SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Financial Statements and Supplementary Information

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

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KPMG LLP
1 East Pratt Street
Baltimore, MD 21202-1128

Independent Auditors' Report

The Board of Trustees
Sheppard and Enoch Pratt Foundation, Inc.:

We have audited the accompanying consolidated balance sheets of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries (collectively, Foundation) as of June 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries as of June 30, 2012 and 2011, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

October 8, 2012

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2012 and 2011

Assets	**2012**	**2011**
Current assets:		
Cash and cash equivalents	$ 54,147,313	40,283,644
Temporary investments	—	757,761
Investments limited or restricted as to use	1,604,768	4,245,009
Accounts receivable, net	24,754,559	31,201,580
Prepaid expenses and other current assets	8,870,715	6,910,597
Total current assets	89,377,355	83,398,591
Investments limited or restricted as to use, less current portion	131,580,950	140,398,317
Notes receivable	2,536,449	2,668,212
Property and equipment, net	193,949,514	198,683,576
Other assets	4,224,363	4,962,696
Total assets	$ 421,668,631	430,111,392
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt	$ 3,853,787	4,536,075
Current portion of obligations under capital leases	490,359	415,702
Accounts payable	6,574,804	6,130,665
Accrued salaries, wages and employee benefits	19,291,316	18,493,572
Third-party payor settlements payable	2,377,636	2,055,490
Self-insurance liabilities	5,455,390	4,521,012
Other accrued expenses	3,608,049	7,005,567
Total current liabilities	41,651,341	43,158,083
Long-term liabilities:		
Long-term debt, less current portion	104,483,471	114,104,923
Obligations under capitalized leases, less current portion	5,208,697	5,164,729
Self-insurance liabilities	7,031,895	6,593,021
Accrued pension liabilities	28,018,605	8,353,388
Other long-term liabilities	2,366,692	1,978,715
Total liabilities	188,760,701	179,352,859
Net assets:		
Unrestricted	221,488,632	240,204,189
Temporarily restricted	7,520,212	6,720,013
Permanently restricted	3,899,086	3,834,331
Total net assets	232,907,930	250,758,533
Total liabilities and net assets	$ 421,668,631	430,111,392

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2012 and 2011

		2012	2011
Unrestricted revenues, gains, and other support:			
Net patient service revenue	$	125,614,102	117,717,886
Residential and educational service revenue		130,711,349	129,056,371
Net assets released from restrictions used for operations		904,793	954,683
Other revenue		24,762,043	22,749,954
Total unrestricted revenues, gains, and other support		281,992,287	270,478,894
Expenses:			
Salaries and wages		154,809,561	148,976,358
Employee benefits		34,920,258	36,605,919
Expendable supplies		16,202,992	15,429,466
Purchased services		40,264,646	38,374,096
Interest		4,473,131	3,927,742
Repairs and minor alterations		7,499,046	7,573,483
Depreciation and amortization		17,234,935	15,229,135
Provision for doubtful accounts		2,166,140	3,321,711
Realized loss on disposal of assets, net		9,190	46,857
Total expenses		277,579,899	269,484,767
Operating income		4,412,388	994,127
Other income (expense):			
Investment income		2,305,099	2,293,975
Realized gain on investments, net		2,152,390	3,802,423
Change in unrealized (loss) gain on investments, net		(5,339,334)	14,023,212
Loss on extinguishment of debt		(3,564,840)	—
Other		1,155,394	1,399,132
Total other income (expense)		(3,291,291)	21,518,742
Excess of revenues over expenses		1,121,097	22,512,869
Other changes in net assets:			
Net assets released from restrictions used for purchases of property and equipment		766,242	703,441
Pension liability adjustment		(20,942,001)	21,837,835
Capital grants		339,105	312,422
Impairment of goodwill		—	(1,618,264)
Increase (decrease) in unrestricted net assets	$	(18,715,557)	43,748,303

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2012 and 2011

		2012	2011
Unrestricted net assets:			
Excess of revenues over expenses	$	1,121,097	22,512,869
Other changes in net assets:			
Net assets released from restrictions used for purchases of property and equipment		766,242	703,441
Pension liability adjustment		(20,942,001)	21,837,835
Capital grant		339,105	312,422
Impairment of goodwill		—	(1,618,264)
Increase (decrease) in unrestricted net assets		(18,715,557)	43,748,303
Temporarily restricted net assets:			
Gifts and grants		2,563,734	1,643,244
Investment income		80,626	105,821
Net gain (loss) on investments		(112,484)	850,933
Net assets released from restrictions for operations		(904,793)	(954,683)
Net assets released from restrictions for purchases of property and equipment		(766,242)	(703,441)
Reclassification of net assets		(60,642)	(229,935)
Increase in temporarily restricted net assets		800,199	711,939
Permanently restricted net assets:			
Gifts		3,257	51,800
Investment income		856	84,101
Reclassification of net assets		60,642	229,935
Increase in permanently restricted net assets		64,755	365,836
Increase (decrease) in net assets		(17,850,603)	44,826,078
Net assets, beginning of year		250,758,533	205,932,455
Net assets, end of year	$	232,907,930	250,758,533

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2012 and 2011

		2012	2011
Cash flows from operating activities:			
Increase (decrease) in net assets	$	(17,850,603)	44,826,078
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:			
Depreciation and amortization		17,234,935	15,229,135
Pension liability adjustment		20,942,001	(21,837,835)
Provision for doubtful accounts		2,166,140	3,321,711
Restricted gifts and grants, net		(1,662,198)	(740,361)
Net realized gain on investments		(2,228,214)	(3,979,078)
Net unrealized loss (gain) on investments		5,527,642	(14,694,865)
Restricted investment income on restricted net assets		(81,482)	(189,922)
Loss on extinguishment of debt		3,564,840	—
Impairment of goodwill		—	1,618,264
Bond issue cost and premium amortization		59,075	—
Unrealized loss (gain) on interest rate swaps		10,565	(190,823)
Net settlement on interest rate swaps		(17,043)	238,736
Capital grant and loss on disposal of assets		(329,915)	(265,565)
Decrease (increase) in accounts receivable, net		4,280,881	(5,405,963)
Decrease (increase) in prepaid expenses and other current assets		(2,032,738)	174,864
Increase (decrease) in accounts payable and accrued expenses and other		(1,766,130)	2,721,227
Increase in self-insurance liabilities		1,373,252	1,904,106
Increase (decrease) in third-party payor settlements payable		322,146	(1,815,789)
Decrease in accrued pension liability		(1,276,784)	(4,714,090)
Net cash provided by operating activities		28,236,370	16,199,830
Cash flows from investing activities:			
Purchases of property and equipment		(12,229,410)	(21,477,206)
Increase in other assets		(454,085)	(230,845)
Proceeds from sale of property and equipment		3,545	6,833
Decrease (increase) in temporary investments		757,761	(22,216)
Decrease in notes receivable		131,763	197,257
Decrease in investments limited or restricted as to use, net		8,226,381	462,936
Net settlement on interest rate swaps		17,043	(238,736)
Net cash used in investing activities		(3,547,002)	(21,301,977)
Cash flows from financing activities:			
Proceeds from debt and other liabilities		96,748,524	8,932,594
Payment of long-term debt principal		(108,701,182)	(4,202,477)
Payment of deferred financing costs		(89,164)	—
Payment on capital lease obligations		(446,075)	(427,532)
Restricted gifts and grants, net		1,662,198	740,361
Net cash (used in) provided by financing activities		(10,825,699)	5,042,946
Net increase (decrease) in cash and cash equivalents		13,863,669	(59,201)
Cash and cash equivalents, beginning of year		40,283,644	40,342,845
Cash and cash equivalents, end of year	$	54,147,313	40,283,644

