

**MARC CENTER OF MESA, INC.
AND
AFFILIATES**

**CONSOLIDATED FINANCIAL STATEMENTS
TOGETHER WITH
INDEPENDENT AUDITORS' REPORT**

June 30, 2011

MARC CENTER OF MESA, INC.
AND
AFFILIATES

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Schmidt Westergard

& COMPANY, PLLC

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Marc Center of Mesa, Inc. and Affiliates

We have audited the accompanying consolidated statement of financial position of Marc Center of Mesa, Inc. (a nonprofit organization) and Affiliates (collectively, the "Organization") as of June 30, 2011, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the Organization's 2010 consolidated financial statements, and, in our report dated October 29, 2010, we expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the AICPA's Auditing Standards Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization'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 consolidated 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Marc Center of Mesa, Inc. and Affiliates as of June 30, 2011, and the changes in their net assets and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Schmidt Westergard & Company, PLLC

Mesa, Arizona
October 21, 2011

MARC CENTER OF MESA, INC. AND AFFILIATES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

	2011	2010
ASSETS		
Cash and cash equivalents	\$ 5,646,404	\$ 6,036,534
Consumer trust funds	49,402	618,513
Accounts receivable, net	1,273,871	1,266,120
Contributions receivable, net	346,961	360,988
Prepaid expenses and other	181,803	278,842
Investments	378,221	196,015
Investments in and receivable from affiliates	729,387	238,524
Property, net	20,858,739	19,651,576
Bond issuance costs, net	303,457	341,341
Deposits	43,757	24,781
TOTAL ASSETS	\$ 29,812,002	\$ 29,013,234
LIABILITIES AND NET ASSETS		
LIABILITIES		
Consumer trust funds	\$ 49,402	\$ 618,513
Accounts payable	1,109,895	602,140
Accrued liabilities	1,918,212	1,848,421
Derivative financial instrument	458,685	525,110
Notes payable	249,473	360,218
Bond payable	7,201,682	7,367,360
Total liabilities	10,987,349	11,321,762
NET ASSETS		
Unrestricted	17,841,123	17,042,759
Temporarily restricted	973,530	638,713
Permanently restricted	10,000	10,000
Total net assets	18,824,653	17,691,472
TOTAL LIABILITIES AND NET ASSETS	\$ 29,812,002	\$ 29,013,234

The accompanying notes are an integral part of this financial statement.

MARC CENTER OF MESA, INC. AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES
For the year ended June 30, 2011
(with summarized comparative totals for the year ended June 30, 2010)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2011	2010
REVENUE AND GAINS (LOSSES)					
Governmental					
Arizona Department of Economic Security	\$ 9,596,183	\$ -	\$ -	\$ 9,596,183	\$ 9,721,086
Arizona Department of Health Services	14,803,286	-	-	14,803,286	12,365,106
City of Mesa	10,000	-	-	10,000	20,394
Other	206,908	-	-	206,908	227,742
Total governmental revenue	24,616,377	-	-	24,616,377	22,334,328
Other					
Service contracts	458,748	-	-	458,748	461,731
Service fees	390,746	-	-	390,746	352,842
United Way contributions	-	87,090	-	87,090	113,672
Other contributions	798,832	355,000	-	1,153,832	984,160
Interest income	16,157	152	-	16,309	8,416
Gain (loss) on disposition of property	(8,906)	-	-	(8,906)	21,800
Rental income	182,524	-	-	182,524	93,015
Income (loss) from investments in affiliates	324,264	-	-	324,264	(80,682)
Other	146,962	-	-	146,962	142,239
Total other revenue and gains (losses)	2,309,327	442,242	-	2,751,569	2,097,193
Total operating revenue and operating gains (losses) before supporting lines of business	26,925,704	442,242	-	27,367,946	24,431,521
Supporting lines of business revenue	1,134,181	-	-	1,134,181	488,986
Less costs of supporting lines of business	(1,487,257)	-	-	(1,487,257)	(318,427)
Gross profit (loss) on supporting lines of business	(353,076)	-	-	(353,076)	170,559
Total revenue and gains (losses)	26,572,628	442,242	-	27,014,870	24,602,080
Net assets released from restrictions	107,425	(107,425)	-	-	-
EXPENSES					
Program services					
Residential	6,531,030	-	-	6,531,030	6,665,884
Employment services	4,004,851	-	-	4,004,851	4,002,021
Day services	4,342,526	-	-	4,342,526	2,610,360
Home services	4,676,705	-	-	4,676,705	5,638,701
Outpatient clinic	2,103,120	-	-	2,103,120	1,192,366
Total program services	21,658,232	-	-	21,658,232	20,109,332

The accompanying notes are an integral part of this financial statement.

