KENNEDY KRIEGER INSTITUTE, INC. AND AFFILIATES

Combined Financial Statements
June 30, 2015 and 2014

Kennedy Krieger Institute, Inc. and Affiliates
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June 30, 2015 and 2014

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Independent Auditor's Report

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the accompanying combined financial statements of Kennedy Krieger Institute, Inc. and Affiliates (the "Institute"), which comprise the combined balance sheets as of June 30, 2015 and 2014, and the related combined statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the years then ended.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of the combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Institute's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institute's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Kennedy Krieger Institute, Inc. and Affiliates at June 30, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

October 16, 2015

Kennedy Krieger Institute, Inc. and Affiliates
Combined Balance Sheets
As of June 30, 2015 and 2014
(in thousands)

ASSETS	2015	2014
Current assets:		
Cash and cash equivalents	$ 7,832	$ 11,138
Patient receivables, less allowances of $3,461 and $3,880	17,759	19,784
Grant and contract receivable	9,806	6,245
Tuition receivable	3,884	5,993
Pledges receivable	5,485	6,977
Prepaid expenses and other	1,611	1,239
Total current assets	46,377	51,376
Non-current assets:		
Property and equipment, net	126,302	129,495
Investments:		
Board designated endowment	49,157	51,444
Investments limited as to use	6,993	7,112
Pledges receivable, less allowances of $2,617 and $1,920	15,432	10,896
Other non-current assets	460	498
Total non-current assets	198,344	199,445
Total assets	$244,721	$250,821
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	24,051	24,108
Line of credit	-	750
Deferred grant revenue	3,152	1,880
Current portion of tax-exempt bonds	2,247	2,180
Total current liabilities	29,450	28,918
Long-term liabilities:		
Tax-exempt bonds	65,545	67,792
Accrued pension	17,416	13,510
Interest rate swap	8,853	7,112
Other long-term liabilities	1,269	1,544
Total long-term liabilities	93,083	89,958
Total liabilities	122,533	118,876
Net assets:		
Unrestricted	84,715	94,991
Temporarily restricted	36,515	35,996
Permanently restricted	958	958
Total net assets	122,188	131,945
Total liabilities and net assets	$244,721	$250,821

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Operations and Other Changes in Unrestricted Net Assets
for the years ended June 30, 2015 and 2014
(in thousands)

	2015	2014
Operating revenues:		
Patient service revenue, net of contractual allowances	$ 141,953	$ 133,795
Bad debt expense	(3,418)	(2,941)
Net patient service revenue	138,535	130,854
Tuition revenue	44,056	43,497
Grant and contract revenue	33,173	31,956
Net assets released for operating activities	7,424	8,488
Investment earnings used for operating activities	1,927	1,901
Unrestricted contributions from fundraising activities, net	1,552	1,363
Other operating revenues	1,557	1,662
Total operating revenues	228,224	219,721
Operating expenses:		
Salaries, wages and benefits	169,418	162,091
Supplies, purchased services, and other	46,668	43,222
Depreciation and amortization	8,590	8,279
Rent	2,026	1,696
Interest	1,522	1,612
Total operating expenses	228,224	216,900
Operating revenues over operating expenses	-	2,821
Non-operating activity:		
Investment income and realized gains, net	986	774
Realized and unrealized (loss) on interest rate swap	(3,096)	(1,503)
Loss on early extinguishment of long-term debt	-	(380)
Realized gain on sale of subsidiaries	100	1,100
Restricted fundraising expenses	(654)	(646)
Net non-operating activities	(2,664)	(655)
Excess of revenue (under) over expenses	(2,664)	2,166
Other changes in unrestricted net assets:		
Unrealized (losses) gains on investments, net	(2,984)	4,543
Net assets released from restrictions used for property and equipment	53	22
Change in funded status of defined benefit plan	(4,681)	(540)
(Decrease) increase in unrestricted net assets	$ (10,276)	$ 6,191

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Changes in Net Assets
for the years ended June 30, 2015 and 2014
(in thousands)

	2015	2014
Unrestricted net assets:		
Excess of revenue (under) over expenses	$ (2,664)	$ 2,166
Change in unrealized (losses) gains on investments, net	(2,984)	4,543
Net assets released from restrictions used		
for property and equipment	53	22
Change in funded status of defined benefit plan	(4,681)	(540)
(Decrease) increase in unrestricted net assets	(10,276)	6,191
Unrestricted net assets, beginning of year	94,991	88,800
Unrestricted net assets, end of year	84,715	94,991
Temporarily restricted net assets:		
Contributions from fundraising activities	7,996	16,723
Net assets released from restrictions used for:		
Purchases of property and equipment	(53)	(22)
Operating activities	(7,424)	(8,488)
Increase in temporarily restricted net assets	519	8,213
Temporarily restricted net assets, beginning of year	35,996	27,783
Temporarily restricted net assets, end of year	36,515	35,996
Permanently restricted net assets:		
Contributions from fundraising activities	-	958
Increase in permanently restricted net assets	-	958
Permanently restricted net assets, beginning of year	958	-
Permanently restricted net assets, end of year	958	958
(Decrease) increase in total net assets	(9,757)	15,362
Total net assets, beginning of year	131,945	116,583
Total net assets, end of year	$ 122,188	$ 131,945

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Cash Flows
for the years ended June 30, 2015 and 2014
(in thousands)

	2015	2014
Cash flows from operating activities:		
Change in net assets	$ (9,757)	$ 15,362
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Net realized and unrealized (gains) losses on investments, net	1,265	(6,281)
Loss on early extinguishment of debt	-	380
Depreciation and amortization	8,590	8,279
Bad debt expense	3,423	2,941
Change in pension liability, net	3,906	148
Change valuation of interest rate swap	1,741	129
Restricted contributions	(7,012)	(6,987)
Gain on sale of subsidiary	(100)	(1,100)
Changes in assets and liabilities:		
Patient receivables	(1,398)	(6,415)
Other receivables	(4,496)	(5,245)
Prepaid expenses and other assets	(334)	185
Accounts payable and accrued expenses	144	(1,833)
Deferred grant revenue	1,273	(122)
Other liabilities	(276)	1,140
Net cash (used in) provided by operating activities	(3,031)	581
Cash flows from investing activities:		
Purchase of property and equipment	(5,397)	(5,717)
Net sales of investments	1,022	1,634
Proceeds from sale of subsidiary	100	100
Changes in investments limited to use	119	1,340
Net cash used in investing activities	(4,156)	(2,643)
Cash flows from financing activities:		
Proceeds from issuance of tax-exempt bonds	-	16,730
Payments on tax-exempt bonds	(2,181)	(2,182)
Payments due to refunding of tax-exempt bonds	-	(19,388)
Proceeds from line of credit	5,750	3,000
Payments on line of credit	(6,500)	(2,250)
Payments on capital lease obligation	(200)	(248)
Proceeds from restricted contributions	7,012	6,987
Net cash provided by financing activities	3,881	2,649
Net (decrease) increase in cash and cash equivalents	(3,306)	587
Cash and cash equivalents, beginning of year	11,138	10,551
Cash and cash equivalents, end of year	$ 7,832	$ 11,138
Cash paid during the year for interest	$ 1,522	$ 1,612

See accompanying notes to combined financial statements.

1. DESCRIPTION OF ORGANIZATION

Kennedy Krieger Institute, Inc. and Affiliates (the "Institute") is an internationally recognized organization dedicated to improving the lives of children, adolescents and young adults through comprehensive patient care, education and research. The Institute's primary operating activities include healthcare services, research, training, special education and fundraising.