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

Sheppard and Enoch Pratt Foundation, Inc. (Foundation or the Company), a not-for-profit, nonstock Company, was organized on June 15, 1984 to engage in activities necessary to provide medical services to the public through the planning and implementation of programs provided by its various subsidiaries. Subsidiary companies, controlled by Foundation, include Sheppard Pratt Health System, Inc. (Health System), Sheppard Pratt Physicians, P.A. (Physicians), Sheppard Pratt Investment, Inc. (Investment Company), Mosaic Community Services, Inc. (Mosaic), Way Station, Inc. (Way Station), Family Services, Inc. (Family Services), Turning Point of Washington County, Inc. (Turning Point), and Sheppard Pratt Preferred Resources, Inc. (Resources).

Health System is a not-for-profit, nonstock company that operates two inpatient hospitals, day hospitals, residential and educational services for children and adolescents, and outpatient programs.

Physicians is a professional company of licensed medical professionals organized on July 1, 1985 exclusively to carry out the charitable, educational and scientific purposes of Foundation and its affiliates. The common stock of Physicians is held by several individuals who are employed by a member of Foundation, Health System, or Physicians and are subject to the terms of a stock agreement. Under the terms of the agreement, the stockholders are required to consult with Foundation regarding its views on any matter with respect to which the stockholder is entitled to vote, and the stockholders may not transfer shares (by sale or gift) without the permission of Foundation. The stock agreement does not allow for the stockholders to receive dividends or any other benefit for having held the stock. If the stockholders cease to be employed by Foundation, Health System, or Physicians, Physicians shall require the stockholders to sell and transfer all of the stock such stockholder owns to a person designated by Foundation. The purchase price for each share of stock of the Company is $1 per share.

Investment Company is a not-for-profit, nonstock company that manages the investments of certain subsidiaries.

Mosaic, Way Station, Family Services, and Turning Point (collectively, the Affiliates) are not-for-profit, nonstock Maryland companies which provide residential, rehabilitation, vocational, and outpatient mental health services across the state of Maryland.

Resources is a for-profit company that was formed for the purpose of providing employee assistance program services to other entities. Resources was inactive as an operating entity for the years ended June 30, 2012 and 2011.

(b) Basis of Presentation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. All majority-owned and affiliated member entities are consolidated. All entities where Foundation exercises significant influence but for which it does not have control are accounted for under the equity method. All other entities are accounted for under the cost method. All significant intercompany accounts and transactions have been eliminated.

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. The net assets of Foundation and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations. Board-designated funds are included within this category of net assets.

Temporarily restricted net assets – Net assets whose use by Foundation has been limited by donors to a specific time or purpose.

Permanently restricted net assets – Net assets that have been restricted by donors to be maintained by Sheppard Pratt in perpetuity. Generally, the donors of these assets permit Foundation to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Contributions with no donor-imposed restrictions are recognized as revenues in the period received as increases in unrestricted net assets.

Unconditional promises to give cash and other assets to Foundation with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. When the 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 statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

(c) Charity Care

Foundation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Foundation does not pursue collection of amounts determined to qualify for charity care, such amounts are not reported as revenue.

(d) Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less that are not limited or restricted as to use.

(e) Temporary Investments

Temporary investments include short-term investments with an original maturity greater than three months and less than one year that are not limited or restricted as to use.

(f) Allowance for Doubtful Accounts

Foundation's policy is to write off all accounts that have been identified as uncollectible. An allowance for uncollectibles is recorded for accounts not yet written off that are anticipated to become uncollectible in future periods. Insurance coverage and credit information are obtained from patients when available. No collateral is obtained for accounts receivable.

(g) Investments Limited as to Use

Investments limited as to use, primarily recorded at fair value, represent assets that have been designated by the board of trustees for special purposes and investments held by the bank trustees under the bond indenture and self-insurance trust arrangements. The principal, income and capital appreciation of the Moses Sheppard and Enoch Pratt bequests are legally unrestricted but are classified, for financial reporting purposes, as board-designated and limited as to use. Assets designated by the board of trustees for particular purposes are controlled by the board of trustees, who at their discretion may subsequently use the assets for other purposes.

Investments of board-designated, temporarily restricted and permanently restricted funds are maintained in a combined investment pool. Related income, realized and unrealized gains and losses on sales of investments are apportioned on the basis of the shares held by each of the respective funds and in accordance with donor restrictions on the use of investment earnings.

Investments are recorded at fair value. Foundation classifies its investment portfolio as trading securities with unrealized gains and losses included in other income, which is included in the excess of revenues over expenses. Investment income and realized gains and losses from all other investments are reported as other income, unless the income is restricted by donors that is reported as previously described above. Unrealized gains and losses on trading securities are included as a component of other income (expense). The investment portfolio is classified as current or noncurrent assets based on management's intention as to use.

Alternative investments represent both subscriptions in private equity venture capital funds and subscriptions in funds-of-funds utilized to diversify the portfolio of Foundation. Annual audited financial statements for these funds are submitted to Foundation and reviewed by management. The funds' financial statements are presented at fair value as estimated in an unquoted market. Foundation's alternative investments are accounted for under the equity method of accounting. The investment balance is equal to Foundation's proportionate interest in the fund's net equity. Individual investment holdings within the investment may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Certain of these investments contain additional capital call requirements, based upon the provisions of the investment agreements.

Investment income from unrestricted cash equivalents, temporary investments, the self-insurance trust and a portion of the debt service accounts maintained by bond trustees are reported as other operating revenue since such income is considered to be a part of Foundation's ongoing central operations of providing healthcare services.

