



SHRINERS HOSPITALS FOR CHILDREN

Combined Financial Statements

December 31, 2006 and 2005

(With Independent Auditors' Report Thereon)

SHRINERS HOSPITALS FOR CHILDREN

Combined Financial Statements

December 31, 2006 and 2005

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KPMG LLP
Suite 1700
100 North Tampa Street
Tampa, FL 33602

Independent Auditors' Report

The Board of Directors
Shriners Hospitals for Children:

We have audited the accompanying combined statements of financial position of Shriners Hospitals for Children as of December 31, 2006 and 2005, and the related combined statements of activities, and cash flows for the years then ended. These combined financial statements are the responsibility of the management of Shriners Hospitals for Children. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Shriners Hospitals for Children's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Shriners Hospitals for Children as of December 31, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in notes 1 and 8 to the combined financial statements, Shriners Hospitals for Children adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of December 31, 2006.

KPMG LLP

April 6, 2007
Certified Public Accountants

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Financial Position

December 31, 2006 and 2005

(In thousands)

Assets	2006	2005
Cash and cash equivalents	\$ 24,506	17,060
Cash and marketable securities held as collateral under securities lending transactions	1,427,170	1,386,471
Receivables	13,647	8,926
Accrued interest and dividends	28,850	26,765
Patient transportation funds held by Shrine temples	40,668	40,720
Inventories and deferred charges	13,166	9,434
Marketable securities	8,075,217	7,430,285
Real estate, mortgages, and miscellaneous	72,030	65,641
Estates in process	311,677	289,291
Beneficial interest in trusts	481,304	444,818
Land, buildings, and equipment, net of accumulated depreciation	700,994	729,823
Total assets	\$ 11,189,229	10,449,234
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 74,524	74,611
Pension benefits	111,953	50,368
Liabilities under securities lending transactions	1,427,170	1,386,471
Other liabilities	39,896	38,405
Total liabilities	1,653,543	1,549,855
Net assets (net of cumulative foreign currency translation adjustment of \$5,149 in 2006 and \$5,241 in 2005):		
Unrestricted:		
Operations	398,972	297,457
Board designated endowment	6,802,490	6,386,305
Board designated for capital expenditures	301,245	217,868
Land, buildings, and equipment	702,962	730,590
Total unrestricted	8,205,669	7,632,220
Temporarily restricted	355,557	334,128
Permanently restricted	974,460	933,031
Total net assets	9,535,686	8,899,379
Total liabilities and net assets	\$ 11,189,229	10,449,234