MARC CENTER OF MESA, INC. AND AFFILIATES
CONSOLIDATED STATEMENT OF ACTIVITIES (CONTINUED)
For the year ended June 30, 2011
(with summarized comparative totals for the year ended June 30, 2010)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2011	2010
EXPENSES (continued)					
Supporting activities					
Management and general	3,326,928	-	-	3,326,928	3,138,180
Fundraising	51,791	-	-	51,791	113,461
Supporting lines of business	911,163	-	-	911,163	192,332
Total supporting activities	4,289,882	-	-	4,289,882	3,443,973
Total expenses	25,948,114	-	-	25,948,114	23,553,305
EXCESS OF REVENUE OVER EXPENSES BEFORE OTHER CHARGES	731,939	334,817	-	1,066,756	1,048,775
OTHER CHARGES					
Unrealized gain (loss) on derivative financial instrument	66,425	-	-	66,425	(525,110)
CHANGE IN NET ASSETS	798,364	334,817	-	1,133,181	523,665
NET ASSETS – Beginning of year	17,042,759	638,713	10,000	17,691,472	17,173,599
Net liabilities assumed - Advocates for the Disabled	-	-	-	-	(5,792)
NET ASSETS – End of year	<u>\$ 17,841,123</u>	<u>\$ 973,530</u>	<u>\$ 10,000</u>	<u>\$ 18,824,653</u>	<u>\$ 17,691,472</u>

The accompanying notes are an integral part of this financial statement.

MARC CENTER OF MESA, INC. AND AFFILIATES
CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2011
(with summarized comparative totals for the year ended June 30, 2010)

	Program Services						Supporting Activities					
	Residential	Employment Services	Day Services	Home Services	Outpatient Clinic	Total Program Services		Management and General	Fundraising	Supporting Lines of Business	Total Supporting Activities	
						2011	2010				2011	2010
Salaries	\$ 3,973,080	\$ 2,424,289	\$ 2,234,524	\$ 2,671,022	\$ 1,481,739	\$ 12,784,654	\$ 12,146,659	\$ 1,398,709	\$ 33,706	\$ 408,269	\$ 1,840,684	\$ 1,881,100
Employee-related expenses	684,269	368,693	388,672	419,081	253,832	2,114,547	2,225,918	402,309	9,320	68,167	479,796	375,588
Occupancy	725,103	312,210	517,587	243,633	91,570	1,890,103	1,707,761	218,978	2,349	140,065	361,392	218,594
Professional fees	158,472	66,502	159,737	898,246	94,921	1,377,878	657,924	207,762	38	35,374	243,174	134,344
Transportation	274,618	113,222	197,279	80,238	11,674	677,031	536,394	32,838	332	74,459	107,629	57,618
Supplies	189,275	183,443	303,754	132,847	71,552	880,871	768,640	348,740	2,089	103,617	454,446	297,543
Equipment rental	12,588	41,937	38,362	14,505	8,180	115,572	154,803	27,149	537	6,160	33,846	38,214
Depreciation	294,161	295,047	261,875	143,563	37,547	1,032,193	1,032,353	159,761	1,562	23,254	184,577	133,570
Other expenses	219,464	199,508	240,736	73,570	52,105	785,383	878,880	530,682	1,858	51,798	584,338	307,402
Total expenses	\$ 6,531,030	\$ 4,004,851	\$ 4,342,526	\$ 4,676,705	\$ 2,103,120	\$ 21,658,232	\$ 20,109,332	\$ 3,326,928	\$ 51,791	\$ 911,163	\$ 4,289,882	\$ 3,443,973

The accompanying notes are an integral part of this financial statement.

MARC CENTER OF MESA, INC. AND AFFILIATES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended June 30, 2011
(with summarized comparative totals for the year ended June 30, 2010)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,133,181	\$ 523,665
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Amortization of discount on long-term contributions receivable	(10,133)	(16,766)
Amortization of bond issuance costs	37,884	34,526
Net unrealized gains on investments	(54,708)	(12,667)
Unrealized (gain) loss on derivative financial instruments	(66,425)	525,110
Net (gains) losses from investments in affiliates	(324,264)	80,682
Depreciation	1,216,770	1,165,914
Donated property	(355,000)	(233,000)
Loss (gain) on disposition of property	8,906	(21,800)
Increase in allowance for doubtful accounts	28,636	14,771
Increase in allowance for uncollectible contributions receivable	50,000	-
Net effect of acquisition of Advocates for the Disabled	-	(200,886)
(Increase) decrease in		
Accounts receivable	(36,387)	(20,125)
Contributions receivable	(25,840)	166,210
Prepaid expenses and other	97,039	75,152
Deposits	(18,976)	63,379
Increase (decrease) in		
Accounts payable	284,054	77,854
Accrued liabilities	69,791	602,128
Net cash provided by operating activities	2,034,528	2,824,147
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash obtained through acquisition of Advocates for the Disabled	-	195,094
Purchases of investments	(127,498)	(65,500)
Proceeds from disposition of property	8,380	21,800
Purchases of property	(1,862,518)	(1,179,894)
Advances to FCS Premier	-	(133,678)
Investments in affiliates	-	(168,165)
Advances to affiliates	(166,599)	(17,363)
Net cash used in investing activities	(2,148,235)	(1,347,706)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings on notes payable	75,000	75,000
Payments on notes payable	(185,745)	(6,815,875)
Payment of bond issuance costs	-	(375,867)
Proceeds from issuance of bond payable	-	7,500,000
Payments on bond payable	(165,678)	(132,640)
Net cash provided by (used in) financing activities	(276,423)	250,618
Net increase (decrease) in cash and cash equivalents	(390,130)	1,727,059
CASH AND CASH EQUIVALENTS - Beginning of year	6,036,534	4,309,475
CASH AND CASH EQUIVALENTS - End of year	\$ 5,646,404	\$ 6,036,534

The accompanying notes are an integral part of this financial statement.