The operations of the Institute are carried out through a number of legal corporate entities. The combined financial statements of the Institute reflect the accounts of the following separate legal corporate entities:

Kennedy Krieger Institute, Inc.
Kennedy Krieger Children's Hospital, Inc.
Hugo W. Moser Research Institute at Kennedy Krieger, Inc.
Kennedy Krieger Education and Community Services, Inc.
Kennedy Krieger Associates, Inc.
PACT: Helping Children with Special Needs, Inc.
Kennedy Krieger Foundation, Inc.
Madison Street Properties, Inc.

Healthcare services are provided through Kennedy Krieger Children's Hospital, Inc. and include a forty-five bed inpatient unit admitting more than 350 patients yearly, over fifty specialty outpatient clinics generating in excess of 172,500 annual visits and the training of over 400 healthcare professionals each year. Net patient service revenue generated through Healthcare activities represents approximately 60% of the Institute's operating revenue in fiscal years 2015 and 2014.

Studies conducted through Research activities within the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. are provided through over 125 government and private awards. Research grant and contract revenue represents approximately 14.5% of the Institute's operating revenue in fiscal years 2015 and 2014. Approximately 76.6% of this revenue comes from departments and agencies of the United States government. Major government sponsors included the Department of Health and Human Services, the Department of Defense and the Department of Justice.

Special education services provided through Kennedy Krieger Education & Community Services, Inc. are conducted through non-public special education schools for students from kindergarten to grade eight, high school, specialized autism programs and partnership programs within public schools. Tuition and related contractual revenue generated through special education services represents approximately 19% and 20% of the Institute's operating revenue in fiscal years 2015 and 2014, respectively. Kennedy Krieger Institute, Inc., Kennedy Krieger Children's Hospital, Inc., Hugo W. Moser Research Institute at Kennedy Krieger, Inc., Kennedy Krieger Education and Community Services, Inc., Kennedy Krieger Associates, Inc., and PACT: Helping Children with Special Needs, Inc. are Maryland non-stock corporations organized for charitable, scientific and educational purposes and are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Kennedy Krieger Foundation, Inc. (the "Foundation"), is a Maryland stock corporation and is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

Madison Street Properties, Inc. ("MSP") is a tax-exempt supporting organization under Section 509(a)(3) of the Internal Revenue Code and is wholly owned by the Foundation. All real and personal property and leasehold rights owned by the Institute are held by MSP, that in turn leases or subleases the property back to each member of the corporate family utilizing it and also provides property management services, including maintenance, security and housekeeping.

The Institute maintains an independent affiliation with The Johns Hopkins University. The formal relationship between the parties is set forth in an affiliation agreement whereby (i) the medical, scientific and other professional staff of the Institute receive primary and adjunct appointments in the appropriate Johns Hopkins University Schools or departments; and (ii) each Institution's independent corporate status is retained. Goods and services are purchased and sold by each organization through arms length transactions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The financial statements of the Institute have been prepared on the accrual basis, which conforms to accounting principles generally accepted in the United States of America. The combined financial statements include the accounts of the Institute after elimination of all significant intercompany accounts and transactions.

The combining supplemental schedules have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. This is the same basis of presentation as the Kennedy Krieger Institute, Inc. and Affiliates Combined Financial Statements

Excess of Revenue over Expenses
The Statements of Operations include excess of revenues over (under) expenses, which is the Institute's performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses consistent with industry practice, include unrealized gains and losses on investments, certain pension related transactions and assets acquired using contributions which by donor restrictions were to be used for the purpose of acquiring such assets.

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

Cash and Cash Equivalents
Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less. These investments are carried at cost, which approximates market value.

Investments and Investment Income
The Institute follows standards issued by the Financial Accounting Standards Board ("FASB") related to fair value accounting. The standards define fair value, establish a framework for measuring fair value and expand disclosures about fair value measurements.

Under these fair value standards, the Institute is required to categorize and disclose certain assets and liabilities, including investments, at fair value, according to three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets of liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following is a description of the Institute's valuation methodologies for investments carried at fair value. These methods may produce a fair value calculation that may not be reflective of future fair values. Furthermore, while the Institute believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of investments could result in a different estimate of fair value at the reporting date.

Where quoted prices are available in active market, investments are classified in Level 1 of the valuation hierarchy. Investments in Level 1 are cash management funds, fixed income investments, exchange-trade equity securities and debt securities. If quoted prices are not available the investments are considered to be Level 2 or Level 3 and other accepted valuation methodologies, such as quotes for similar securities are used. These valuation services estimate fair values using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads.

As part of the Institute's overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the Institute's principal markets. Investments in Level 2 include cash management funds, corporate obligations, fixed income investments, other domestic equity investment, foreign equity investments and funds held in trust by others. See Notes 7 and 8 for additional details related to the Institute's investments.

Investment income, with the exception of unrealized gains and losses, is included in excess of revenues over expenses in the non-operating activity section of the Statement of Operations. Unrealized gains and losses on all investments are shown below excess of revenues over expenses.

Allowance for Doubtful Accounts
An allowance for doubtful accounts is recorded for patient receivables which are anticipated to become uncollectible in future periods. Receivables deemed to be uncollectible have been written off.

Grant and Contract Revenue and Receivable
Grant and contract revenues are recorded through cost reimbursement arrangements when allowable costs are incurred, through service rates as services are provided or when contractual terms are satisfied. Grant and contract receivables are recorded when earned. A reserve for uncollectible accounts has been estimated and recorded against grant and contract receivables.

Tuition Revenue and Receivable
Tuition revenue is recognized when earned over the school term (July to June). Tuition receivables are recorded when earned. The Institute does not record an allowance as tuition is paid in full by the local education agencies of the State of Maryland at state approved tuition rates.

Pledges Receivable
Unconditional promises to give cash and other assets to the Institute are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the commitment is received in writing.

Pledges receivable from capital campaigns and other restricted and unrestricted donations, have been recorded net of an allowance for uncollectible pledges. The allowance for uncollectible pledges receivable is estimated based on the nature and source of each pledge including pledge payment history and the donor's likelihood of honoring the commitment. The allowance is applied to pledges greater than one year. Multi-year pledges are recorded at their estimated present value using a risk-free rate of return of 2% for both 2015 and 2014.

Assets Limited as to Use
Assets limited as to use primarily include assets held by trustees under bond indenture, self-insurance trust arrangements, deferred compensation plans and other restricted gift arrangements.

Property and Equipment
Property and equipment acquisitions are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives:

Buildings and Improvements	30-40 years
Fixed Equipment	10-15 years
Furniture and Equipment	3-5 years

Equipment purchases under grants, where title to the equipment rests with the grantor, are recorded as expenditures of the grant and are not capitalized or depreciated.

Board Designated Investments for Endowment
The Board of Directors of the Institute has designated certain assets, including accumulated unrestricted gifts to serve as an endowment for the Institute. The Board may authorize the withdrawal or transfer of such amounts at any time to further the purpose of the Institute and, accordingly, such amounts are classified as unrestricted net assets. Interest, dividends and realized gains and losses from the endowment are included in investment income and net realized gains on the Combined Statements of Operations. Unrealized gains and losses are recorded in other changes in unrestricted net assets.

Deferred Financing Costs
Costs incurred related to the issuance of bonds payable have been deferred and are being amortized over the life of the bonds using the effective interest method.

Accrued Expenses
Accrued expenses are operating expenses that have been incurred but which have not been paid as of the balance sheet date. These expenses are typically periodic and due within one year or less. They include expenses incurred for payroll, employee benefits, subcontracts, interest and other operating items.

Deferred Grant Revenue
Deferred grant revenue has been recorded to reflect the portion of cash received on awarded grants where the grantor restrictions for its use have not been satisfied. Typically, the donor restrictions are satisfied within a year, therefore, deferred grant revenue is classified as a current liability.

Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets
Unrestricted net assets represent those net assets utilized in the operating activities of the Institute.

Temporarily restricted net assets are those whose use by the Institute has been limited by donors, grantors and other contracts to a specific purpose or time period. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Combined Statements of Operations as net assets released from restrictions. Temporarily restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Permanently restricted net assets represent those net assets that have been restricted by donors to be maintained in perpetuity. The donors of these assets usually permit the Foundation to use all or part of the income earned on the investments for general or specific purposes.

Estimated Professional and General Liability Costs
The provision for estimated professional and general liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Derivatives
The use of derivatives by the Institute is generally limited to interest rate swaps. The Institute follows accounting guidance on derivative financial instruments that are based on whether the derivative instrument meets the criteria for designation as cash flow or fair value hedges. The criteria for designating a derivative as a hedge include the assessment of the instrument's effectiveness in risk reduction, matching of the derivative instrument to its underlying transaction, and the assessment of the probability that the underlying transaction will occur. The Institute's only derivative financial instrument is an interest rate swap agreement without hedge accounting designation.

The Institute recognizes its interest rate swap as a liability on the Combined Balance Sheet at fair value. The change in the value of this derivative is recorded as an unrealized gain or loss in the Combined Statements of Operations.

Pension Plans
The Institute follows current technical guidance for reporting and accounting for pension benefits provided to employees. This guidance requires recognition of the funded status of a defined benefit plan in the balance sheet as an asset or liability if the plan is over funded or underfunded, respectively. Changes in the funded status of a plan are required to be recognized in the year in which the changes occur through changes in unrestricted net assets. The guidance also requires the measurement date of the plan's funded status to be the same as the company's fiscal year end.

Short-term investments
Short-term investments are carried at fair value and are comprised of instruments with an average duration of 1 to 3 years.

Investments
The fair values for marketable equity, government, and fixed income securities included in long-term investments are based on quoted market prices. Alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers and are valued at the latest available unaudited net asset value of the investments.

Long-term Debt Obligations
Management estimates that the fair value of long-term debt is equal to its carrying value.

Assets Whose Use is Limited
Assets whose use is limited are comprised of investments held for self-insurance obligations and debt service requirements and are valued as stated above.

Reclassifications
Certain reclassifications have been made to conform with the current year financial statement presentation.

New Accounting Pronouncements
In May 2014, the FASB issued a standard on Revenue from Contracts with Customers. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The Institute is evaluating the impact this will have on the combined financial statements beginning in fiscal year 2019.

3. NET PATIENT SERVICE REVENUE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

Net patient service revenues from inpatient and outpatient services are reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered including estimates for contractual allowances with third-party payors and bad debts.

The Institute has agreements with third-party payors that provide for payments to the Institute at amounts different from its established rates. Net patient service revenue is comprised of the following:

(in thousands)

	2015	2014
Gross Inpatient Revenue	$ 52,832	$ 51,382
Less: Contractual Allowances	(10,592)	(9,594)
Bad Debt Expense	(545)	(468)
Net Inpatient Revenue	41,695	41,320
Gross Outpatient Revenue	110,544	101,922
Less: Contractual Allowances	(10,831)	(9,915)
Bad Debt Expense	(2,873)	(2,473)
Net Outpatient Revenue	96,840	89,534
Net Patient Service Revenue	$ 138,535	$ 130,854

The percentage of patient service revenue generated by payor category for the fiscal years ended June 30, 2015 and 2014 is as follows:

	2015	2014
Medicaid	38%	38%
Blue Cross	22%	22%
Commerical	20%	20%
Managed Care	11%	9%
Self pay and other	7%	8%
Medicare	2%	3%
	100%	100%

The Allowance for Doubtful Accounts is based upon management's assessment of historical and expected net collections considering trends in healthcare coverage, economic conditions and payor mix. Management assesses the adequacy of the allowance periodically based upon historical collection and write off experience. After collection of amounts due from insurers, the Institute follows internal guidelines for placing certain past-due balances with collection agencies.

	2015	2014
Beginning Allowance for doubtful accounts	$ 3,856	$ 3,158
Plus: Bad debt expense	3,418	2,941
Less: Bad debt write-offs, net of recoveries	(3,813)	(2,243)
Ending Allowance for doubtful accounts	$ 3,461	$ 3,856

A summary of the payment arrangements with major third-party payors and patient financial assistance follows.

Maryland Medicaid
Since January 1, 2007 the Institute has been under a prospective payment system ("PPS") with Maryland Medicaid for both inpatient and outpatient services. Service-based per diem rates for inpatient services are annually adjusted by market basket update factors published by the Centers for Medicare and Medicaid Services ("CMS"). Outpatient services are reimbursed as a percentage of charges and subject to the lower of cost versus charges. Base year costs are trended forward annually using the CMS outpatient PPS market basket update factor and compared to actual charges. No retroactive settlement occurs under these arrangements.

Out of State Medicaid
The Institute has entered into payment agreements with many out-of-state Medicaid Plans. The majority of these payment agreements reflect similar rates paid by Maryland Medicaid. No retroactive settlement occurs under these agreements.

Commercial Insurance
The Institute has also entered into payment agreements with commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis of payment to the Institute under these agreements includes prospectively determined rates per day or discharge, discounts from established charges and prospectively determined daily rates. No retroactive settlement occurs under these agreements.

Medicare
Certain inpatient and outpatient services rendered to Medicare beneficiaries are subject to retrospective cost-based reimbursement. Medicare cost reports have been filed through 2014 and final settled through 2013. No significant settlement due to or from the Medicare Program has been estimated and as a result no receivable or payable has been recorded at June 30, 2015 or 2014.

Financial Assistance and Community Benefit
The Institute provides services without charge or at discounted charges to patients who meet certain criteria under its financial assistance policy. The criteria for financial assistance considers the patient or patient's family's ability to pay at time of service. The Institute uses the federal poverty guidelines to determine eligibility for free care or discounted care. In addition, the Institute's policy applies to patients who are medically indigent. The Institute also offers payment plan options to assist patients who experience a financial hardship paying their hospital and professional services bills, but who might not qualify for financial assistance.

The cost for services and supplies furnished under the Institute's financial assistance policy aggregated approximately $908 and $824 in 2015 and 2014, respectively. The cost has been estimated based on a cost to charge ratio and applied to financial assistance charges.

In addition to patient financial assistance and payment plan options, the Institute provides various community benefits across the developmental disability populations within the State of Maryland. The foundation of its community benefits envisions that all persons with developmental disabilities ("DD") lead fully inclusive and meaningful lives. A community needs assessment was conducted to understand the needs of the community served. Based on the needs assessment, the Institute promotes and hosts educational forums, provides respite care resources, acts as a resource finder, provides advocacy and legal services, promotes and arranges information exchange among patients, families and professionals, promotes workforces development, is a leader in healthcare training in DD, conducts research, among other things.

(in thousands)

4. TUITION REVENUE

Tuition revenue generated by school programs is summarized as follows:

	2015	2014
High school	$ 13,470	$ 13,737
Lower/middle school	12,549	12,175
Leap/Autism	7,154	7,129
Montgomery County	5,401	5,397
Partnership programs	4,917	4,278
PACT daycare	519	735
Other	46	46
	$ 44,056	$ 43,497

Over 530 students are enrolled in special education programs each year and come from fourteen Maryland counties, Washington, D.C. and other sources. The percentage of tuition revenue generated by jurisdiction is as follows:

	2015	2014
Prince George's County, MD	21.2%	21.4%
Baltimore City, MD	20.5%	21.0%
Other MD Counties	18.8%	18.3%
Baltimore County, MD	13.8%	14.0%
Anne Arundel County, MD	12.9%	12.2%
Montgomery County, MD	9.1%	9.7%
Washington, DC	3.5%	3.2%
Other	0.2%	0.2%
Total	100.0%	100.0%

5. GRANT AND CONTRACT REVENUE

Grant and contract revenue is generated through the following activities:

	2015	2014
Research	$ 24,236	$ 22,875
Community service	7,438	6,866
Training	1,499	2,215
	$ 33,173	$ 31,956

(in thousands)

Research revenue includes all research initiatives funded through government and private sources. Community service revenue consists of services provided to individuals and families with special needs in a community-based setting and is funded through government programs. Training revenue represents government funding of training programs for professionals in the field of developmental disabilities.