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Activities

Years ended December 31, 2006 and 2005

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2006</u>	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2005</u>
Operating revenues, gains, and other support:								
Investment return designated for support of current operations	\$ 554,301	—	—	554,301	523,395	—	—	523,395
Gifts and bequests	34,994	—	—	34,994	37,325	—	—	37,325
Fund raising	17,878	—	—	17,878	15,673	—	—	15,673
Hospital assessments	1,769	—	—	1,769	1,876	—	—	1,876
Reimbursements from Canadian Provinces	4,657	—	—	4,657	3,673	—	—	3,673
Other	2,630	—	—	2,630	1,749	—	—	1,749
Total operating revenues, gains, and other support	<u>616,229</u>	<u>—</u>	<u>—</u>	<u>616,229</u>	<u>583,691</u>	<u>—</u>	<u>—</u>	<u>583,691</u>
Operating expenses:								
Hospitals	531,503	—	—	531,503	510,406	—	—	510,406
Research	28,497	—	—	28,497	24,982	—	—	24,982
Headquarters, administrative, and board related	36,814	—	—	36,814	33,850	—	—	33,850
Fund raising	8,174	—	—	8,174	5,816	—	—	5,816
Total operating expenses	<u>604,988</u>	<u>—</u>	<u>—</u>	<u>604,988</u>	<u>575,054</u>	<u>—</u>	<u>—</u>	<u>575,054</u>
Increase in net assets from operating activities	<u>11,241</u>	<u>—</u>	<u>—</u>	<u>11,241</u>	<u>8,637</u>	<u>—</u>	<u>—</u>	<u>8,637</u>
Other changes:								
Investment return greater than amounts designated for support of current operations	407,820	—	—	407,820	31,822	—	—	31,822
Gifts and bequests	394	222,238	6,023	228,655	504	201,230	7,234	208,968
Life memberships	181	—	—	181	218	—	—	218
Changes in estimated value of estates in process and beneficial interest in trusts	—	21,645	35,396	57,041	—	2,246	2,979	5,225
Change in patient transportation funds held by Shrine temples	(52)	—	—	(52)	5,127	—	—	5,127
Change in minimum pension liability	(4,248)	—	—	(4,248)	21,140	—	—	21,140
Other, net	(5,839)	(1,072)	10	(6,901)	(1,850)	(1,140)	45	(2,945)
Net assets released from restrictions	221,382	(221,382)	—	—	201,828	(201,828)	—	—
Foreign currency translation adjustments	(92)	—	—	(92)	505	—	—	505
Total other changes	<u>619,546</u>	<u>21,429</u>	<u>41,429</u>	<u>682,404</u>	<u>259,294</u>	<u>508</u>	<u>10,258</u>	<u>270,060</u>
Increase (decrease) in net assets before effect of adoption of SFAS No. 158	<u>630,787</u>	<u>21,429</u>	<u>41,429</u>	<u>693,645</u>	<u>267,931</u>	<u>508</u>	<u>10,258</u>	<u>278,697</u>
Effect of adoption of SFAS No. 158	<u>(57,338)</u>	<u>—</u>	<u>—</u>	<u>(57,338)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Increase in net assets	<u>573,449</u>	<u>21,429</u>	<u>41,429</u>	<u>636,307</u>	<u>267,931</u>	<u>508</u>	<u>10,258</u>	<u>278,697</u>
Net assets at beginning of year	<u>7,632,220</u>	<u>334,128</u>	<u>933,031</u>	<u>8,899,379</u>	<u>7,364,289</u>	<u>333,620</u>	<u>922,773</u>	<u>8,620,682</u>
Net assets at end of year	<u>\$ 8,205,669</u>	<u>355,557</u>	<u>974,460</u>	<u>9,535,686</u>	<u>7,632,220</u>	<u>334,128</u>	<u>933,031</u>	<u>8,899,379</u>

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Cash Flows

Years ended December 31, 2006 and 2005

(In thousands)

	2006	2005
Cash flows from operating activities:		
Change in net assets	\$ 636,307	278,697
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	43,763	43,752
Loss (gain) on disposal of property and equipment	6,258	(471)
Realized and unrealized gains on investments	(720,018)	(350,443)
Gifts and bequests designated by the board or restricted by donor for long-term investment	(228,836)	(209,186)
Changes in operating assets and liabilities:		
Receivables	(4,721)	3,592
Accrued interest and dividends	(2,085)	(2,208)
Patient transportation funds held by Shrine temples	52	(5,127)
Inventories and deferred charges	(3,732)	(440)
Estates in process	(22,386)	(1,104)
Beneficial interest in trusts	(36,486)	8,795
Accounts payable and accrued expenses	(87)	6,317
Pension benefits	61,585	(11,880)
Net cash used in operating activities	(270,386)	(239,706)
Cash flows from investing activities:		
Additions to property and equipment	(21,192)	(33,816)
Proceeds from sale of investments	5,860,529	7,527,815
Investment purchases	(5,791,832)	(7,455,773)
Net cash (used in) provided by investing activities	47,505	38,226
Cash flows from financing activities:		
Gifts and bequests designated for board endowment	222,632	201,734
Gifts and bequests permanently restricted by donors	6,023	7,234
Life memberships	181	218
Change in other liabilities	1,491	(454)
Net cash provided by financing activities	230,327	208,732
Net increase in cash and cash equivalents	7,446	7,252
Cash and cash equivalents at beginning of year	17,060	9,808
Cash and cash equivalents at end of year	\$ 24,506	17,060