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Marc Center of Mesa, Inc. (“Marc Center”) is a nonprofit corporation, incorporated in the state of Arizona on August 6, 1957 to provide places of residence, employment services, training, education, rehabilitation, and behavioral health services for developmentally disabled children and adults, as well as people with severe mental illness. Marc Center provides services throughout Maricopa County, Arizona. During the year ended June 30, 2010, Marc Center acquired Advocates for the Disabled, Inc. (“Advocates”) by an action by the Board of Directors of Advocates granting Marc Center the sole power to appoint directors to the Advocates’ Board. The acquisition of Advocates has been accounted for in a manner similar to the pooling of interests method.

TecMarc, Inc. (“TecMarc”) is an Arizona corporation and was incorporated in March 2008 to conduct the business of information technology sales and support and property management services. TecMarc’s revenue makes up all of supporting lines of business revenue in the accompanying statement of activities. TecMarc has 1,000 shares of authorized common stock, all of which have been issued to Marc Center.

The Foundation for People with Disabilities (the “Foundation”) is a nonprofit corporation, incorporated in the state of Arizona on January 29, 1988, to provide housing for disabled individuals in residential settings and employment training facilities throughout Maricopa County. Marc Center is the sole member of the Foundation’s Board of Directors. During the year ended June 30, 2010, the Foundation transferred substantially all of its property to Marc Center to facilitate the completion of bond financing.

The Village at Oasis Park – Phase I, Inc. (the “Village”) is a nonprofit corporation and was incorporated in the state of Arizona in October 2009 to provide housing for seniors who have disabled children. The Village’s Board of Directors consists of the Executive Committee of Marc Center and other individuals selected by the Executive Committee of Marc Center.

Prior Year Summarized Information

The consolidated financial statements include certain prior-year summarized comparative information in total but not by net asset class or by function. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization’s consolidated financial statements for the year ended June 30, 2010 from which the summarized information was derived.

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Marc Center, Advocates, TecMarc, the Foundation, and the Village (collectively, the “Organization”). All significant inter-organization transactions have been eliminated in consolidation.

Basis of Presentation

The consolidated financial statements are presented in accordance with FASB ASC 958, under which the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Organization considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to an allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to accounts receivable. Accounts receivable are considered past due 30 days after the invoice date. Accounts receivable past due 90 days or more totaled approximately \$65,000 and \$46,000 at June 30, 2011 and 2010, respectively. The Organization does not require collateral on accounts receivable balances and does not generally charge interest on past due balances.

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

Changes in the allowance for doubtful accounts were as follows for the years ended June 30:

	<u>2011</u>	<u>2010</u>
Allowance for doubtful accounts, beginning of year	\$ 102,607	\$ 87,836
Provision for realization losses	82,251	60,952
Write-offs	<u>(53,615)</u>	<u>(46,181)</u>
Allowance for doubtful accounts, end of year	<u>\$ 131,243</u>	<u>\$ 102,607</u>

Investments

The Organization reports investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. Investments at June 30, 2011 and 2010 totaled approximately \$378,000 and \$196,000, respectively, all of which were invested in mutual funds. Net unrealized gains for the year ended June 30, 2011 and 2010 totaled approximately \$55,000 and \$13,000, respectively.

Investments in and Receivable from Affiliates

The balance of investments in and receivable from affiliates consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
<i>Partners in Recovery, LLC</i>		
Original investment in Partners in Recovery, LLC ("PIR")	\$ 105,915	\$ 105,915
Due from PIR	78,541	17,363
Marc Center's share of accumulated PIR net income	452,747	88,515
<i>FCS Premier, LLC</i>		
Original investment in FCS Premier, LLC ("FCS")	50,000	50,000
Due from FCS	208,406	133,678
Marc Center's share of accumulated FCS net losses	(289,098)	(173,541)
Losses in excess of investment and receivables	30,693	-
<i>BuildMarc, LLC</i>		
Original investment in BuildMarc, LLC ("BuildMarc")	12,250	12,250
TecMarc's share of accumulated BuildMarc net income	<u>79,933</u>	<u>4,344</u>
Total investments in and receivable from affiliates	<u>\$ 729,387</u>	<u>\$ 238,524</u>

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

Partners In Recovery, LLC

During the year ended June 30, 2009, Marc Center entered into an investment in PIR, a newly formed Arizona limited liability company, in order to provide behavioral health services. PIR is one of four Provider Network Organizations (“PNO”) that are contracted with Magellan Health Services of Arizona, Inc. (“Magellan”) to provide behavioral health services to adults in Maricopa County. Magellan is the Regional Behavioral Health Authority (“RBHA”) contracted by the Arizona Department of Health Services for Maricopa County. Marc Center has a 50% membership interest in PIR. While Marc Center does not have control of PIR, it does have the ability to exercise significant influence over PIR and has an ongoing economic interest in the net assets of PIR. Accordingly, the Organization reports Marc Center’s interest in the net assets of PIR, as well as any change in the net assets of PIR, in a manner similar to the equity method of accounting for investments in common stock.

Marc Center’s investment in PIR at June 30, 2011 and 2010 was approximately \$559,000 and \$194,000, respectively, which includes Marc Center’s original investment of approximately \$106,000 plus Marc Center’s share of PIR’s increase in net assets of approximately \$364,000 and \$89,000 for the years ended June 30, 2011 and 2010, respectively.