Grant and contract revenue includes recoveries of facility and administrative costs, with certain limitations and exclusions. Certain revenues and costs in current and prior years are subject to audit and retroactive settlement. No reserve has been recorded for any potential settlements as amounts are not known or are considered immaterial.

6. CONTRIBUTIONS FROM FUNDRAISING ACTIVITIES

During 2015 and 2014, the Institute recognized contributions from fundraising activities as summarized below:

	2015	2014
Contributions		
Temporarily Restricted	$ 7,996	$ 16,723
Permanently Restricted	-	958
Unrestricted	1,552	1,363
Total Contributions	$ 9,548	$ 19,044
Fundraising expenses		
Unrestricted	$ 1,828	$ 1,257
Restricted	654	646
Total Expenses	$ 2,482	$ 1,903

Restricted contributions are made up of annual giving and capital campaign contributions which are classified as temporarily restricted net assets on the Combined Balance Sheets. Permanently restricted contributions reflect gifts where the corpus cannot be utilized but where investment earnings are available for use. These contributions are classified as permanently restricted net assets on the Combined Balance Sheets. Unrestricted contributions reflect gifts with no donor restrictions and are reported on the Combined Statements of Operations.

Fundraising expenses are reported as operating expenses for those expenses related to Unrestricted Contributions and non-operating expenses for those expenses related to Restricted Contributions. Expenses related specifically to special events are netted with the revenue from those events.

(in thousands)

7. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30, 2015 and 2014 consist of the following:

	2015	2014
Board designated endowment		
Money market funds	$ 677	$ 872
Fixed income mutual funds	11,420	11,779
Equity securities and funds	21,854	22,311
Multi-asset class funds	13,940	14,870
Absolute return fund	1,266	1,612
Total Board designated endowment	49,157	51,444
Investments limited as to use		
Money market funds	304	391
Multi-asset class funds	1,845	3,922
Fixed income mutual funds	2,325	695
Equity securities and funds	2,519	2,104
Total assets limited to use	6,993	7,112
Total Investments	$ 56,150	$ 58,556

Board Designated for Endowment
The Institute maintains certain investments as Board designated for endowment ("endowment funds"). These endowment funds are made up of unrestricted gifts and bequests and certain reserve funds. They have been set aside by the Institute's Board of Directors to fund new initiatives and other needs necessary in furtherance of the mission of the Institute and its subsidiary entities. The Board of Directors maintains the power to release these funds. The endowment funds are classified within unrestricted net assets.

Changes in endowment funds held by the Institute at June 30, 2015 and 2014 are as follows:

	2015	2014
Board Designated Endowment, beginning of year	$ 51,444	$ 46,797
Investment return:		
Unrealized (losses) gains	(2,680)	4,034
Realized gains	1,779	1,749
Investment income, net	1,009	732
Total investment return	108	6,515
Appropriation of endowment assets for expenditure	(2,395)	(1,868)
Endowment, end of year	$ 49,157	$ 51,444

(in thousands)

The Investment Committee of the Board of Directors (“Investment Committee”) sets the investment policy for the endowment funds, including investment and spending guidelines. Investments of the endowment funds are based on the objective of achieving capital appreciation and investment income. Assets are invested in a manner that is intended to achieve an average annual real return in excess of inflation while assuming an acceptable level of investment risk. To monitor the effectiveness of the investment strategy of endowment funds, performance goals are established and monitored related to benchmark indices and returns earned by comparable funds.

To satisfy its long-term rate of return objectives of the endowment funds, the Institute employs a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current income (interest and dividends). The investment policy includes a target asset allocation that is well diversified among suitable asset classes and that is expected to generate, on average, the level of expected return necessary to meet the endowment fund’s objectives while assuming a level of risk (volatility) consistent with achieving that return.

The asset allocation of the endowment funds at June 30, 2015 and 2014 is summarized below. The Investment Committee regularly reviews the actual asset allocation against the target and periodically rebalances the investment, as appropriate.

	Target Allocation	Actual Allocation 2015	Actual Allocation 2014
Equities	40%	44%	43%
Fixed income	27%	23%	23%
Multi-asset class	33%	29%	29%
Absolute return funds	0%	3%	3%
Cash	0%	1%	2%
	100%	100%	100%

The investment policy also provides for an endowment earnings withdrawal to be used in support of operating activities, as determined by Institute management and approved through the annual budget. The annual withdrawal is determined based on 4% of the three-year average market value of the portfolio. Withdrawals of $2,395 and $1,868 were made in 2015 and 2014, respectively to fund operating needs and have been reported as operating revenues.

Investments with a market value of $1,160 and $1,286 as of June 30, 2015 and 2014, respectively have been pledged as collateral under the Institute’s self-funded unemployment insurance plan.

(in thousands)

Investments Limited As To Use

Investments limited as to use at June 30, 2015 and 2014 are made up of the following:

	2015	2014
Self insurance trust fund	$ 3,957	$ 4,154
Deferred compensation	1,269	1,094
Permanently restricted fund	1,021	1,074
Planned gifts, net of reserve	451	495
Donor advised fund	295	295
Total investments limited as to use	$ 6,993	$ 7,112

Investment Income and Gains and Losses

Investment income and realized gains and losses are comprised of the following:

	2015	2014
Investment income		
Interest and dividend income	$ 1,194	$ 937
Realized gain on investments, net	1,719	1,738
Less: Investment earnings used for operating activites	(1,927)	(1,901)
Net investment income	$ 986	$ 774
Net unrealized (loss) gain on investments	$ (2,984)	$ 4,543

The Institute reviews investments to determine whether these investments are other-than-temporarily impaired. Factors considered in the evaluation of these assets include the anticipated holding period, the extent and duration of below cost valuation and the current condition and outlook of the business and industry. As a result of this assessment, no impairment losses were recognized in 2015 and 2014.

The following table presents the fair value and unrealized loss of the Institute's investments including unrealized losses that are not deemed other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2015:

	Less than 12 Months		12 Months or Greater		Total	
Description	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed income securities	$7,521	$ (602)	$2,006	$ (674)	$ 9,527	$ (1,276)
Equity securities	731	(146)	-	-	731	(146)
Total	$8,252	$ (748)	$2,006	$ (674)	$10,258	$ (1,422)

These securities included seven common stocks and three fixed income securities. The Institute evaluated the near-term prospects of the issuers of each of these securities in relation to the severity and duration of the impairment. Based upon this evaluation and the Institute's intent to hold these investments for a reasonable period of time for a forecasted recovery of fair value, the Institute does not consider these investments to be other-than-temporarily impaired at June 30, 2015.

(in thousands)

8. FAIR VALUE MEASUREMENTS

The following tables present the fair value of investments and liabilities as of June 30, 2015 and June 30, 2014, by the valuation hierarchy defined above and also presents information on the liquidity aspects of each investment.