(h) Pledges

Pledges, less an allowance for uncollectible amounts, are recorded as receivables in the year the pledge is made unless the pledge carries conditions that have not been met. Conditional pledges are recorded as contributions when the conditions of the pledge have been satisfied. Pledges receivable are recorded at net realizable value which is calculated using a discount rate of 3% at June 30, 2012 and 5% at June 30, 2011.

(i) Property and Equipment

Property and equipment acquisitions are recorded at cost (except donated property and equipment that are recorded at their fair market value at the date of receipt). Depreciation is computed on the straight-line method and charged to operations over estimated useful lives ranging from 20 to 40 years for buildings and improvements and 3 to 10 years for furniture, equipment, information systems hardware and software and motor vehicles. Property and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the property and equipment. Interest costs incurred on borrowed funds during the period of construction are capitalized as a component of the cost of acquiring those assets.

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

(j) Costs of Borrowing

Deferred financing costs and debt premiums are amortized using the effective interest method and charged to operations as a component of interest expense over the term of the related debt.

(k) Estimated Self-Insurance Liability Claims

The estimated self-insured professional liability claims are reflected as a liability and include actuarially determined estimates of the ultimate costs for both reported claims and claims incurred but not reported. Costs under self-insurance programs for employee health benefits and workers' compensation include estimates for both reported claims and claims incurred but not reported, based on an evaluation of pending claims and past experience. These estimates are based on actuarial analysis of historical trends, claims asserted and reported incidents. Receivables for amounts in excess of self-insurance retention limits are recorded at their net realizable value and are due from highly rated commercial insurance companies.

(l) Pension Benefits

Pension benefits are recorded in accordance with *Defined Benefit Plans-Pension* (ASC Subtopic 715-30), which requires the recognition of the funded status of pension plans within the accompanying balance sheets. As of June 30, 2012 and 2011, the funded status of the pension plan has been recorded within long-term liabilities.

(m) Patient Service Revenue

Foundation has agreements with third-party payors that provide for payments to Foundation at amounts different from its established rates. Payment arrangements include prospectively determined rates per day, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with certain third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Differences between the estimated amounts and final settlements are reported in operations in the year of settlement.

Foundation's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered, (note 16).

(n) Residential and Educational Service Revenue

Foundation provides educational services to special needs children under arrangements with the Maryland State Department of Education (MSDE). On an annual basis, a prospective rate per student is set with MSDE based upon an approved operating budget. Subsequently, as services are provided, invoices are submitted to each student's local school district for payment on a monthly basis.

Foundation also operates two levels of residential services for adolescents: residential treatment centers (RTCs) and respite care. Substantially all of the RTC services are reimbursed by the State of Maryland Medicaid Program on a cost basis subject to annual ceilings. Foundation receives an interim per diem rate during the year and ultimately settles final payment based upon an audited cost report filing. Respite services are provided through a Purchase of Care Agreement with the Maryland Department of Human Resources. Services are provided and reimbursed on an interim per diem basis and are subject to cost settlement based upon an audit of the program's operating expenses. Foundation accrues any difference between interim payments and estimates of expected cost settlement for both RTCs and respite care.

(o) Impairment of Long-Lived Assets

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate an impairment in the value of long-lived assets. In accordance with the provisions of ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, if there is an indication that the carrying amount of an asset is not recoverable, Foundation estimates the projected undiscounted cash flows, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss is determined by comparing the historical carrying value of the asset to its estimated fair value. Estimated fair value is determined through an evaluation of recent and projected financial performance using standard industry valuation techniques.

In addition to consideration of impairment upon the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are changed, the carrying value of affected assets is allocated over the remaining lives.

In estimating the future cash flows for determining whether an asset is impaired and if expected future cash flows used in measuring assets are impaired, Foundation groups its assets at the lowest level for which there are identifiable cash flows independent of other groups of assets.

(p) Rental Income

Foundation has agreements with various organizations and individual clinicians to rent office space and land. Foundation recognizes the rent under the leases, using the straight-line method, net of an allowance for doubtful accounts, where necessary, in other income.

(q) Excess of Revenues over Expenses

The consolidated statements of operations include a performance indicator, the excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include changes in pension liability adjustments, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets) and grants for capital purposes.

(r) Income Taxes

Foundation and its subsidiaries, except for Resources, have been recognized as tax-exempt organizations under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code and are not subject to income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. The operations of Resources, a for-profit company, are not significant to the consolidated financial statements. Foundation has cumulative net operating losses of $1.7 million for unrelated business activities, which expire at various dates through 2032. The Foundation's deferred tax assets, including the asset related to its net operating losses, are fully reserved as they are not expected to be utilized. Foundation accounts for income taxes under ASC 740, *Income Taxes*.

(s) Leases

Lease arrangements, including assets under construction, are capitalized when such leases convey substantially all the risks and benefits incidental to ownership. Capital leases are amortized over either the lease term or the life of the related assets, depending upon available purchase options and lease renewal features. Amortization related to capital leases is included in the statements of operations within depreciation or amortization expense.

(t) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

(2) New Accounting Pronouncements

In January 2010, FASB issued ASU No. 2010-07, *Not-for-Profit Entities (Topic 958), Not-for-Profit Entities: Mergers and Acquisition* (ASU 2010-07), which codified previous guidance on accounting for a combination of not-for-profit entities and applies to a combination that meets the definition of either a merger of a not-for-profit entities or an acquisition by a not-for-profit entity. ASU 2010-07 also amends previous guidance for the reporting of goodwill and other intangibles and noncontrolling interests in consolidated financial statements to make their provisions fully applicable to not-for-profit entities.

This guidance establishes that goodwill will be tested annually for impairment and an impairment loss be recognized if it is determined that the carrying amount of the reporting unit's net assets exceeds its fair value. Beginning July 1, 2010, Foundation applied the transition provisions of the guidance, which requires Foundation to cease amortization of previously recognized goodwill and to test goodwill for impairment annually or more frequently if events or circumstances indicate that the carrying value of an asset may not be recoverable. Foundation completed a transitional goodwill impairment test. Foundation identified the reporting unit as the aggregate of all of Foundation's subsidiaries and determined the carrying value of such reporting unit by assigning the assets and liabilities including the existing goodwill to the reporting unit. Foundation estimated the fair value of the reporting unit based on a discounted cash flow analysis as well as using standard industry valuation techniques. Foundation determined that the carrying amounts exceeded the fair value of the reporting unit as of July 1, 2010. Foundation then allocated the estimated fair value of the assets and liabilities of such reporting unit and determined that the carrying amount of the goodwill exceeded the implied fair value of the goodwill. Accordingly, Foundation wrote off its goodwill of $1,618,264 as a reduction in other changes in net assets as of July 1, 2010.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24), which clarified that a healthcare entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. ASU 2010-24 was adopted effective beginning July 1, 2011 and resulted in Foundation recording an additional liability and related receivable of approximately $530,000. The adoption of ASU 2010-24 did not have a significant impact on Foundation's consolidated statement of operations, changes in net assets and cash flows.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure*. ASU 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. ASU 2010-23 was adopted July 1, 2011. (See note 3).