Summarized financial statement information of PIR as of and for the years ended June 30 is as follows:

	2011 (Audited)	2010 (Audited)
Statements of financial position		
Total assets	\$ 4,902,389	\$ 1,577,946
Total liabilities	\$ 3,785,065	\$ 1,189,086
Unrestricted net assets	1,117,324	388,860
Total liabilities and unrestricted net assets	\$ 4,902,389	\$ 1,577,946
Statements of activities		
Revenue	\$ 18,993,518	\$ 18,613,061
Expenses		
Program services	17,171,065	17,688,005
Supporting activities	1,093,989	748,026
Total expenses	18,265,054	18,436,031
Change in unrestricted net assets	728,464	177,030
Marc Center's ownership percentage	50%	50%
Marc Center's share of change in net assets	\$ 364,232	\$ 88,515

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

FCS Premier, LLC

During the year ended June 30, 2010, Marc Center entered into an investment in FCS, a newly formed Arizona limited liability company, in order to provide food services training opportunities for people with disabilities at a corporate office building. Marc Center has a 50% membership interest in FCS. While Marc Center does not have control of FCS, it does have the ability to exercise significant influence over FCS and has an ongoing economic interest in the net assets of FCS. Accordingly, the Organization reports Marc Center's interest in the net assets of FCS, as well as any changes in the net assets of FCS, in a manner similar to the equity method of accounting for investments in common stock.

For the year ended June 30, 2010, Marc Center's share of FCS's decrease in net assets of approximately \$174,000 reduced Marc Center's original investment of \$50,000 to zero and reduced an amount due from FCS by approximately \$124,000, leaving a balance due from FCS of approximately \$10,000 at June 30, 2010. For the year ended June 30, 2011, Marc Center's share of FCS's decrease in net assets of approximately \$116,000 reduced a due from related party balance of approximately \$85,000 to zero, and the remaining balance of approximately \$31,000 was recorded in accrued liabilities on the consolidated statement of financial position.

Summarized financial statement information of FCS as of and for the year ended June 30 is as follows:

	2011 (Unaudited)	2010 (Unaudited)
Statements of financial position		
Total assets	\$ 250,432	\$ 413,681
Total liabilities	\$ 728,629	\$ 660,764
Unrestricted net assets	(478,197)	(247,083)
Total liabilities and unrestricted net assets	\$ 250,432	\$ 413,681
Statements of activities		
Revenue	\$ 420,422	\$ 214,165
Expenses		
Program services	625,475	538,798
Supporting activities	26,061	22,450
Total expenses	651,536	561,248
Change in unrestricted net assets	(231,114)	(347,083)
Marc Center's ownership percentage	50%	50%
Marc Center's share of change in net assets	\$ (115,557)	\$ (173,541)

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

BuildMarc, LLC

During the year ended June 30, 2010, TecMarc entered into an investment in BuildMarc, LLC (“BuildMarc”), in order to provide construction services and jobs for people with disabilities. TecMarc has a 49% membership interest in BuildMarc. While TecMarc does not have control of BuildMarc, it does have the ability to exercise significant influence over BuildMarc and has an ongoing economic interest in the members’ equity of BuildMarc. Accordingly, the Organization reports TecMarc’s interest in the members’ equity of BuildMarc, as well as any changes in the members’ equity of BuildMarc, in a manner similar to the equity method of accounting for investments in common stock.

TecMarc’s investment in BuildMarc at June 30, 2011 and 2010 was approximately \$92,000 and \$17,000, respectively, which includes TecMarc’s original investment in BuildMarc of approximately \$13,000 plus TecMarc’s share of BuildMarc’s net income of approximately \$76,000 and \$4,000 for the years ended June 30, 2011 and 2010, respectively.

Summarized financial statement information of BuildMarc as of and for the year ended June 30 is as follows:

	2011 (Unaudited)	2010 (Unaudited)
Balance sheet		
Total assets	\$ 318,117	\$ 171,345
Total liabilities	\$ 129,987	\$ 137,479
Members' equity	188,130	33,866
Total liabilities and members' equity	\$ 318,117	\$ 171,345
Statement of operations		
Net sales	\$ 823,533	\$ 219,864
Cost of sales	639,254	210,267
Gross profit	184,279	9,597
Operating expenses and other	30,015	731
Net income	154,264	8,866
TecMarc's ownership percentage	49%	49%
TecMarc's share of net income	\$ 75,589	\$ 4,344

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

Property

Purchased property is stated at cost. Property acquired by gift is stated at estimated fair value at the date of the contribution. Depreciation is provided using the straight-line method over estimated useful lives ranging from four to twenty-five years. In the absence of donor restrictions on how gifts of long-lived assets must be used, the Organization does not imply time restrictions on such contributions.

Governmental Revenue

The Organization has contracts with state governmental agencies and various insurance companies to provide services to clients with developmental disabilities and severe mental illness. Revenue from these contracts is recognized as the services are performed.

Contributions

Contributions of cash or other assets are recognized as revenue when received at the estimated fair value on the date of contribution. Promises to give are recognized as revenue when the donor makes a promise to give to the Organization that is, in substance, unconditional. Promises to give that are received with conditions are not recognized until those conditions are substantially met, unless the likelihood that the Organization will not fulfill the conditions is remote, in which case the contribution is recognized when the promise is made. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Fundraising Costs

All fundraising costs are expensed in the period incurred.