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

(1) Summary of Significant Accounting Policies

(a) Combined Organizations

Shriners Hospitals for Children (the Hospitals) provide quality, specialized medical care, in the areas of orthopaedics, severe burns, and spinal cord injuries, through a network of 22 hospitals located throughout the United States, Canada, and Mexico. This medical care is provided at no cost to patients, families, or third-party payors. The Hospitals also fund intensive programs in pediatric orthopaedic and burns research. The Hospitals rely principally on gifts and investment earnings to support their operations and research programs.

The combined financial statements of Shriners Hospitals for Children include the following organizations:

- Shriners Hospitals for Children, a Colorado Corporation
- Shriners Hospitals for Children, a Canadian Corporation
- Shriners Hospitals for Children (Quebec) Inc.
- The Shriners' Hospital for Children, a Massachusetts Corporation
- Shriners Hospitals for Children, a Mexican Association

Additionally, the combined financial statements include the activities of Promotora Mexicana de Servicios Medicos S.A. de C.V., a Mexican Corporation, which was organized to facilitate the construction of the new Mexico City hospital. All significant accounts and transactions between Hospital corporations have been eliminated.

Shriners Hospitals for Children, a Colorado Corporation and The Shriners' Hospital for Children, a Massachusetts Corporation, have been recognized as exempt from U.S. federal income tax on related income under Section 501(a) of the Internal Revenue Code as organizations described in Section 501(c)(3) of the Internal Revenue Code. The Canadian and Quebec Corporations and the Mexican Association and Corporation are also exempt from income tax on related income in accordance with the laws of their respective countries.

(b) Basis of Presentation

The combined financial statements are presented on the accrual basis of accounting. Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets. The Hospitals report gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of activities as net

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

- Unrestricted net assets consist of investments and otherwise unrestricted amounts that are available for use in carrying out the activities of the Hospitals. The majority of unrestricted net assets as of December 31, 2006 and 2005 represent board designated endowment.
- Temporarily restricted net assets represent those amounts which are not available until future periods or are donor restricted for specific purposes. The Hospitals report estates in process, charitable lead trusts, and charitable remainder trusts, as increases in temporarily restricted net assets as these assets are not available for expenditure until future periods.
- Permanently restricted net assets result from gifts and bequests from donors who place restrictions on the use of the funds, which mandate that the original principal be invested in perpetuity. Permanently restricted net assets also include perpetual lead trusts.

(c) *Operating Measure*

Changes in net assets from operating activities represents the revenues, gains, and other support designated to operate the Hospitals, less expenses and other costs associated with Hospital operating activities and costs to generate operating revenues.

Receipts from unrestricted noncash gifts, unrestricted bequests, life memberships from Shriners, and realized and unrealized gains (losses) from investments (not part of the investment return designated for operations) are generally designated by the board of directors (the Board) for endowment purposes. All other unrestricted revenues are available to support the operations of the Hospitals.

(d) *Liquidity*

Assets are presented in the accompanying combined statements of financial position according to their nearness of conversion to cash, and liabilities according to the nearness of their maturity and resulting use of cash.

(e) *Use of Estimates*

The preparation of the combined financial statements requires management of the Hospitals to make a number of estimates and assumptions that affect the reported amounts in the combined financial statements and accompanying notes. Actual results could differ from those estimates.

Significant estimates have been made by management with regards to estates in process. These estimates are subject to significant fluctuation due to changes that occur in the valuation of assets associated with these estates and the timing of information received from executors of these estates. Actual results could differ materially from these estimates, making it reasonably possible that a material change in these estimates could occur in the near term.