In July 2011, the FASB issued ASU No. 2011-07 *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07), which requires a healthcare entity to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, enhanced disclosures about an entity's policies for recognizing revenue, assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for doubtful accounts are required. The adoption of ASU 2011-07 is effective for fiscal year 2013.

(3) Charity Care and Community Services

Foundation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The estimated cost of charity care provided during the years ending June 30, 2012 and June 30, 2011 was $6,406,558 and $3,097,346 respectively.

Foundation provides the community with other healthcare services and programs, including teaching of psychiatric residents, providing programs and facilities for teaching other medical health professionals, providing behavioral health educational programs for the general public, and conducting research to improve treatment of behavioral health problems.

(4) Investments Limited or Restricted as to Use

Investments limited or restricted as to use, stated at fair value, except for the real estate investment, which is recorded at cost and investments in partnerships and alternative investments, which are recorded under the equity method include the following at June 30:

	2012	2011
Board-designated, unrestricted:		
Portion of pooled investments	$ 112,579,192	114,464,869
Other investments	6,282,133	6,406,896
Held by trustees:		
Under self-insurance trusts	4,204,037	4,271,174
Under bond indentures	—	10,119,332
Donor-restricted:		
Temporarily restricted portion of pooled investments	2,102,994	2,295,497
Other temporarily restricted investments	4,118,276	3,251,227
Permanently restricted portion of pooled investments	3,249,789	3,185,889
Other permanently restricted investments	649,297	648,442
Total investments limited or restricted as to use	133,185,718	144,643,326
Current portion	1,604,768	4,245,009
Investments limited or restricted as to use, less current portion	$ 131,580,950	140,398,317

Foundation manages a significant component of its investments limited or restricted as to use in a combined investment pool. The combined investment pool has been allocated based on donor restrictions, where applicable, as follows at June 30:

	2012	2011
Board-designated unrestricted	$ 112,579,192	114,464,869
Temporarily restricted	2,102,994	2,295,497
Permanently restricted	3,249,789	3,185,889
Total	$ 117,931,975	119,946,255

The combined investment pool is comprised of the following at June 30:

	2012	2011
Cash and cash equivalents	$ 2,940,772	4,608,023
Corporate bonds	12,189,553	12,285,804
Marketable equity securities	29,795,345	31,568,099
Mutual funds	52,390,654	51,237,640
Other (primarily alternative investments under equity method)	20,615,651	20,246,689
Total	$ 117,931,975	119,946,255

Other board-designated investments consist of the following at June 30:

	2012	2011
Cash and cash equivalents	$ 941,746	1,366,992
Mutual funds	1,375,283	1,055,482
Real estate held for future development, at cost	3,024,329	3,031,370
Other	940,775	953,052
	$ 6,282,133	6,406,896

The funds held by trustees under self-insurance trusts are comprised of the following at June 30:

	2012	2011
Cash and cash equivalents	$ 605,391	672,560
Fixed income investments	3,598,646	3,598,614
	$ 4,204,037	4,271,174

The funds held by trustees under bond indentures are comprised of the following at June 30:

		2011
Interest Fund	$	936,337
Debt Service Reserve Fund		5,956,692
Debt Service Principal Fund for 2003 Bonds		1,920,002
Prefunded Bonds, Mosaic		1,177,894
Sinking Fund for Way Station Debt		128,407
	$	10,119,332

The funds held by trustees under bond indentures are comprised of the following at June 30:

		2011
Cash and cash equivalents	$	3,040,474
Fixed income investments		7,078,858
	$	10,119,332

In 2012, certain funds were utilized to reduce outstanding debt in connection with the Foundation's refinancing of long term debt. (See note 10).

The total investment return, net of investment fees, including the return from the combined investment pool, is summarized as follows for the years ended June 30:

		2012	2011
Investment income:			
Unrestricted	$	2,305,099	2,293,975
Temporarily restricted		80,626	105,821
Permanently restricted		856	84,101
		2,386,581	2,483,897
Net realized gains on sales of investments:			
Unrestricted		2,152,390	3,802,423
Temporarily restricted		75,824	176,655
		2,228,214	3,979,078
Net unrealized (losses) gains on investments:			
Unrestricted		(5,339,334)	14,023,212
Temporarily restricted		(188,308)	671,653
Total unrealized (losses) gains		(5,527,642)	14,694,865
Total investment (loss) income on combined investment pool		(912,847)	21,157,840
Investment income on other unrestricted investments and cash and cash equivalents		816,672	527,757
Investment income on self-insurance trust assets		633	37,011
Total investment (losses) income	$	(95,542)	21,722,608

(5) Disclosures about Fair Value of Financial Instruments

Foundation accounts for its financial assets and liabilities, in accordance with ASC Subtopic 820-10 as discussed in note 2. ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. Specifically, the guidance provides for the following:

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value;
- Establishes a three-level hierarchy for fair value measurement;
- Requires consideration of Foundation's nonperformance risk when valuing liabilities; and
- Expands disclosures about instruments measured at fair value.

The three-level valuation hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Foundation's market assumptions. The three-level valuation hierarchy is defined as follows:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar investments in markets that are not active; and model-derived valuations whose significant inputs are observable; and
- Level 3 – Instruments whose significant inputs are unobservable.

The table below presents Foundation's investable assets and liabilities as of June 30, 2012, aggregated by the three-level valuation hierarchy:

		Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$	7,679,308	—	—	7,679,308
Equities:					
Common stocks		28,746,632	—	—	28,746,632
Mutual funds		50,598,717	4,440,045	—	55,038,762
Other		1,194,014	—	—	1,194,014
Fixed income:					
Collateralized mortgage obligation		—	1,422,790	—	1,422,790
Corporate bonds		—	10,382,611	—	10,382,611
Government issued bonds			3,598,647	—	3,598,647
Total assets	$	88,218,671	19,844,093	—	108,062,764
Liabilities:					
Interest rate swap	$	—	(286,456)	—	(286,456)
Total liabilities	$	—	(286,456)	—	(286,456)

The table below presents Foundation's investable assets and liabilities as of June 30, 2011, aggregated by the three-level valuation hierarchy:

		Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$	9,417,757	—	—	9,417,757
Equities:					
Common stocks		31,169,356	—	—	31,169,356
Mutual funds		53,913,098	—	—	53,913,098
Other		1,198,106	—	—	1,198,106
Fixed income:					
Collateralized mortgage obligation		—	—	—	—
Corporate bonds		—	11,366,548	—	11,366,548
Government issued bonds		—	11,355,744	—	11,355,744
Total assets	$	95,698,317	22,722,292	—	118,420,609
Liabilities:					
Interest rate swap	$	—	(275,891)	—	(275,891)
Total liabilities	$	—	(275,891)	—	(275,891)

Foundation did not have significant transfers between Levels, or Level III measurements, thus, no additional disclosures were necessary.