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting activities benefited, determined by specific identification and estimates of time spent and benefits derived.

MARC CENTER OF MESA, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(with summarized comparative totals as of June 30, 2010)

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continued)

Reclassifications

Certain reclassifications have been made to the 2010 summarized comparative totals to conform to the 2011 presentation. The reclassifications had no effect on the change in net assets.

Income Tax Status

Marc Center, Advocates, the Foundation, and the Village are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. FCS, in which Marc Center has an ownership interest, is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. PIR, in which Marc Center has an ownership interest, has submitted an application to the Internal Revenue Service ("IRS") for exempt status under Section 501(c)(3) of the Internal Revenue Code. Management of PIR anticipates approval of that application in the normal course of its activities. Accordingly, no liability or provision for federal or state income taxes for Marc Center, Advocates, the Foundation, the Village, FCS, or PIR is reflected in the accompanying consolidated financial statements.

TecMarc is not exempt from income taxes and any income is subject to taxation. BuildMarc, in which TecMarc has an ownership interest, is also subject to taxation. For the year ended June 30, 2011 and 2010, TecMarc did not have taxable income.

The Organization applies provisions of FASB ASC 740 *Income Taxes* which provides guidance on uncertainty in income taxes. Under that guidance, uncertain tax positions are accounted for based on whether it is "more-likely-than-not" that the position will be upheld by the taxing authority upon examination. The Organization has identified the tax exempt status of certain entities in these consolidated financial statements as tax positions. However, the Organization has determined that these tax positions do not result in an uncertainty that requires recognition in the consolidated financial statements.

The entities in these consolidated financial statements file informational returns and income tax returns in the U.S. federal jurisdiction and in the state of Arizona. Federal returns are generally subject to examination for three years after they have been filed and state returns are generally subject to examination for four years after they have been filed. The entities in these consolidated financial statements have not yet filed tax returns for the year ended June 30, 2011.

Interest and penalties, if any, are accrued as a component of management and general expenses when assessed. As of June 30, 2011, the Organization has not accrued interest or penalties related to uncertain tax positions.

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(2) ACCOUNTING ESTIMATES

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

(3) CONTRIBUTIONS RECEIVABLE

Contributions receivable consisted of the following at June 30:

	2011	2010
Receivable in less than one year	\$ 507,050	\$ 411,285
Receivable in one to five years	48,750	118,675
	555,800	529,960
Total contributions receivable	555,800	529,960
Less - Unamortized discount	(8,839)	(18,972)
	546,961	510,988
Subtotal	546,961	510,988
Less - Allowance for uncollectible contributions	(200,000)	(150,000)
	346,961	360,988
Total contributions receivable, net	\$ 346,961	\$ 360,988

Contributions receivable due in more than one year were discounted using rates of approximately 5%.

(4) CONDITIONAL PROMISES TO GIVE

During the years ended June 30, 2007 and 2006, the Organization received conditional promises to give as part of agreements with Value Options (Magellan replaced Value Options as the RBHA contracted for Maricopa County during the year ended June 30, 2008). Under the 2007 agreement, unrestricted title to two single-family residences, with an estimated value of \$607,000 at the date of the agreements, will be transferred to the Organization if certain conditions are met. Under the 2006 agreement, unrestricted title to one single-family residence, with an estimated value of \$300,000 at the date of the agreement, will be transferred to the Organization if certain conditions are met. The condition for the transfer of title is that the Organization functions as landlord of the residences for a period of twenty-five years. During this period, the Organization will collect rent from the tenants and will be responsible for repairs and maintenance on the residences. Once all conditions have been met, the Organization will recognize the fair value of the property in the consolidated financial statements.

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(4) CONDITIONAL PROMISES TO GIVE (continued)

During the year ended June 30, 2002, the Organization received a conditional promise to give as part of an agreement with Value Options. Under the agreement, unrestricted title to a 12-unit apartment building will be transferred to the Organization if certain conditions are met. The estimated value of the property was \$450,000 at June 30, 2002. The condition for the transfer of title is that the Organization functions as landlord of the building for a period of fifteen years. During this period, the Organization will collect rent from the tenants and will be responsible for repairs and maintenance on the building. Under a separate agreement with Magellan, the Organization provides services to the tenants of the building. Once all conditions have been met, the Organization will recognize the fair value of the property in the consolidated financial statements.

(5) PROPERTY

Property consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Land	\$ 4,399,756	\$ 4,257,671
Buildings	18,264,238	17,143,236
Leasehold improvements	854,978	489,851
Vehicles	1,567,701	1,674,390
Furniture and equipment	1,357,555	1,048,603
Construction in progress	<u>489,806</u>	<u>191,834</u>
Total property	26,934,034	24,805,585
Less - Accumulated depreciation	<u>(6,075,295)</u>	<u>(5,154,009)</u>
Property, net	<u>\$ 20,858,739</u>	<u>\$ 19,651,576</u>

Depreciation expense for the years ended June 30, 2011 and 2010 totaled approximately \$1,217,000 and \$1,166,000, respectively.