(f) *Cash Equivalents*

For purposes of the combined statements of cash flows, the Hospitals consider all highly liquid investments made from operating cash accounts, and with an original maturity of three months or less, to be cash equivalents.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

(g) Inventories

Inventories of supplies are stated at the lower of cost (first-in, first-out method) or market.

(h) Marketable Securities

Marketable securities are measured at fair value and include investments in equity securities with readily determinable fair values and investments in debt securities. Investment income (including gains and losses on investments, interest, and dividends) is included in the combined statements of activities as increases or decreases in unrestricted net assets unless the income is restricted by donor or law.

It is the Board's policy to maintain a long-term investment portfolio to support the operating and research activities of the Hospitals. In order to preserve the value of the investment portfolio and to eliminate the impact of market fluctuations on operations, the Board designates only a portion of cumulative realized gains for support of current operations. Remaining amounts are included in other changes in the combined statements of activities and are reinvested to support operations of future years.

(i) Securities Loaned

Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140) requires the Hospitals to recognize cash received as collateral for assets transferred to brokers in security lending transactions along with the obligation to return the cash. The Hospitals generally receive collateral in the form of cash in an amount in excess of the fair value of securities loaned. The Hospitals monitor the fair value of securities loaned on a monthly basis with additional collateral obtained as necessary. At December 31, 2006 and 2005, the Hospitals held \$1,427,170 and \$1,386,471, respectively of cash and marketable securities as collateral deposits. The collateral is included as both an asset and a liability in the Hospitals' combined financial statements. The securities on loan had a fair value of \$1,387,214 and \$1,348,589 at December 31, 2006 and 2005, respectively, and are included in marketable securities on the accompanying statements of financial position.

(j) Estates in Process

The Hospitals recognize a receivable and revenue for their interest in estates in process based on the inventories of estate assets and conditions contained in the respective wills. Amounts expected to be received in future years are discounted to provide estimates in current year dollars. The Hospitals record estates in process (when the court declares the related will valid) as either temporarily restricted net assets, as these assets will not be available for expenditures until future periods (typically one to five years), or as permanently restricted net assets. As funds from an estate (other than permanently restricted) are collected, temporarily restricted net assets are reclassified to unrestricted net assets, and reported in the combined statements of activities as net assets released from restrictions.

(k) Beneficial Interest in Trusts

The Hospitals have a beneficial interest in a variety of trust agreements. Many of these trusts are charitable lead trusts where the Hospitals receive distributions from the trust, which in most cases are

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

administered by a third party. Perpetual lead trusts are recorded at the fair value of the trust assets and are classified as permanently restricted net assets. All other charitable lead trusts are recorded at the present value of the estimated future distributions expected to be received by the Hospitals, and are classified as temporarily restricted net assets.

Charitable remainder trusts and pooled income funds represent trust agreements where the Hospitals maintain custody of the related assets and make specified distributions to a designated beneficiary or beneficiaries over the term of the trust. Assets under both types of trusts are recorded at fair value. Annuity liabilities associated with charitable remainder trusts are determined based on the present value of the estimated future payments to be paid to the designated beneficiaries. Deferred income is recognized on gifts to pooled income funds representing the discounted value of the assets for the estimated time period until the donor's death. The difference between the recorded assets and the annuity liabilities or deferred income associated with pooled income funds is classified as temporarily restricted net assets.

Subsequent adjustments to the carrying value of the respective assets and related liabilities or deferred income are recognized in the combined statements of activities as changes in the value of beneficial interest in trusts.

Included in other liabilities in the accompanying combined statements of financial position are annuity liabilities of \$30,794 and \$30,462 and deferred income of \$8,979 and \$7,820 at December 31, 2006 and 2005, respectively.

(l) Land, Buildings, and Equipment

Land, land improvements, buildings, and equipment are stated at cost, if purchased, or at estimated fair value at date of receipt if acquired by gift. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

(m) Impairment or Disposal of Long-Lived Assets

The Hospitals account for long-lived assets in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the use and eventual disposition of the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. There has been no impairment recorded as of December 31, 2006 or 2005.