Foundation's Level 1 securities primarily consist of common stock, U.S. Treasury securities, exchange-traded mutual funds, and cash. Foundation determines the estimated fair value for its Level 1 securities using quoted (unadjusted) prices for identical assets or liabilities in active markets.

Foundation's Level 2 securities consist of corporate bonds, government issued bonds, mutual funds, and derivative instruments, which are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active or model-derived valuations whose significant inputs are observable. Valuation models require a variety of inputs, including contractual terms, market fixed prices, inputs from forward price yield curves, notional quantities, measures of volatility, and correlations of such inputs.

Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement.

The carrying amount of cash and cash equivalents, accounts receivable, third-party payor settlements receivable or payable, other current assets, accounts payable, and accrued expenses approximates fair value because of the short-term maturity of these instruments. The fair value of Foundation's long-term debt, except for the Series A portion of the 2012 Bonds, is estimated to approximate the carrying amount because interest rates are variable and determined frequently based on prevailing market conditions. The estimated fair value of the Series A portion of the 2012 Bonds at June 30, 2012 and the Series 2003 Bonds at June 30, 2011 was approximately $34,032,000 and $32,809,766, respectively. Due to the subjective nature of the terms of the Foundation’s notes receivable and capital lease obligations, their fair values cannot be estimated.

(6) Temporarily Restricted Assets

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

		2012	2011
Pledges receivable, net of unamortized discount of $64,000 at June 30, 2012 and $85,977 at June 30, 2011	$	1,013,346	946,001
Less allowance for uncollectible pledges		40,000	62,000
Net pledges receivable		973,346	884,001
Other investments		1,458,657	3,230,342
Portion of pooled investments (note 4)		2,102,994	2,295,497
Restricted cash and investments		2,985,215	310,173
	$	7,520,212	6,720,013

The net realizable value of the unconditional pledges receivable at June 30, 2012 was calculated using an average discount rate of 3%. The net present value of pledges receivable and the expected collection period at June 30, 2012 are as follows:

2013	$	462,995
2014		300,580
2015		158,709
2016		47,932
2017		43,130
	$	1,013,346

(7) Note Receivable

In connection with the land lease described in note 8, Investment Company provided a loan and a line of credit to the Maryland Economic Development Company (MEDCO) to help finance the development of university student housing located on the campus of Foundation. The unsecured term loan of $3.75 million is payable in equal quarterly installments between the initial repayment date (January 2004) and June 30, 2031. MEDCO repaid approximately $132,000 during the years ended June 30, 2012 and 2011, respectively, which resulted in an outstanding balance of $2,536,449 and $2,668,212 at June 30, 2012 and 2011, respectively. The loan bears interest at the rate of 12% per annum. Foundation has included approximately $315,000 and $335,000 of interest income from the loan in investment income during the fiscal years ended June 30, 2012 and 2011, respectively.

(8) Property and Equipment

Property and equipment at June 30 are summarized as follows:

		2012	2011
Land	$	20,329,215	19,744,689
Land improvements		7,966,561	7,584,934
Buildings and building improvements		246,629,938	239,641,581
Furniture and equipment		55,185,791	52,942,970
Vehicles		5,357,084	5,135,543
Construction in progress		4,463,795	4,266,560
		339,932,384	329,316,277
Less accumulated depreciation		145,982,870	130,632,701
	$	193,949,514	198,683,576

Assets under capital lease, at June 30, 2012 and 2011, of $8,032,728 and $7,626,566, respectively, were included in building and building improvements and furniture and equipment in the table above. Accumulated depreciation of assets under capital leases totaled $3,066,878 and $2,567,285 at June 30, 2012 and 2011, respectively.

Certain land, buildings, improvements, and equipment are pledged as collateral for the debt described in note 10.

Depreciation expense for the years ended June 30, 2012 and 2011 was $17,219,029 and $14,994,056, respectively.

In June 2001, the Health System entered into a 40-year ground lease with MEDCO, whereby MEDCO leases certain parcels of land from Foundation. The base year rental income, included in other revenue in the accompanying statements of operations is $885,500 and increases by 3.00% per annum over the life of the lease. MEDCO has constructed student housing on the leased parcels of land (the MEDCO lease). Unpaid accrued rent bears interest at 12.65% per annum.

The payment of ground rent is subordinate to the payment of debt on the MEDCO loan. Based on current cash flow projections, it is anticipated that the full amount of rent accruing will not be paid. Foundation has recorded an allowance for a portion of the unpaid accrued rent, and the related interest on the unpaid rents for fiscal years 2007 through 2012. Partial ground rent payments of $1,842,074 and $1,387,949 were accrued as a receivable at June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, Foundation has recorded total ground rent receivable in prepaid expenses and other current assets in the accompanying consolidated balance sheets of $6,838,965 and $6,421,445, respectively, with a related reserve of $4,996,891 and $5,033,496, respectively.

(9) Other Assets

The other assets balance is composed of the following at June 30:

	2012	2011
Workers' compensation excess insurance receivable	$ 298,450	—
Deferred financing costs	118,981	3,242,547
Intangible assets	1,307,000	1,307,000
Cash surrender value of life insurance and other	2,847,033	2,330,864
	4,571,464	6,880,411
Accumulated amortization	(347,101)	(1,917,715)
	$ 4,224,363	4,962,696

(10) Long-Term Debt

Long-term debt consists of the following at June 30:

	2012	2011
Maryland Health and Higher Educational Facilities Authority (MHHEFA) Revenue Bonds, Series 2012	96,030,993	—
MHHEFA Revenue Bonds, Series 2003	$ —	80,910,000
MHHEFA Series D pooled loan program	4,570,000	4,760,000
Maryland Industrial Development Financing Authority Revenue Bonds, Series C	—	255,000
Bank note	557,202	652,445
Mortgages on real estate	7,128,063	7,402,531
Bank financing agreement	—	22,932,594
Other debt	51,000	1,355,000
	108,337,258	118,267,570
Plus unamortized bond premium	—	373,428
	108,337,258	118,640,998
Less current portion	3,853,787	4,536,075
	$ 104,483,471	114,104,923