Fair Value of Investments
as of June 30, 2015

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 981	$ -	$ -	$ 981
Fixed income mutual funds (2)	13,745	-	-	13,745
Equity securities and funds (3)	20,489	3,591	-	24,080
Multi-asset class funds (4)	3,176	12,607	1,561	17,344
Total Investments	$38,391	$16,198	$ 1,561	$56,150
Liabilities:				
Interest rate swap	$ -	$ 8,853	$ -	$ 8,853
Total Liabilities	$ -	$ 8,853	$ -	$ 8,853

Fair Value of Investments
as of June 30, 2014

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 1,262	$ -	$ -	$ 1,262
Fixed income mutual funds (2)	12,476	-	-	12,476
Equity securities and funds (3)	16,836	7,283	-	24,119
Multi-asset class funds (4)	5,918	12,874	1,907	20,699
Total Investments	$36,492	$20,157	$ 1,907	$58,556
Liabilities:				
Interest rate swap	$ -	$ 7,112	$ -	$ 7,112
Total Liabilities	$ -	$ 7,112	$ -	$ 7,112

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(in thousands)

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

(3) Equity securities and funds include investments in domestic and international common stocks and common stock mutual funds and collective trusts with next day or monthly liquidity.

(4) Multi-asset class funds include investments in mutual funds or collective trusts whose underlying investments include domestic and international common stocks and other equity securities, government and corporate bonds and other fixed income securities, real asset securities and cash and cash equivalent investments. All funds offer either next day or monthly liquidity.

During 2015 and 2014, there were no transfers between levels.

The Institute has classified certain of its international equity and multi-asset class funds in Level 2 of the fair value hierarchy, as the significant inputs to the overall valuations are based on market-observable data or information derived from or corroborated by market-observable data.

The Institute has also classified the valuation of its interest rate swap in Level 2 of the fair value hierarchy. For over-the-counter derivatives that trade in liquid markets, such as interest rate swaps, model inputs (i.e. contractual terms, market prices, yield curves, credit curves, and measures of volatility) can generally be verified, and model selection does not involve significant management judgment.

9. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30, 2015 and 2014 is as follows:

	2015	2014
Land	$ 4,657	$ 4,657
Building and improvements	164,213	162,622
Furniture & equipment	35,420	28,588
	204,290	195,867
Less accumulated depreciation	(79,450)	(71,045)
	124,840	124,822
Construction in progress	1,462	4,673
Property and equipment, net	$ 126,302	$ 129,495

Depreciation expense was $8,553 and $8,240 in 2015 and 2014, respectively.

(in thousands)

10. PLEDGES RECEIVABLE

Pledges receivable at June 30, 2015 and 2014 are summarized below:

	2015	2014
Within one year	$ 5,485	$ 7,708
One to five years	18,049	12,085
Subtotal	23,534	19,793
Less: Present value adjustment	(1,114)	(856)
Allowance for uncollectible pledges	(1,503)	(1,064)
Net pledges receivable	$ 20,917	$ 17,873

The present value adjustments for 2015 and 2014 were made utilizing a discount rate of 2% for each year. The allowance for uncollectible pledges has been estimated based on management evaluation of each pledge's likelihood to be collected and using historical pledge write-off rates.

11. SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Institute to concentrations of credit risk consist primarily of cash and cash equivalents, investments and patient accounts receivable.

The Institute typically maintains cash and cash equivalents in commercial banks. The short-term investments consist primarily of money market funds. The Federal Deposit Insurance Corporation insures funds up to $250,000 per depositor.

The fair value of the Institute's investments are subject to various market fluctuations which include changes in the interest rate environment and general economic conditions.

The Institute records patient receivables due for services provided to patients and others. The majority of these patients either qualify for federal/state assistance programs or have insurance through commercial insurance companies or managed care organizations. The Institute maintains reserves for potential losses and such losses have been within management's expectations. The mix of patient receivables due from patients and third-party payors at June 30, 2015 and 2014 are as follows:

	2015	2014
Medicaid	14.3%	11.4%
Medicaid Managed Care Organizations	11.0%	10.5%
Total Medical Assistance	25.3%	21.9%
Commercial Insurance	38.8%	45.6%
Blue Cross	17.6%	17.0%
Managed Care	9.5%	7.9%
Self-pay and other	5.5%	4.6%
Medicare	3.3%	3.0%
	100.0%	100.0%

(in thousands)

12. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at June 30, 2015 and 2014 are made up of the following:

	2015	2014
Accounts payable and other accrued expenses	$ 8,886	$ 9,143
Payroll	4,962	5,108
Vacation	4,497	4,286
Research subcontracts	1,246	752
Workers' compensation, unemployment and health benefits	2,750	3,148
Self Insurance - general/professional liability	1,571	1,443
Credit balance receivables	139	228
	$ 24,051	$ 24,108

13. DEBT

Tax-exempt Bonds

Tax-exempt bonds issued through Maryland Health and Higher Educational Facilities Authority (“MHHEFA”) at June 30, 2015 and 2014 consisted of the following:

	2015	2014
MHHEFA Series 2010 Bonds	28,057	28,471
MHHEFA Series 2011 Bonds	18,514	19,117
MHHEFA Series 2012 Bonds	5,056	6,145
MHHEFA Series 2013 Bonds	16,165	16,240
	67,792	69,973
Less current portion	(2,247)	(2,181)
	$ 65,545	$ 67,792

The Series 2010 Bonds are privately placed with BB&T through a $30,000 bank qualified term loan with a maturity date of December 1, 2017. The Series 2011 Bonds are privately placed with Bank of America through a $19,610 non-bank qualified term loan with a maturity date of June 1, 2021. Both loans are being amortized through July 1, 2036. Terms of the loan agreements with both banks call for interest to be paid based on a percentage of 30-day LIBOR plus a bank spread. Principal payments under both loans are due in monthly installments on the first day of each month.

The Series 2012 Bonds were privately placed in October 2012 with BB&T through a $7,880 non-bank qualified term loan with a maturity date of July 1, 2019. The loan is also being amortized through the same period. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan agreement call for a fixed interest rate of 2.21%.

(in thousands)

The Series 2013 Bonds issued through MHHEFA were privately placed with Bank of America through a $16,730 non-bank qualified term loan with a maturity date of July 1, 2023. The loan is being amortized through July 1, 2033. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan call for a fixed interest rate of 3.62%.

The obligated group for the Series 2010, Series 2011, Series 2012, and 2013 Series Bonds (the "Bonds") include Kennedy Krieger Institute, Inc. and each of its affiliated entities. The Bonds were issued in parity and contain certain restrictions on the Institute's ability to incur additional indebtedness, restrict its use of facilities, maintain stipulated insurance coverage and maintain a rate structure sufficient to meet its total annual cash requirements. The Institute must maintain compliance with certain financial covenants contained in the bond indentures and loan agreements. At June 30, 2015 and 2014, the Institute was in compliance with all covenants in accordance with these agreements.

The aggregate future maturities of bonds payable for the next five years and thereafter are summarized below at June 30, 2015.

2016	$ 2,247
2017	2,299
2018	2,356
2019	2,854
2020	2,847
Thereafter	55,189
	$ 67,792

Unamortized bond financing costs of $460 in 2015 and $497 in 2014 are included in other non-current assets. Amortization expense was $37 and $39 in 2015 and 2014, respectively. A loss on the early extinguishment of long-term debt associated with the refunding of the 2013 Bond was recorded in 2014 in the amount of $380.

Line of Credit
The Institute maintains a working capital line of credit with Bank of America. The committed amount under the line of credit is $7,000 and is committed through November 30, 2015. Total draws of $0 and $750 were outstanding against the line of credit at June 30, 2015 and 2014, respectively. The line of credit is secured by a pledge on the revenues of the Institute and the financial covenant requirements are consistent with those of the Series 2011 and 2013 Bonds.