(n) Foreign Currency Translation

Revenues and expenses of the Canadian and Quebec corporations and the Mexican Association and Corporation are translated using average exchange rates during the year, while monetary assets and liabilities are translated into U.S. dollars using current exchange rates at the end of the year. Nonmonetary asset and liability items (land, buildings, and equipment) and related revenues,

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

expenses, gains and losses are remeasured using historical exchange rates. Resulting translation adjustments are accumulated in the combined statement of financial position caption “Cumulative foreign currency translation adjustment,” a separate component of net assets.

(o) Contributed Services

No amounts have been reflected in the combined financial statements for contributed services. The Hospitals’ programs pay for most services requiring specific expertise. However, many individuals (Shriners and non-Shriners) volunteer their time at the Hospitals and perform a variety of tasks that assist the Hospitals with specific programs and various committee assignments.

(p) Recently Adopted Accounting Standards

Effective December 31, 2006, the Hospitals adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 158 requires organizations to recognize the funded status of defined benefit pension and other postretirement plans as a net asset or liability and to recognize changes in that funded status in the year in which the changes occur to the extent those changes are not included in the net periodic cost. The funded status reported on the balance sheet as of December 31, 2006, under SFAS 158, was measured as the difference between the fair value of plan assets and the benefit obligation of the plan. The incremental effect of applying SFAS 158 on the Hospitals’ financial position as of December 31, 2006 was an increase of \$57,338 in the liability for pension benefits and a decrease of \$57,338 in unrestricted net assets.

SFAS 158 also requires the use of a measurement date that is consistent with the organization’s year-end. The Hospitals currently use a September 30 measurement date and plan to adopt a December 31 measurement date in 2007.

(2) Marketable Securities

Marketable securities at December 31, 2006 and 2005 consist of:

	2006		2005	
	Cost	Fair value	Cost	Fair value
Short-term investments	\$ 373,390	373,390	236,025	236,025
U.S. Government securities	1,880,857	1,900,855	1,912,586	1,922,068
Corporate bonds	553,917	553,045	548,921	548,611
International stocks	990,821	1,302,466	884,283	1,056,269
Common and preferred stocks	3,204,983	3,945,461	3,160,214	3,667,312
	\$ 7,003,968	8,075,217	6,742,029	7,430,285

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

Investment yield and total return was comprised of the following components for the years ended December 31, 2006 and 2005, respectively:

	<u>2006</u>	<u>2005</u>
Interest	\$ 134,618	111,339
Dividends	95,837	82,944
Trust income	17,401	15,171
Rents and royalties	8,838	8,452
Other income	3,466	2,725
Less investment management fees	<u>(18,057)</u>	<u>(15,857)</u>
Total yield from investments	242,103	204,774
Net realized gains from investments	291,982	230,746
Net unrealized gains from investments	<u>428,036</u>	<u>119,697</u>
Total return on investments	<u>962,121</u>	<u>555,217</u>
Less investment return designated for support of current operations:		
Yield from investments	(242,103)	(204,774)
Cumulative realized gains from investments sales	<u>(312,198)</u>	<u>(318,621)</u>
	<u>(554,301)</u>	<u>(523,395)</u>
Investment return greater than amounts designated for support of current operations	\$ <u>407,820</u>	<u>31,822</u>

(3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2006 and 2005 consist of:

	<u>2006</u>	<u>2005</u>	<u>Estimated useful lives</u>
Land	\$ 24,046	25,299	—
Land improvements	11,344	10,784	5 – 20 years
Buildings	809,382	767,136	40 – 50 years
Equipment	312,868	270,944	4 – 25 years
	<u>1,157,640</u>	<u>1,074,163</u>	
Less accumulated depreciation	<u>(464,297)</u>	<u>(430,691)</u>	
	693,343	643,472	
Construction in progress	7,651	66,844	
Information systems under development	<u>—</u>	<u>19,507</u>	
Land, buildings, and equipment, net	\$ <u>700,994</u>	<u>729,823</u>	

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

(4) Board Designated for Capital Expenditures

The Board has designated a portion of net assets to fund future commitments for land, building, and equipment expenditures.