In May 2003, Obligated Group, comprised of Sheppard and Enoch Pratt Foundation, Inc., Health System, Physicians, and Investment Company, issued tax-exempt Series 2003 Bonds in the original amount of $91,140,000 to finance the construction of a 192-bed inpatient hospital, and renovation of certain existing facilities and common areas, which was completed in February 2006 (the Project) and to repay then existing debt. The Series 2003 Bonds were issued pursuant to a loan agreement and trust indenture between MHHEFA and Obligated Group. Portions of the Series 2003 Bonds (Series A) in the original amount of $45,590,000 bore interest semiannually at fixed rates ranging from 2.8% to 5.3%. The Series A Bonds were subject to annual mandatory sinking fund requirements commencing in 2029 through 2037. The Series B Bonds were subject to annual mandatory principal requirements commencing in 2007 through 2028. Principal payments varied in increasing amounts from $600,000 with the final installment of $3,425,000 in 2028. The Series B Bonds were originally issued as auction rate securities. Pursuant to the original governing documents, in February 2008, Foundation elected to convert the Series B Bonds from auction rate securities to variable rate demand bonds backed by a five-year bank letter of credit which was scheduled to expire on July 1, 2013. The amount of Series B Bonds outstanding at June 30, 2011 was $43,075,000. Both Series A and Series B debt were refinanced as part of the March 2012 transaction.

In December 2009, Obligated Group entered into a financing agreement with Bank of America for up to $30,000,000 to borrow funds for various capital acquisitions. This loan was refinanced as part of the March 2012 transaction.

In March 2012, the Obligated Group refinanced certain outstanding indebtedness including the 2003 Series A and Series B bonds and the Bank of America financing agreement. The Series 2012 bonds were issued by MHHEFA and purchased by SunTrust in a direct placement loan arrangement. The Series 2003 A bonds were advance refunded with proceeds of the Series 2012A bonds. The Series 2003 B bonds and the Series 2009 bonds were refunded with proceeds of the Series 2012 B bonds. The Foundation recorded a loss on extinguishment of debt of approximately $3.6 million in connection with this transaction.

The Series 2012 A bonds are fixed rate bonds in the principal amount of $34,032,000 bearing interest at a fixed rate of 2.84%. The initial term of the credit facility is 15 years, and the final scheduled maturity is July 1, 2036. The Series 2012 B bonds are variable rate bonds in the principal amount of $62,182,000 bearing interest at 77% of the sum of 1 month LIBOR plus 1.1% (1.0% at June 30, 2012). The initial term of the credit facility is 10 years and the final scheduled maturity is July 1, 2035. The Series 2012 A and B bonds are being repaid using a 24 year amortization.

The Series 2012 Bonds are secured by a trust indenture and Obligated Group has granted SunTrust and MHHEFA a security interest in its revenues. The Series 2012 Bonds require Obligated Group to satisfy certain measures of financial performance as long as the Series 2012 Bonds are outstanding.

In September 2006, Mosaic borrowed $5,420,000 through the MHHEFA Series D pooled loan program. This loan was used to defease certain bonds issued in 1996 by the Maryland Economic Development Company and certain bonds issued in 2001 by Baltimore County, Maryland for Revisions, Inc. (an entity which subsequently merged with Mosaic) and for certain renovations and equipment purchases. The variable rate bonds are supported by a bank letter of credit which expires in October 2015. The terms of the loan, while subject to long-term amortization (20 years) may be put at the option of the bond holders. At such time, the letter of credit bank would advance fund the put bonds on behalf of Mosaic under the terms of the letter of credit. Mosaic would be required to repay such advances under the letter of credit on October 1, 2015. The effective interest rate on this debt was approximately 0.2% and 3.6% for 2012 and 2011 respectively. The defeased debt, which was repaid in August 2011, is included in “other debt” above at June 20, 2011 and bore interest at an effective rate of 8.5% in 2011.

The Maryland Industrial Development Financing Authority Revenue Bonds, Series C (Way Station Bonds) were tax-exempt revenue bonds issued for the construction of the Way Station facility. The Way Station Bonds were due in monthly payments of principal and interest, bore interest at a fixed rate of 4.3%, were due December 31, 2011, were secured by the first deed of trust on Way Station Bonds, and were secured by an irrevocable direct pay letter of credit by a commercial bank. The letter of credit of approximately $1,742,000 expired in January 2012, and the debt was repaid in full.

Way Station has a bank note on a property in the Frederick, Maryland area with a total outstanding balance of $557,202 and $571,529 at June 30, 2012 and 2011, with an interest rate of 4.25% and a maturity date of 2019. In addition, Way Station has a noninterest bearing loan due in 2023 and is secured by a lien on one of its properties. As of June 30, 2012 and 2011, the outstanding balance was $51,000 and $56,000, respectively.

Way Station also has a mortgage on a property in the Frederick, Maryland area with a total outstanding balance of $77,651 and $80,927 at June 30, 2012 and 2011, with an interest rate of 2% and a maturity date of 2031.

Family Services has mortgages on 15 properties in the Gaithersburg, Maryland area with a total outstanding balance of $4,674,825 and $4,918,724 at June 30, 2012 and 2011, respectively, with interest rates ranging from 5.75% to 6.5%, and maturity dates ranging from August 2012 to December 1, 2039.

Mosaic has mortgages on 23 properties in the Baltimore County and Carroll County areas with a total outstanding balance of $2,375,587 and $2,483,807 at June 30, 2012 and June 2011 respectively, with interest rates ranging from 0% to 8.5%, and maturity dates ranging from March 2014 to May 2038.

In addition, Mosaic has a variable rate line of credit with Bank of America in the amount of $1,000,000 which is secured by certain assets of Mosaic. At June 30, 2012 and 2011, Mosaic had an outstanding balance of $0 and $174,000 respectively.

Repayment of long-term debt, including mandatory sinking fund redemptions, in each of the next five fiscal years is as follows:

2013	$	3,853,787
2014		3,772,449
2015		3,696,807
2016		12,711,320
2017		3,321,168
2018 and thereafter		80,981,727
	$	108,337,258

Interest payments were $3,631,483 and $3,571,319 in 2012 and 2011.

(11) Other Financial Instruments

During the year ended June 30, 2006, Foundation received a gift annuity from donors. Under the terms of such agreement, Foundation agreed to pay 6% annually of the contributed amount (approximately $1 million) on a quarterly basis over the remaining lives of the donors. Accordingly, as of June 30, 2012 and 2011, the net present value of the estimated remaining payments of approximately $588,500 and $621,000, respectively, have been recorded as an other long-term liability.