14. RETIREMENT PLANS

The Institute maintains defined benefit and defined contribution plans covering substantially all of its employees.

Defined Benefit Plan
The Institute's defined benefit pension plan (the "plan") provides benefits to staff-level employees based on years of service and the employees' final average compensation. The Institute's policy is to annually fund the amount necessary to meet minimum funding requirement under ERISA. Contributions of $1,360 and $1,350 were made for 2015 and 2014, respectively.

(in thousands)

The net periodic benefit cost calculated in accordance with current guidance for employer's accounting for pension obligations is $817 and $956 for 2015 and 2014, respectively.

The following table sets for the plan's funded status and benefit obligations recognized in the Institute's financial statements at June 30, 2015 and 2014:

	2015	2014
Change in benefit obligation:		
Projected benefit obligation at beginning of year	$ 49,717	$ 45,996
Interest cost	2,087	2,153
Actuarial loss	3,136	3,885
Benefits paid	(1,674)	(2,317)
Projected benefit obligation at end of year	$ 53,266	$ 49,717
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 36,208	$ 32,633
Actual return on plan assets	(44)	4,542
Employer contribution	1,360	1,350
Benefits paid	(1,674)	(2,317)
Fair value of plan assets at end of year	$ 35,850	$ 36,208
Funded status at end of year		
Net amount recognized in the balance sheet:		
Non-current liabilities	$ (17,416)	$ (13,510)
Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets:		
Accumulated actuarial loss	$ (20,977)	$ (16,528)
Net unrestricted net assets previously reflected	3,561	3,018
Net amount recognized	$ (17,416)	$ (13,510)
Components of net periodic pension cost:		
Interest cost	$ 2,087	$ 2,153
Expected return on plan assets	(2,714)	(2,620)
Loss on amortization	1,444	1,423
Net periodic pension cost	$ 817	$ 956
Changes in net assets not yet reflected in the statement of operations:		
Unrecognized net loss	$ 5,894	$ 1,965
Amortization of unrecognized net loss	(1,444)	(1,423)
Total changes in plan assets and obligations not yet reflected	$ 4,450	$ 542
Total changes in plan assets and benefit obligations	$ 5,267	$ 1,498
Unrecognized net loss to be amortized over next fiscal year	$ 1,956	

(in thousands)

	2015	2014
Additional information:		
Accumulated benefit obligation	$53,266	$49,717
Expected contributions in fiscal year ending June 30, 2016	$1,200	

Expected benefit payments for fiscal year ending June 30, 2015:

2016	$ 1,391
2017	1,512
2018	1,647
2019	1,759
2020	1,907
Next five years	11,977

Weighted-average assumptions to determine benefit obligations:	2015	2014
Discount rate	4.35%	4.25%
Salary increase	Non applicable	Non applicable
Measurement date	June 30	June 30
Participant census data used	January 1, 2015	January 1, 2014

Weighted-average assumptions to determine pension expense:	2015	2014
Discount rates	4.25%	4.75%
Expected return on plan assets	7.50%	8.00%
Salary increase	Non applicable	Non applicable

The discount rate assumption has been developed based on the use of the Moody's AA and Barclays Capital US Long Credit AA bond indices. The liability duration of the plan is consistent with the duration of these indices and, therefore, management believes they provide an appropriate index for determining the discount rate assumption.

In determining the expected long-term rate of return on plan assets, the Institute evaluated the historical long-term rate of return for each class of asset in the plan and utilized a proprietary portfolio return calculator in determining an acceptable range of expected returns.

In 2014 the Society of Actuaries completed a mortality study and issued a new base mortality table ("RP-2014") and new mortality improvement scale ("MP-2014"). The Institute adopted the Mercer modified MRP-2007 base mortality table and the Mercer modified MMP-2007 generational projection scale in 2015 resulting in a $3,800 increase in the benefit obligation. In 2014, the RP-2000 base mortality table and the Scale AA generational projection scale through 2021 was used.

The following tables present fair value measurements for plan assets as of June 30, 2015 and 2014, by the valuation hierarchy as defined in footnote 8 and also includes the liquidity aspects of each investment:

(in thousands)

Fair Value Measurements for Plan Assets
as of June 30, 2015

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 589	$ -	$ -	$ 589
Fixed income mutual funds (2)	7,372	-	-	7,372
Equity securities and funds (3)	13,337	2,279	-	15,616
Multi-asset class funds (4)	3,660	8,114	499	12,273
Total Investments	$ 24,958	$ 10,393	$ 499	$ 35,850

Fair Value Measurements for Plan Assets
as of June 30, 2014

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 326	$ -	$ -	$ 326
Fixed income mutual funds (2)	7,857	-	-	7,857
Equity securities and funds (3)	10,704	4,521	-	15,225
Multi-asset class funds (4)	3,887	8,278	635	12,800
Total Investments	$ 22,774	$ 12,799	$ 635	$ 36,208

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

(3) Equity securities and funds include investments in domestic and international common stocks and common stock mutual funds and collective trusts with next day or monthly liquidity.

(4) Multi-asset class funds include investments in mutual funds or collective trusts whose underlying investments include domestic and international common stocks and other equity securities, government and corporate bonds and other fixed income securities, real asset securities and cash and cash equivalent investments. All funds offer either next day or monthly liquidity.

(in thousands)

The plan's target allocations and actual asset allocation at June 30, by asset category, was as follows:

	Target Allocation	Actual Allocation 2015	Actual Allocation 2014
Equities	40%	44%	42%
Fixed income	27%	21%	22%
Multi-asset class	33%	33%	33%
Absolute return funds	-	1%	2%
Cash	-	1%	1%
	100%	100%	100%

The objectives of the plan's investment strategy are to maximize the plan's funded status and minimize the Institute's contributions and plan expense.

The Investment Committee establishes a target asset allocation and regularly reviews the actual asset allocation against the target. It also periodically rebalances the investment allocations, as appropriate.

Defined Contribution Plans

The Institute maintains qualified defined contribution retirement plans which are in compliance with section 401(k) and 403(b) of the Internal Revenue Code. The 401(k) plan is active and available to all employees (including all faculty and senior staff members) and provides for up to a 50% employer match on employee contributions up to certain levels of compensation. During 2015 and 2014, the aggregate contributions to the 401(k) plan were $14,645 and $14,353. The 403(b) plan was available to all faculty and senior staff to make elective deferrals, however was frozen to new deferrals effective March 31, 2007, then terminated effective December 10, 2014.

Deferred Compensation (457(b)) Plan

The Institute also offers a non-qualified deferred compensation plan for certain of its executives which allows for the deferral of compensation up to IRS limits. A deferred balance of $1,269 and $1,094 in fiscal years 2015 and 2014, respectively, was reported in Investments limited as to use in the Combined Balance Sheet. An associated liability of an equal amount is included in Other long-term liabilities in the Combined Balance Sheet. The Institute makes no contributions to the Deferred Compensation Plan.

15. INTEREST RATE SWAP

The Institute manages the fixed/variable mix of its debt portfolio, including hedging exposure to increasing interest expense on variable rate debt, by utilizing an interest rate swap. The Institute maintains a fixed payor interest rate swap which hedges the variable interest rate risk on the majority of the outstanding balance of the Series 2010 and 2011 Series Bonds. Under the terms of the agreement with a local bank, the Institute pays a fixed rate of 3.636% and receives 67% of 30-day LIBOR on notional amounts that reduce annually until July 2036. Notional amounts of $38,443 and $38,999 were effective June 30, 2015 and 2014, respectively. Under the terms of the agreement, no collateral requirements exist on the part of the Institute.