Construction and other major projects committed to by the Board are as follows:

Project	Total appropriation	Unexpended at December 31, 2006
Honolulu	\$ 73,000	72,865
St. Louis	84,163	83,993
Intermountain	4,383	1,461
Portland	76,140	76,140
Philadelphia	14,172	14,169
Other	9,730	5,444
Approved equipment expenditures:		
PACS imaging	22,000	22,000
Information systems projects	13,329	13,194
Other equipment	11,979	11,979
	<u>\$ 308,896</u>	<u>301,245</u>

(5) Transactions with the Imperial Council of the Ancient Arabic Order of the Nobles of the Mystic Shrine for North America

The Shriners Hospitals for Children organizations were founded by the Imperial Council of the Ancient Arabic Order of the Nobles of the Mystic Shrine for North America (Imperial Council).

The International Headquarters building and equipment is owned by Shriners Hospitals for Children. A portion of the building is occupied by the Imperial Council, which is allocated a share of the operating costs and depreciation of the building and equipment. The allocation of the costs is based upon the portion of the building occupied by the Imperial Council in relation to the total occupied space in the building.

The Hospitals and the Imperial Council also share other costs based on the estimated fair value received by each organization. Additionally, hospital assessments, donations, and other charitable receipts from Shrine temples are collected and remitted to the Hospitals by the Imperial Council.

At December 31, 2006 and 2005, amounts of \$117 and \$68, respectively, were due from the Imperial Council, and are included in receivables in the accompanying combined statements of financial position.

(6) Fund Raising Activities

The Hospitals are financially supported through each Shriner’s annual hospital assessment, income from investments, gifts and bequests from the general public and from Shriners, and certain fund raising activities conducted by Shriners. Shrine temples and Shriners raise funds for both fraternal and charitable

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

purposes. Shrine fund raising activities consist of paper sale donations, football games, golf tournaments, and other miscellaneous activities. The name "Shriners Hospitals for Children" may be used in connection with a fund raising activity by a Shrine temple or Shriner only with the written consent of the Imperial Council and the Hospitals when the proceeds are to benefit Shriners Hospitals for Children. Some of these funds are retained by individual Shrine temples for the support of their respective hospital patient transportation fund.

Through the efforts of the donor relations committee, which oversees the development activities of the Hospitals, gifts and bequests are solicited and received to support the operations of the Hospitals or are designated by the Board for endowment purposes. Although the costs of these activities are included in fund raising expenses, the associated revenues are reported as gifts and bequests in the accompanying combined statements of activities.

The Hospitals also engage in other fund raising activities to generate donations and to develop their donor base. These activities are conducted through an agreement with Barton Cotton, an unrelated third party.

Fund raising revenues and costs for the years ended December 31, 2006 and 2005 consist of the following:

	2006	2005
Revenues from Shrine temple sponsored events	\$ 10,245	10,589
Barton Cotton revenue	7,394	5,050
Other revenue	239	34
	\$ 17,878	15,673
Fund raising costs paid directly by Shrine temples in connection with fund raising events	\$ 1,587	1,596
Donor relations expense	2,336	1,716
Barton Cotton expense	4,154	2,403
Other allocated costs	97	101
	\$ 8,174	5,816

Revenues from Shrine temple sponsored events are reported net of direct costs of \$4,095 and \$4,691 for 2006 and 2005, respectively.