(12) Pension Plan, Employees' Thrift Plan and Life, Accident and Health Plan

Foundation has a noncontributory defined benefit pension plan that covers eligible employees of Health System and Physicians. The benefits are based on the employees' credited service and average compensation during the five consecutive years, taken from the last 10 years of service before retirement, which produces the highest result. The funding policy is to contribute annually amounts actuarially determined to provide for benefits attributed to service to date and benefits expected to be earned in the future. Prior service cost is being amortized on a straight-line basis over the estimated term of employment of current employees.

ASC Subtopic 715-30, *Defined Benefit Plans-Pension*, requires Foundation to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan in the accompanying consolidated balance sheets, with a corresponding adjustment to unrestricted net assets. The pension liability adjustment to unrestricted net assets represents the change in net unrecognized actuarial losses and unrecognized prior service costs that have not yet been recognized as part of excess of revenues over expenses. Those amounts will be subsequently recognized as a component of net periodic pension cost pursuant to Foundation's historical accounting policy for amortizing such amounts.

The following are deferred pension costs that have not yet been recognized in periodic pension expense but instead are included as a component of unrestricted net assets, as of June 30, 2012 and 2011. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

		Amounts in unrestricted net assets to be recognized during the next fiscal year	Amounts recognized in unrestricted net assets at June 30, 2012	Amounts recognized in unrestricted net assets at June 30, 2011
Net prior service cost	$	47,481	222,270	893,118
Net actuarial loss		2,634,580	35,111,974	13,499,125
Total	$	2,682,061	35,334,244	14,392,243

In 2011, Foundation made available a special limited one-time lump-sum payment option to certain former employees who had a deferred vested benefit of $25,000 or less under the plan. As a result, Foundation made payments under this program of approximately $2.2 million.

The Plan's change in benefit obligations, the change in plan assets, current funded status and the components of net periodic pension cost as of and for the years ended June 30, 2012 and 2011 are as follows:

		2012	2011
Accumulated benefit obligation at the end of the year	$	156,222,066	129,076,789
Changes in benefit obligations:			
Projected benefit obligation at the beginning of the year	$	140,257,297	141,062,746
Service cost		4,681,155	5,226,615
Interest cost		7,848,392	7,576,711
Actuarial (loss) gain		22,079,499	(6,908,915)
Benefits paid		(5,005,674)	(6,699,860)
Projected benefit obligation at the end of the year		169,860,669	140,257,297
Changes in plan assets:			
Fair value of plan assets at beginning of the year		131,903,909	106,157,433
Actual return on plan assets		9,943,829	21,446,336
Contributions to the plan		5,000,000	11,000,000
Benefits paid		(5,005,674)	(6,699,860)
Fair value of plan assets at end of the year		141,842,064	131,903,909
Funded status	$	(28,018,605)	(8,353,388)

Net periodic pension expense includes the following components for the years ended June 30:

		2012	2011
Service cost	$	4,681,155	5,226,615
Interest cost		7,848,392	7,576,711
Expected return on plan assets		(9,502,193)	(9,030,927)
Amortization of prior service cost		670,848	736,772
Amortization of net loss		25,014	1,776,739
Net pension expense	$	3,723,216	6,285,910

The following table presents the weighted average assumptions used to determine benefit obligations and net periodic benefit expense for the Plan for 2012 and 2011:

	2012	2011
Discount rates (benefit obligation)	4.64%	5.67%
Discount rates (benefit expense)	5.67	5.50
Rate of compensation increase	4.00	4.00
Expected long-term return on plan assets	7.10	8.00

(Continued)

(a) Determination of Expected Long-Term Rate of Return

In developing the expected long-term rate of return on assets assumption, Foundation considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

In 2012, Foundation increased its investments in fixed income securities and reduced its investments in equity securities. This change in asset allocation prompted a reduction in the expected long term return on plan assets assumption to 7.1% (8.0% in 2011).

(b) Investment Policy and Objectives

The investment policy and objectives are established by the trustees of Foundation. The plan objectives include achieving and maintaining fully funded status and minimizing volatility with reasonable and prudent levels of risk. The investment policy is based on a long-term perspective. An investment advisory firm engaged by Foundation trustees selects investment managers, makes investment decisions in keeping with the Pension Investment Policy Statement developed by the trustees, and reviews fund performance and funding status routinely. The percentage allocation to each asset class may vary depending upon the funded status of the Plan.

Foundation monitors the investment managers' performance and ensures adequate diversification by asset class to further mitigate the risks associated with the investment program. Management believes that its assets are invested in accordance with its overall investment policies at June 30, 2012 and 2011.

A Foundation trustee serves as an investment manager for a portion of the investment portfolio totaling approximately $13,000,000 as of June 30, 2012. The same trustee served as an investment manager for a portion of the pension and investment portfolios totaling approximately $30,900,000 as of June 30, 2011.

(c) Plan Assets

Foundation's pension plan weighted average asset allocations at the measurement dates of June 30, 2012 and 2011 by asset category are as follows:

	Target allocation	**2012**	**2011**
Equity securities	46%	45%	64%
Debt securities	54	51	7
Cash and cash equivalents	—	1	18
Other (including private equity/ real estate funds)	—	3	11
	100%	100%	100%

In accordance with ASC Subtopic 715-20, *Defined Benefit Plans-General-Disclosures*, nonpublic entities are required to report the fair value of each major category of pension plan asset within the fair value hierarchy. ASC Subtopic 820-10, *Fair Value Measurements and Disclosures Overall*, provides guidance for the fair value hierarchy, which is as a valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Refer to note 4, for descriptions of each of the three levels within the valuation hierarchy.

The table below presents Foundation's pension plan investable assets as of June 30, 2012 aggregated by the three level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 793,563	—	—	793,563
Collective trusts-equity	—	64,185,723	—	64,185,723
Collective trusts – fixed income	—	72,970,851	—	72,970,851
Private equity and real estate funds	—	—	3,891,927	3,891,927
Total assets	$ 793,563	137,156,574	3,891,927	141,842,064

The table below presents Foundation's pension plan investable assets as of June 30, 2011 aggregated by the three level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 23,697,051	—	—	23,697,051
Common stocks	28,902,170	—	—	28,902,170
Other equities	1,195,326	—	—	1,195,326
Mutual funds	53,912,070	—	—	53,912,070
Government-issued bonds	—	54,715	—	54,715
Corporate bonds	—	9,167,921	—	9,167,921
Private equity and real estate funds	—	10,474,846	4,499,810	14,974,656
Total assets	$ 107,706,617	19,697,482	4,499,810	131,903,909

The majority of the investments held by the plan are now Level 2 securities, as approximately $107 million of investments in Level 1 securities were replaced by Level 2 collective trust securities during the year ended June 30, 2012. There were no significant transfers between levels during the year ended June 30, 2011. Foundation has the ability to liquidate the collective trusts on a daily basis.