(in thousands)

The fair value of the interest rate swap and the related unrealized (losses) were as follows as of June 30, including the classification on the Combined Balance Sheets and Statements of Operations:

	Fair Market Value	
	2015	2014
Interest rate swap liability	$ 8,853	$ 7,112

	Amount of (loss) recognized in Non-operating activity	
	2015	2014
Unrealized (loss) on interest rate swap valuation	$ (1,741)	$ (129)
Interest rate swap payments	(1,355)	(1,374)
Total realized & unrealized (loss) on interest rate swap	$ (3,096)	$ (1,503)

16. TEMPORARILY AND PERMANENTLY RESTRICTED ASSETS

Temporarily restricted net assets were held for the following purposes at June 30, 2015 and 2014:

	2015	2014
Capital Campaigns	$ 17,585	$ 16,651
Research and clinical projects	18,930	19,345
	$ 36,515	$ 35,996

During 2015 and 2014, temporarily restricted net assets were released by satisfying donor restrictions in the following amounts:

	2015	2014
Property and equipment	$ 53	$ 22
Operating activities	7,424	8,488
Total	$ 7,477	$ 8,510

Permanently restricted net assets were held in perpetuity for the following purpose at June 30, 2015 and 2014:

	2015	2014
Restricted for the Physically Challenged Sports Program	$ 958	$ 958

17. SELF INSURANCE

Professional and General Liability

The Institute maintains a self-insurance trust (the "Trust") for general and professional liability to cover liability claims arising out of the ordinary course of its business. Excess coverage with an insurance company is in place to cover losses above self-insured retention levels.

Assets in the Trust are to provide for payment of professional and general liability claims and expenses. Potential losses from asserted and unasserted claims are accrued based on estimates that incorporate the Institute's past experience, as well as other considerations, including the nature of each claim or incident, applicable insurance coverage and relevant trend factors.

An accrued liability related to asserted and unasserted self-insured general and professional liability claims of $1,571 and $1,443 has been recorded at June 30, 2015 and 2014, respectively, and is included in Accrued expenses. Investments in the Trust have a market value of $3,957 and $4,154 at June 30, 2015 and 2014, respectively and are reported in Investments limited as to use on the Combined Balance Sheets.

Workers' Compensation, Unemployment and Health Benefits

The Institute self-insures its workers' compensation, unemployment and employee health and dental benefits. Losses from claims identified by the Institute, as well as provisions for estimated losses for incurred but not reported incidents, are accrued based on estimates that incorporate the past experience of the Institute, as well as other considerations, including the nature of the claims or incidents and relevant trend factors. An accrued liability of $2,750 and $3,148 has been recorded at June 30, 2015 and 2014, respectively for these self-insured plans and is included in accrued expenses on the Combined Balance Sheets.

18. COMMITMENTS AND CONTINGENCIES

Litigation

The Institute is involved in claims and litigation on professional liability and personnel matters that arise in the ordinary course of its business. This litigation is not expected to result in losses that exceed insurance limits or have a materially adverse effect on the Institute's financial position.

There have been several claims filed against the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. arising out of two Federally-funded research studies performed in the early 1990s. The Institute has insurance believed adequate to cover any compensatory damages awarded for these claims. In some of these claims, the plaintiff has asserted punitive damages, which if awarded, would not be covered by insurance. Management believes that it is unlikely that punitive damages would be awarded in any of these claims. The outcome of these claims is not probable or estimable; therefore, no liability has been recorded on the Combining Balance Sheets at June 30, 2015 and 2014.

Rental Lease Commitments

Through the creation of MSP, all property and major equipment is leased/subleased to each operating entity. These transactions are eliminated through the combining of the Institute's financial statements.

(in thousands)

MSP has entered into various external agreements to rent office space under non-cancelable operating lease agreements. Minimum rental payments to be made under these leases are:

2016	2,010
2017	2,055
2018	1,656
2019	452
2020	324
Thereafter	479
	$ 6,976

Rent expense on external lease commitments for the years ended June 30, 2015 and 2014 was $2,026 and $1,696, respectively.

Charitable Gift Annuities
The Institute has received charitable gift annuities from donors from which the Institute has guaranteed payments to the donor on a quarterly basis until the donor's death.

The Institute has recorded gift annuities, net of reserves, consistent with the rates adopted by the American Council on Gift Annuities at the time of issuance of the gift annuity. Assets maintained on outstanding annuity agreements exceed the amount of the reserve. Gift annuities with a market value of $1,023 and $1,106 and reserves for annuity payments of $572 and $611 to make gift annuity payments have been recorded in 2015 and 2014, respectively, and are included in Investments limited as to use on the Combined Balance Sheets.

19. FUNCTIONAL EXPENSES

The Institute provides specialty pediatric health care services, administers professional training programs, conducts laboratory and clinical research, operates special education school programs, administers community-based services, conducts fundraising activities and operates ancillary ventures. Expenses related to providing these services are as follows:

	2015	2014
Special pediatric healthcare services	$ 109,603	$ 107,768
Research	21,349	19,238
Education/community services	40,678	38,720
Fundraising activities	2,100	1,445
Operation of facilities	26,505	26,279
General and administrative	28,643	24,096
	$ 228,878	$ 217,546

20. SALE OF AFFILIATES

Adaptive Equipment Systems (AES)
In connection with its 2004 sale of AES, the Foundation received $100 in 2015 and 2014, representing settlement payments on an incentive earnout agreement. These payments are reflected as a gain on sale of subsidiary in the Combined Statements of Operations.

Chesapeake Rehab Equipment (CRE)
In connection with its sale of CRE in 2011, the Foundation entered into a 3-year $3,000 non-compete agreement with the buyer: The non-compete agreement expired on June 30, 2014. A gain on sale of subsidiary of $1,000, representing the annual amortization of the non-compete commitment, was recorded in 2014 in the Combined Statement of Operations.

21. SUBSEQUENT EVENTS

Kennedy Krieger Institute has evaluated subsequent events through October 16, 2015, which is the date the financial statements were issued. There have been no events subsequent to that date that needed to be disclosed.

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Report of Independent Auditors
on Accompanying Combining Information

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the combined financial statements of Kennedy Krieger Institute, Inc. and Affiliates, as of June 30, 2015 and for the year then ended and our report thereon appears on pages 1-2 of this document. That audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining information is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the balance sheet, statement of operations and statement of changes in net assets of the individual companies and is not a required part of the combined financial statements. Accordingly, we do not express an opinion on the balance sheet, statement of operations and statement of changes in net assets of the individual companies.

PricewaterhouseCoopers LLP

October 16, 2015

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SUPPLEMENTAL COMBINING FINANCIAL STATEMENTS

Kennedy Krieger Institute, Inc. and Affiliates
Combining Balance Sheet Information
June 30, 2015