(7) Patient Transportation Funds Held by Shrine Temples

Shrine temples pay for substantially all of the costs of transporting patients to individual Shriners Hospitals. These costs are supported by funds retained from fund raising events held for the benefit of Shriners Hospitals for Children (see note 6), as well as local donations from Shriners and the general public. The activities of the Shrine temple patient transportation funds are reflected as a change in patient transportation funds held by Shrine temples in the accompanying combined statements of activities.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

The activities of the patient transportation funds reflected for the years ended December 31, 2006 and 2005 are as follows:

		<u>2006</u>	<u>2005</u>
Temple revenues restricted for patient transportation	\$	16,586	16,839
Patient transportation costs		<u>(16,638)</u>	<u>(11,712)</u>
Net change	\$	<u>(52)</u>	<u>5,127</u>

(8) Retirement Plans

The employees of U.S. hospitals are included in the Shriners Hospitals for Children Employees' Retirement Plan and the Shriners Hospitals for Children Supplemental Retirement Plan (collectively, the Pension Plans). Benefits are based on years of service and the employees' compensation during the highest five consecutive years of employment. Contributions are made to the Pension Plans in accordance with ERISA requirements. In addition, the Hospitals sponsor a postretirement life insurance plan (the Postretirement Plan).

As discussed in note 1(p), effective December 31, 2006, the Hospitals adopted the recognition and disclosure provisions of SFAS 158. SFAS 158 requires companies to recognize the funded status of defined benefit pension and other postretirement plans as a net asset or liability on its statement of financial position.

The following sets forth the Pension Plans' and the Postretirement Plan's benefit obligations, fair value of plan assets, and funded status, using a measurement date of September 30, 2006 and 2005:

		<u>Pension Plans</u>		<u>Postretirement Plan</u>	
		<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Fair value of plan assets	\$	176,482	159,102	—	—
Less benefit obligation		<u>281,278</u>	<u>253,862</u>	<u>8,390</u>	<u>8,167</u>
Funded status	\$	<u>(104,796)</u>	<u>(94,760)</u>	<u>(8,390)</u>	<u>(8,167)</u>

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

The following sets forth the amounts recognized in the combined financial statements as of December 31, 2006 and 2005, respectively.

	Pension Plans		Postretirement Plan	
	2006	2005	2006	2005
Amounts recognized in the statements of financial position consist of:				
Unfunded benefit obligation	\$ (103,593)	—	(8,360)	—
Accrued benefit costs	—	(34,726)	—	(5,349)
Additional minimum liability	—	(10,293)	—	—
	<u>\$ (103,593)</u>	<u>(45,019)</u>	<u>(8,360)</u>	<u>(5,349)</u>
Amounts recognized in unrestricted net assets consist of:				
Net actuarial loss	\$ 68,073	—	177	—
Prior service cost	201	—	1,580	—
Transition obligation	—	—	240	—
	<u>\$ 68,274</u>	<u>—</u>	<u>1,997</u>	<u>—</u>

The loss, prior service credit, and transition amount expected to be recognized in net periodic benefit cost in 2007 are \$2,891 for the Pension Plans and \$334 for the Postretirement Plan.

The accumulated benefit obligation for the Pension Plans was \$225,907 and \$204,770 at December 31, 2006 and 2005, respectively. The accumulated benefit obligation differs from the benefit obligation above in that it includes no assumption about future compensation levels. It represents the actuarial present value of future payments to plan participants using current and past compensation levels.

Net Periodic Benefit Cost

Net periodic benefit cost for defined benefit plans includes the following components:

	Pension Plans		Postretirement Plan	
	2006	2005	2006	2005
Net periodic benefit cost recognized	\$ 18,637	19,950	1,183	1,216
Change in minimum liability	4,248	(21,140)	—	—

Weighted average assumptions used in determining the net periodic costs of the Pension Plans and the Postretirement Plan are:

	Pension Plans		Postretirement Plan	
	2006	2005	2006	2005
Discount rate	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	4.00	4.00	N/A	N/A
Expected return on plan assets	7.75	8.50	N/A	N/A

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

The overall expected long-term rate of return on assets is 7.75%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Employer's contributions and payments to beneficiaries for 2006 and 2005 were as follows:

	Pension Plans		Postretirement Plan	
	2006	2005	2006	2005
Employer contribution	\$ 18,043	11,896	140	110
Benefits paid	11,230	7,850	140	110

Plan Assets

The weighted average asset allocation of the Pension Plans benefits at December 31, 2006 and 2005 were as follows:

Asset category	Pension Plans assets at December 31	
	2006	2005
Common stocks	46%	55%
U.S. government and agency issues	15	18
Corporate and miscellaneous bonds	21	18
Mutual funds	14	5
Short-term investments	4	4
Total assets	100%	100%

The Pension Plans do not have a targeted asset allocation at December 31, 2006 and 2005.

Contributions

Annual contributions are determined based upon calculations prepared by the plans' actuary. Expected contributions to the Pension Plans and the Postretirement Plan for the year beginning January 1, 2007 are \$11,186 and \$261, respectively.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid out of the plans:

	<u>Pension Plans</u>	<u>Postretirement Plan</u>
Fiscal year:		
2007	\$ 9,497	261
2008	10,417	284
2009	11,361	306
2010	12,712	333
2011	13,798	360
2012-2016	89,698	2,270

The Hospitals also have a retirement savings plan for all eligible employees. Under this plan, the Hospitals match 50% of the first 6% of voluntary contributions made from eligible compensation by employees. Matching contributions by the Hospitals to the retirement savings plan were \$4,823 and \$4,869 in 2006 and 2005, respectively.

Canadian and Mexican hospital employees are included in government retirement programs.

(9) Estimated Malpractice Costs and Other Contingencies

The Hospitals are self-insured for claims attributed to malpractice and workers compensation from providing professional and patient care services. Claims alleging malpractice have been asserted against the Hospitals and are currently in various stages of litigation. Additional claims may be asserted against the Hospitals arising from services provided to patients through December 31, 2006. Liabilities for malpractice and workers compensation claims are established based on specific identification and historical experience using actuarial methodologies. It is the opinion of management that estimated malpractice and workers compensation claims accrued should be adequate to provide for potential losses resulting from both reported claims and claims incurred but not reported.

The Hospitals are also a party to various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate outcome of such claims and legal actions will have a material adverse effect on the financial position or activities of the Hospitals.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2006 and 2005

(In thousands)

(10) Designated Unrestricted Net Assets

In accordance with Board policy, the Hospitals designate their unrestricted net assets in the following categories: operations, board designated, and land, buildings, and equipment. The following schedule reflects changes in these designated categories for the year ended December 31, 2006:

	<u>Operations</u>	<u>Board designated</u>	<u>Land, buildings, and equipment</u>	<u>Total</u>
Increase in unrestricted net assets resulting from operating activities	\$ 11,241	—	—	11,241
Investment return greater than amounts designated for support of current operations	—	407,820	—	407,820
Gifts and bequests	—	394	—	394
Life memberships	—	181	—	181
Change in patient transportation funds held by Shrine temples	(52)	—	—	(52)
Change in minimum pension liability and effect of adoption of SFAS 158	(61,586)	—	—	(61,586)
Other, net	8,596	(9,378)	(5,057)	(5,839)
Net assets released from restrictions	—	221,382	—	221,382
Foreign currency translation adjustments	(95)	3	—	(92)
Transfers:				
For operations	99,648	(99,648)	—	—
Depreciation expense	43,763	—	(43,763)	—
Property and equipment additions	—	(21,192)	21,192	—
	<hr/>	<hr/>	<hr/>	<hr/>
Increase (decrease) in unrestricted net assets	101,515	499,562	(27,628)	573,449
Unrestricted net assets at beginning of year	<hr/>	<hr/>	<hr/>	<hr/>
	297,457	6,604,173	730,590	7,632,220
Unrestricted net assets at end of year	<hr/>	<hr/>	<hr/>	<hr/>
	\$ 398,972	7,103,735	702,962	8,205,669