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(5) PROPERTY (continued)

In November 2008, the City of Mesa transferred title to one residential property and one commercial property to the Organization. Approximately \$270,000 of temporarily restricted contribution revenue was recognized by the Organization during the year ended June 30, 2009 related to the transfer of these properties. The transfer agreements stipulated that the properties must be used in qualifying programs for five years from the date of the transfers. In addition, the Organization was required to sign two promissory notes to the City of Mesa totaling \$399,000, which will be forgiven at the end of the five year period if the Organization has used the properties as required. The notes do not accrue interest and the Organization is not required to make any payments. Since the Organization believes that the probability of triggering any payments on this note is highly remote, the \$399,000 has not been recorded as a liability in the accompanying consolidated statement of financial position.

In June 2010, the City of Mesa transferred title to two residential properties to the Organization. The transfer agreements stipulate that the properties must be used as affordable rental housing and that the properties cannot be sold without written approval from the City of Mesa for twenty years from the date of the transfers. Approximately \$233,000 of temporarily restricted contribution revenue was recognized by the Organization during the year ended June 30, 2010 related to the transfer of these properties.

In April 2011, the city of Mesa transferred title to four residential properties to the Organization. The transfer agreements stipulate that the properties must be used as affordable rental housing and that the properties cannot be sold without written approval from the City of Mesa for twenty years from the date of the transfers. Approximately \$355,000 of temporarily restricted contribution revenue was recognized by the Organization during the year ended June 30, 2011 related to the transfer of these properties.

(6) BOND ISSUANCE COSTS

Bond issuance costs consist of legal costs, underwriting fees, printing costs and other costs incurred to obtain, secure and rate the bond described in Note 10. These issuance costs totaled approximately \$376,000 and are being amortized over the 10-year term of the bond using the straight-line method (which approximates the effective interest method). Amortization of the bond issuance costs was approximately \$38,000 and \$35,000 for the years ended June 30, 2011 and 2010, respectively, and is included in interest expense.

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(7) NOTE PAYABLE - BANK LINE OF CREDIT

The Organization has a \$750,000 revolving line of credit with a bank which bears interest at the bank's prime rate (3.25% at June 30, 2011) with a 4% floor. The balance outstanding cannot exceed the balance of outstanding receivables (as defined). This line of credit is secured primarily by receivables and furniture and equipment of the Organization and expired in September 2011. The line of credit was then renewed through November 2011 with interest on any outstanding balance at the bank's prime rate with a 4% floor. There was no activity on this line of credit during the year ended June 30, 2011.

The line of credit requires the Organization to maintain certain financial ratios, such as current ratio, debt service coverage ratio, and debt to net worth ratio, as defined in the agreements. At June 30, 2011, the Organization was in compliance with these requirements.

(8) DERIVATIVE FINANCIAL INSTRUMENT: INTEREST RATE SWAP

In July 2009, the Organization entered into an interest rate swap agreement that effectively converted approximately \$7,500,000 of the Organization's LIBOR-based variable-rate debt to a fixed rate. The counterparty to the swap agreement is the bank (a major U.S. financial institution) that holds the Organization's LIBOR-based variable-rate bond payable. Under the swap agreement, the Organization pays interest at a fixed rate of 4.8% and, in return, receives interest at a variable rate based on 65% of the one-month LIBOR rate (0.19043% at June 30, 2011) plus a margin of 2.125%. The net effect of the swap is to fix the interest rate on \$7,500,000 of the Organization's LIBOR-based variable-rate bond payable at 4.8%.

The interest rate swap agreement qualifies as a cash flow hedge, and accordingly, the fair value of the interest rate swap agreement, which is adjusted regularly, is recorded in the Organization's consolidated statement of financial position as an asset or liability, as necessary, with a corresponding adjustment to other charges. The fair value of the Organization's interest rate swap at June 30, 2011 and 2010 was a liability totaling approximately \$459,000 and \$525,000, respectively. The unrealized holding gain on this interest rate swap was approximately \$66,000 for the year ended June 30, 2011. The unrealized holding loss on this interest rate swap was approximately \$525,000 for the year ended June 30, 2010.

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(9) NOTES PAYABLE

Notes payable consisted of the following at June 30:

	2011	2010
Notes payable to banks and finance companies; due in monthly installments totaling approximately \$8,000, including interest ranging from 6.75% to 8.25%, with a weighted average interest rate of 7.20%; maturing through June 2013; collateralized by vehicles and equipment.	\$ 86,919	\$ 156,216
Note payable to a finance company; due in monthly installments of approximately \$4,000, including interest at approximately 6.4%; final payment in June 2013; collateralized by software and equipment.	87,554	129,002
Note payable to the Arizona Community Foundation; principal balance due at maturity with no interest accrued; maturing in April 2012.	75,000	-
Note payable to the Arizona Community Foundation; principal balance due at maturity with no interest accrued; matured in December 2011.	-	75,000
Total notes payable	\$ 249,473	\$ 360,218

Annual principal payments on notes payable are scheduled as follows:

Year Ending June 30	
2012	\$ 178,513
2013	70,960
Total notes payable	\$ 249,473

Interest expense for the years ended June 30, 2011 and 2010 totaled approximately \$473,000 and \$385,000, respectively, which includes interest on the notes payable above and on the bond payable (Note 10). Of those amounts, approximately \$0 and \$5,000 represents interest expense from the Foundation for the years ended June 30, 2011 and 2010, respectively. Approximately \$0 and \$34,000 of interest expense was capitalized during the years ended June 30, 2011 and 2010, respectively. In addition, approximately \$38,000 and \$35,000 of interest expense for the years ended June 30, 2011 and 2010, respectively, was amortization on the bond issuance costs (Note 6).

