248)
(DECREASE) INCREASE IN NET ASSETS	(21,201,699)	(2,974,869)	3,353,172	(718,435)		(21,541,891)	2,345,367	(245,246)		(10,080)	7,000	(19,444,799)
NET ASSETS, BEGINNING	140,983,779	36,335,815	32,351,700	2,507,557		211,578,851	3,511,808	1,237,365		1,125,000		216,321,102
NET ASSETS, ENDING	\$119,182,080	\$33,360,947	\$35,704,872	\$1,789,122	\$	\$190,037,021	\$5,957,255	\$ 992,119	\$1,125,000	\$ (10,080)	\$ (1,125,000)	\$198,876,313

See Notes to Consolidated Financial Statements