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institute at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foundation, Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties, Inc.	Combining Eliminations	Combined Totals
Assets								
Current assets:								
Cash and cash equivalents	$ 1,603,677			$ 5,882,970	$ 345,245			$ 7,831,892
Patient receivables, net	17,604,861				154,400			17,759,261
Grant and contract receivable	165,180	7,860,960	$ 1,429,876		350,030			9,806,046
Tuition receivable			3,884,465					3,884,465
Pledges receivable				5,460,813	24,050			5,484,863
Due from affiliates	85,887,260		5,718,465	7,165,018	2,816,750	$ 15,743,484	$ (117,330,977)	-
Prepaid expenses and other	1,438,845	148,384	199,678	6,960	1,697		(185,000)	1,610,564
Total Current Assets	106,699,823	8,009,344	11,232,484	18,515,761	3,692,172	15,743,484	(117,515,977)	46,377,091
Non-current assets:								
Property and equipment, net					10,998	126,290,573		126,301,571
Investments:								-
Board designated endowment				48,907,246	249,976			49,157,222
Investments limted as to use	5,225,441			1,767,557				6,992,998
Pledges receivable, net				15,408,365	23,512			15,431,877
Other non-current assets						460,134		460,134
Total non-current assets	5,225,441			66,083,168	284,486	126,750,707		198,343,802
Total assets	$ 111,925,264	$ 8,009,344	$ 11,232,484	$ 84,598,929	$ 3,976,658	$ 142,494,191	$ (117,515,977)	$ 244,720,893
Liabilities and net assets								
Current liabilities:								
Accounts payable and accrued expenses	22,777,903	1,245,837	(29,974)		57,876			24,051,642
Due to affiliates	689,836	10,136,267			2,600,220	103,904,654	(117,330,977)	-
Deferred grant revenue	85,415	2,903,970	52,362		110,662			3,152,409
Current portion of tax-exempt bonds						2,247,209		2,247,209
Total Current Liabilities	23,553,154	14,286,074	22,388		2,768,758	106,151,863	(117,330,977)	29,451,260
Non-current Liabilities:								
Tax-exempt bonds						65,544,597		65,544,597
Accrued pension	17,416,165							17,416,165
Interest rate swap						8,852,876		8,852,876
Other long-term liabilities	1,268,513							1,268,513
Total long-term liabilities	18,684,678					74,397,473		93,082,151
Total liabilities	42,237,832	14,286,074	22,388		2,768,758	180,549,336	(117,330,977)	122,533,411
Net assets:								
Unrestricted	65,412,217	(11,067,912)	10,759,011	57,483,543	368,125	(38,055,145)	(185,000)	84,714,839
Temporarily restricted	4,275,215	4,791,182	451,085	26,157,164	839,775			36,514,421
Permanently restricted				958,222				958,222
Total net assets	69,687,432	(6,276,730)	11,210,096	84,598,929	1,207,900	(38,055,145)	(185,000)	122,187,482
Total liabilities and net assets	$ 111,925,264	$ 8,009,344	$ 11,232,484	$ 84,598,929	$ 3,976,658	$ 142,494,191	$ (117,515,977)	$ 244,720,893

Kennedy Krieger Institute, Inc. and Affiliates
Combining Statement of Operations
Year Ended June 30, 2015

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institue at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foudation Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties Inc.	Combining Eliminations	Combined Totals
Net patient service revenue	$134,002,024	$ 1,526,488	$ 2,504,713		$ 502,277			$138,535,502
Tuition revenue	46,020		43,533,770		519,015		$ (42,976)	44,055,829
Grant and contract revenue	1,499,969	24,235,545	5,888,408		1,559,405		(10,000)	33,173,327
Net assets released for operating activities	1,753,106	1,394,959	459,459	$ 3,596,063	220,386			7,423,973
Investment earnings used for operating activities								-
Unrestricted contributions from								-
fundraising activities, net				1,551,652				1,551,652
Other operating revenues	928,809	3,194,420			286,526	$32,317,376	(33,243,085)	3,484,046
Total operating revenues	138,229,928	30,351,412	52,386,350	5,147,715	3,087,609	32,317,376	(33,296,061)	228,224,329
Operating expenses:								
Salaries, wages and benefits	101,988,648	18,782,837	38,708,864	1,107,924	2,506,763	6,323,212		169,418,248
Supplies, purchased services and other	20,500,393	9,597,274	6,872,576	523,592	319,522	10,497,644	(1,642,837)	46,668,164
Space costs, net	13,479,374	4,534,876	6,308,105	3,697,316	265,498	3,368,055	(31,653,224)	-
Rent						2,025,603		2,025,603
Interest						1,522,336		1,522,336
Depreciation					9,382	8,580,526		8,589,908
Total operating expenses	135,968,415	32,914,987	51,889,545	5,328,832	3,101,165	32,317,376	(33,296,061)	228,224,259
Operating revenues over (under) expenses	2,261,513	(2,563,575)	496,805	(181,117)	(13,556)	-	-	70
Non-operating activity:								
Investment income and realized gains, net	173,287			812,072				985,359
Realized and unrealized (loss) on interest rate swap						(3,096,024)		(3,096,024)
Realized gain on sale of subsidiary				100,000				100,000
Restricted fundraising expenses				(653,709)				(653,709)
Net non-operating activity	173,287	-	-	258,363	-	(3,096,024)	-	(2,664,374)
Excess of revenues over expenses	2,434,800	(2,563,575)	496,805	77,246	(13,556)	(3,096,024)		(2,664,304)
Other changes in unrestricted net assets:								-
Unrealized (losses) on investments, net	(287,744)			(2,696,183)				(2,983,927)
Net assets released from restrictions used for								-
property and equipment					24	52,976		53,000
Change in funded status of defined benefit plan	(4,681,404)							(4,681,404)
Increase (decrease) in unrestricted net assets	$ (2,534,348)	$ (2,563,575)	$ 496,805	$(2,618,937)	$ (13,532)	$ (3,043,048)	$ -	$ (10,276,635)

Kennedy Krieger Institute, Inc. and Affiliates
Combining Statement of Changes in Net Assets
Year Ended June 30, 2015

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institue at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foudation Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties Inc.	Combining Eliminations	Combined Totals
Unrestricted net assets:								
Excess of revenue over expenses	$ 2,434,800	$ (2,563,575)	$ 496,805	$ 77,246	$ (13,556)	$ (3,096,024)		$ (2,664,304)
Unrealized (losses) on investments	(287,744)			(2,696,183)				(2,983,927)
Net assets released from restrictions used for property and equipment					24	52,976		53,000
Change in funded status of defined benefit plan	(4,681,404)							(4,681,404)
Increase (decrease) in unrestricted net assets	(2,534,348)	(2,563,575)	496,805	(2,618,937)	(13,532)	(3,043,048)		(10,276,635)
Unrestricted net assets, beginning of year	67,946,564	(8,504,339)	10,262,205	60,102,478	381,660	(35,012,094)	$ (185,000)	94,991,474
Unrestricted net assets, end of year	$65,412,216	$ (11,067,914)	$ 10,759,010	$57,483,541	$ 368,128	$(38,055,142)	$ (185,000)	$ 84,714,839
Temporarily restricted net assets:								
Contributions from fundraising activities	1,097,536	2,148,386	727,398	3,768,781	199,921	52,976		7,994,998
Net assets released from restrictions used for property and equipment					(24)	(52,976)		(53,000)
Net assets released from restrictions used for operating activities	(1,753,106)	(1,394,959)	(459,459)	(3,596,063)	(220,386)			(7,423,973)
Increase (decrease) in temporarily restricted net assets	(655,570)	753,427	267,939	172,718	(20,489)	-	-	518,025
Temporarily restricted net assets, beginning of year	4,930,785	4,037,755	183,146	25,984,446	860,264			35,996,396
Temporarily restricted net assets, end of year	$ 4,275,215	$ 4,791,182	$ 451,085	$26,157,164	$ 839,775	$ -	$ -	$ 36,514,421
Permanently restricted net assets:								
Contributions received								
Increase in permanently restricted net assets								
Permanently restricted net assets, beginning of year				958,222				958,222
Permanently restricted net assets, end of year				958,222				958,222
Increase(decrease) in net assets	(3,189,918)	(1,810,148)	764,744	(2,446,219)	(34,021)	(3,043,048)		(9,758,610)
Net assets, beginning of year	72,877,349	(4,466,584)	10,445,351	87,045,146	1,241,924	(35,012,094)	(185,000)	131,946,092
Net assets, end of year	$69,687,431	$ (6,276,732)	$ 11,210,095	$84,598,927	$ 1,207,903	$(38,055,142)	$ (185,000)	$122,187,482