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(10) BOND PAYABLE

In July 2009, the Organization entered into loan agreements with the Industrial Development Authority of the County of Maricopa to issue Community Services Facilities Revenue Bonds, Series 2009A (“Series 2009A”) in the amount of \$7,500,000 for a term of ten years, and to issue Community Services Facilities Revenue Bonds, Series 2009B (“Series 2009B”) in the amount of \$1,620,929 for a term of eleven years and six months. Series 2009A and Series 2009B (collectively “the Bonds”) are collateralized by certain real property as set forth in the agreements. The Organization borrowed the full amount of \$7,500,000 under Series 2009A, and approximately \$7,202,000 and \$7,367,000 was outstanding at June 30, 2011 and 2010, respectively. As of June 30, 2011, no amounts had been borrowed under Series 2009B.

Interest on the Bonds is payable monthly under variable interest rate provisions. Series 2009A is due in monthly principal amounts of approximately \$13,000 to \$20,000 with a final balloon payment in July 2019. Series 2009A bears interest at 65% of the one-month LIBOR rate (0.19043% at June 30, 2011) plus 2.125%. Series 2009A is subject to an interest rate swap agreement (Note 8). Series 2009B bears interest at an annual floating rate equal to the sum of 65% of the prime rate (3.25% at June 30, 2011) plus .65%, but not less than 3.90% annually.

Annual principal payments on the bond payable are scheduled as follows:

Year Ending June 30	
2012	\$ 174,493
2013	183,052
2014	192,040
2015	201,460
2016	211,345
Thereafter	<u>6,239,292</u>
Total bond payable	<u><u>\$ 7,201,682</u></u>

The Organization is required to maintain certain net asset, liquidity, and indebtedness ratios, and must comply with other general covenants of the Loan Agreement. As of June 30, 2011, the Organization was in compliance with those requirements.

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(11) RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at June 30:

	2011	2010
Restrictions on donated property (Note 5)	\$ 857,514	\$ 502,514
Time restrictions on contributions receivable	87,090	107,425
Other	28,926	28,774
Total temporarily restricted net assets	\$ 973,530	\$ 638,713

Permanently restricted net assets are to be maintained in perpetuity. The income from these funds is temporarily restricted for use in promoting independent living.

(12) CAPITAL CAMPAIGNS

Administrative and Day Services Program Building

Contributions receivable at June 30, 2011 and 2010 included two promises to give related to the administrative and day services program building capital campaign in previous years totaling approximately \$152,000 and \$148,000, respectively (net of unamortized discount on long-term promises to give totaling approximately \$9,000 and \$13,000 at June 30, 2011 and 2010, respectively).

Employment Building

Contributions receivable at June 30, 2011 and 2010 included one promise to give related to the employment building capital campaign from previous years of approximately \$190,000.

(13) CASH FLOW INFORMATION

Supplemental Disclosure of Cash Flow Information

Cash paid for interest was approximately \$436,000 and \$388,000, of which approximately \$0 and \$34,000 was capitalized for the years ended June 30, 2011 and 2010, respectively.

During the year ended June 30, 2011, the Organization acquired property through accounts payable of approximately \$224,000.

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(14) COMMITMENTS

The Organization leases office space, residential houses, vehicles, and equipment under various non-cancelable operating leases that expire at various dates through January 2030. Several leases have renewal options. The Organization also leases residential houses and equipment under various month-to-month leases.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms in excess of one year are scheduled as follows:

Year Ending June 30	
2012	\$ 556,484
2013	576,578
2014	419,161
2015	299,278
2016	90,000
Thereafter	<u>238,375</u>
Total future minimum lease payments	<u><u>\$ 2,179,876</u></u>

Rent expense for the years ended June 30, 2011 and 2010 totaled approximately \$1,082,000 and \$745,000, respectively, net of approximately \$0 and \$137,000 of sublease rental income for the years ended June 30, 2011 and 2010, respectively.

(15) CONCENTRATIONS

Revenue

The Organization received significant portions of its total revenue for the years ended June 30, 2011 and 2010 from the Arizona Department of Economic Security (“DES”) and the Arizona Department of Health Services (“ADHS”) through contracts that are renewed annually.

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(15) CONCENTRATIONS (continued)

The percentages of total revenue and the amounts of accounts receivable (before the allowance for doubtful accounts) from DES and ADHS are as follows as of and for the years ended June 30:

	2011		2010	
	Total Revenue	Accounts Receivable	Total Revenue	Accounts Receivable
DES	36%	\$ 865,235	40%	\$ 855,516
ADHS	55%	182,555	51%	76,325
Total	91%	\$ 1,047,790	91%	\$ 931,841

Revenue from Magellan makes up approximately 95% and 94% of the governmental revenue from ADHS as reported in the consolidated statement of activities for the years ended June 30, 2011 and 2010, respectively.

Uninsured Cash

The Organization maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts and does not expect to experience any such losses. However, at June 30, 2011, the Organization's uninsured balance was approximately \$4,078,000.

(16) EMPLOYEE BENEFIT PLANS

The Organization sponsors a defined contribution plan (the "Plan") covering substantially all employees. The Plan provides for employer contributions based primarily on employee participation. The total contributions made to the Plan by the Organization were approximately \$0 and \$48,000 for the years ended June 30, 2011 and 2010, respectively. Due to uncertainties in state funding, the Organization stopped matching contributions in October 2009. However, the Organization continued to accrue matching contributions in anticipation of making the contributions when economically feasible, and approximately \$165,000 and \$114,000 of unpaid matching contributions were included in accrued liabilities in the consolidated statement of financial position at June 30, 2011 and 2010, respectively.

The Organization also has a non-qualified deferred compensation plan (the "Non-Qualified 457b Plan") covering certain officers and executives. The Non-Qualified Plan provides for employer contributions at the discretion of the Board of Directors of the Organization. Employee deferrals are limited to 85% of annual compensation. Total contributions made to the Non-Qualified 457b Plan by the Organization were approximately \$128,000 and \$68,000 for the years ended June 30, 2011 and 2010, respectively, all of which was included in accrued liabilities at June 30, 2011 and 2010.

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(16) EMPLOYEE BENEFIT PLANS (continued)

In May 2010, after the completion of an independent executive compensation wage study, the Organization established a second non-qualified deferred compensation retirement plan (the "Non-Qualified 457f Plan") covering the current President and CEO (the "Participant"). Under the terms of the Non-Qualified 457f Plan, the Organization will distribute pre-defined post-retirement payments to the Participant over a 15-year period based on a 5-year vesting schedule beginning March 31, 2009. On June 30, 2011 and 2010, the present value of the vested post retirement benefits was \$89,000 and \$78,000, respectively, and these liabilities are included in accrued liabilities in the consolidated statement of financial position. While the Organization had set aside approximately \$89,000 and \$78,000 at June 30, 2011 and 2010, respectively, in a separate account, these funds remain available to general creditors of the Organization.

(17) RELATED PARTY TRANSACTIONS

Related party transactions not elsewhere disclosed are as follows:

Contributions from members of the Board of Directors and employees totaled approximately \$2,000 for each of the years ended June 30, 2011 and 2010. Included in contributions receivable at June 30, 2011 and 2010 was approximately \$4,000 from members of the Board of Directors and employees.

During the years ended June 30, 2011 and 2010, Marc Center received construction services from BuildMarc in the amount of approximately \$224,000 and \$122,000, respectively, all of which was included in accounts payable at June 30, 2011 and 2010.

During the years ended June 30, 2011 and 2010, Marc Center charged PIR for administrative services, including accounting and management services. Additionally, PIR reimbursed Marc Center for various expenses paid by Marc Center on behalf of PIR. Marc Center received a total of approximately \$208,000 and \$158,000, for the years ended June 30, 2011 and 2010, respectively, of which approximately \$79,000 and \$17,000 was in investments in and receivable from affiliates at June 30, 2011 and 2010, respectively.

During the year ended June 30, 2011, Marc Center entered into an agreement with two banks to guarantee certain debts of FCS. Marc Center has guaranteed FCS's line of credit, which has a limit of approximately \$50,000, and had a balance of approximately \$13,000 at June 30, 2011. Additionally, Marc Center has guaranteed a \$250,000 promissory note, which had a balance of approximately \$156,000 at June 30, 2011.

During the year ended June 30, 2011, Marc Center entered into an agreement to guarantee PIR's line of credit, which has a limit of approximately \$500,000, and had a balance of approximately \$500,000 at June 30, 2011.

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(18) LITIGATION

The Organization is involved in legal proceedings which are being defended and handled in the ordinary course of business. The Organization believes that the results of these legal proceedings will not have a material adverse effect on the Organization's financial condition.

(19) FAIR VALUE MEASUREMENTS

FASB ASC 820 provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets and liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability (i.e., interest rates, yield curves, etc.);
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

For assets and liabilities measured at fair value on a recurring basis, the fair value hierarchy requires the use of observable market data when available. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety.

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(19) FAIR VALUE MEASUREMENTS (continued)

Following is a description of the valuation methodologies used for assets measured at fair value:

Investments

Investments are valued at the net asset value of shares held by the Organization. Net asset value is based on quoted market prices for identical assets.

Derivative financial instrument

The Organization's derivative financial instrument described in Note 8 is recorded at fair value, which has been calculated based primarily on observable interest rates and yield curves for the term of the swap.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Organization believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain assets could result in a different fair value measurement.

The following tables set forth by level, within the fair value hierarchy, the Organization's assets and liabilities that are measured at fair value as of June 30:

	2011			
	Level 1	Level 2	Level 3	Total
Investments	\$ 378,221	\$ -	\$ -	\$ 378,221
Derivative financial instrument	-	(458,685)	-	(458,685)
	2010			
	Level 1	Level 2	Level 3	Total
Investments	\$ 196,015	\$ -	\$ -	\$ 196,015
Derivative financial instrument	-	(525,110)	-	(525,110)

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(20) SUBSEQUENT EVENTS

Subsequent events were evaluated by management through October 21, 2011, the date on which the consolidated financial statements were available to be issued. There were no events or transactions occurring after June 30, 2011, but prior to October 21, 2011, that provided additional evidence about conditions that existed at June 30, 2011.