Foundation's pension plan invests in six alternative investments, which are primarily hedge funds of funds and private equity funds. Such investments are typically carried at estimated fair value. Foundation uses the practical expedient to report the net asset values of these funds as an estimate of fair value. Most of the funds have not had changes in the redemption policies during fiscal year 2012, and the policies range primarily from 30 to 90 days. Determination of fair value is performed on a quarterly basis by the General Partner(s) of the funds. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for these investments existed.

ASC 715-20 also requires that nonpublic entities provide a reconciliation of the beginning and ending balances for the Level 3 plan assets. In accordance with this guidance, changes to Foundation's level 3 plan assets, are summarized as follows:

		Private equity and real estate funds
Balance as of June 30, 2010	$	3,780,249
Additions:		
Contributions/purchases		2,176,200
Disbursements:		
Withdrawals/sales		(1,456,639)
Net change		719,561
Balance as of June 30, 2011		4,499,810
Additions:		
Contributions/purchases		407,207
Disbursements:		
Withdrawals/sales		(1,036,573)
Net unrealized gains/(losses)		21,483
Net change		(607,883)
Balance as of June 30, 2012	$	3,891,927

(d) Contributions

Foundation contributed approximately $5 million to its pension plan for the year ended June 30, 2012 ($11 million in 2011). The Foundation expects to contribute $6 million to its pension plan for the fiscal year ended June 30, 2013.

(e) Estimated Future Benefit Payments

The following benefit payments, which reflect expected future employee service, as appropriate, are expected to be paid from the plan in each of the fiscal years as follows:

2013	$ 6,095,706
2014	6,824,995
2015	7,533,500
2016	8,285,593
2017	9,026,636
2018 – 2022	53,854,047

The expected benefits to be paid are based on the same assumptions used to measure Foundation benefit obligation at June 30, 2012.

Effective July 1, 2006, Foundation elected to not allow employees hired on or after July 1, 2006 to participate in either the defined benefit pension plan or the current employees' thrift plan. Instead, such employees participate in a new employees' thrift plan. The new employee's thrift plan expense was approximately $1,840,000 and $1,326,000 in 2012 and 2011, respectively. The retirement benefits for employees hired on or prior to June 30, 2006 under the defined benefit plan and employees' thrift plan remain unchanged.

Foundation sponsors an employees' thrift plan for certain employees of Health System and Physicians. Foundation may provide a discretionary contribution to the employees' thrift plan. There were no discretionary contributions to the thrift plan in 2012 and 2011.

Foundation maintains a self-insured life, accident and health plan for employees of Health System and Physicians which provides for monthly contributions in amounts sufficient to cover the costs of basic hospital, surgical and diagnostic benefits and administrative expenses. The life, accident, and health plan expense was $9,163,952 in 2012 and $9,569,346 in 2011.

Certain of the subsidiaries maintain various tax sheltered annuity accounts, defined contribution plans or other retirement benefit plans. These subsidiaries have the option to issue discretionary matching contributions to the plans. During the years ended June 30, 2012 and 2011, these subsidiaries contributed approximately $390,451 and $414,415, respectively, to the plans.

(13) Leases

Foundation leases office space under long-term operating leases, which expire at various dates through 2020 some of which require increasing monthly payments expiring over the next several years. The following is a schedule of the future minimum lease payments under operating leases as of June 30, 2012 that have initial or remaining lease terms in excess of one year for each of the years ending June 30:

2013	$	3,242,172
2014		2,200,245
2015		1,854,531
2016		1,262,005
2017		1,098,791
Thereafter		4,475,522
Total minimum lease payments	$	14,133,266

Rent expense was approximately $5,323,426 and $6,160,777 in 2012 and 2011, respectively. Foundation also leases various equipment under short-term leases.

Foundation leases a school building and certain software and equipment related to its electronic medical records system, which are recorded in the consolidated balance sheets as capital leases. The school building lease has an initial lease term of 10 years, and Foundation has the right to extend the lease term for two successive periods of 5 years each. An agreement was signed in June 2012 to extend the electronic medical records system lease through June 2015, which resulted in an increase to the capital lease asset obligation of approximately $1 million. In addition, an agreement was signed in 2012 for an additional data research module of the electronic medical record system which resulted in the recording of an additional capital lease obligation of approximately $500,000.

The following is a schedule of future minimum lease payments under capital leases as of June 30, 2012.

2013	$	769,999
2014		797,638
2015		790,896
2016		429,811
2017		443,555
Thereafter		4,827,660
Total minimum lease payments		8,059,559
Less amount representing interest		2,360,503
Present value of net minimum lease payments		5,699,056
Less obligations under capital leases, current portion		490,359
Obligations under capital leases, less current portion	$	5,208,697

(14) Self-Insurance Programs and Litigation

Foundation is from time to time subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of pending legal proceedings will not have a material effect on the consolidated financial statements. In this regard, Foundation maintains a self-insurance program for professional liability claims, and a related trust fund has been established for the purpose of setting aside assets based on actuarial funding recommendations. Under the trust agreement, the assets can only be used for the payment of professional and general liability claims, related expenses, and the cost of administering the trust. Certain claims-made based professional and occurrence-based general liability insurance coverages have been purchased to provide protection for claims in excess of the self-insured amounts. The assets of the trust are classified as investments limited as to use in the accompanying consolidated balance sheets in the amount of $605,391 and $672,560 at June 30, 2012 and 2011, respectively. The related claims liabilities of $6,733,445 and $6,593,021 as of June 30, 2012 and 2011, respectively, are recorded on an undiscounted basis and represent estimates for asserted claims and unasserted claims arising from reported incidents and unreported incidents. Management believes that the provision for loss is adequate at June 30, 2012 and 2011; however, the ultimate liability may differ significantly. Management is aware of certain asserted and unasserted legal claims, none of which, in the opinion of management, is expected to result in losses in excess of insurance limits.

Health System and Physicians are also self-insured for unemployment claims and have established a letter of credit arrangement of approximately $1,227,000 in 2012 and $1,208,000 in 2011 in accordance with the requirements of the Maryland Department of Employment and Training. Also, Foundation is self-insured for workers' compensation claims up to $500,000. Investments of approximately $3,599,000 at June 30, 2012 and 2011 are being held in an account at a financial institution to secure the payment of claims. These investments are included in the balance of investments limited or restricted as to use. The related liabilities of $3,946,847 and $2,867,360 as of June 30, 2012 and 2011, respectively, are recorded in the accompanying consolidated balance sheets. Foundation records outstanding losses and loss expenses for workers' compensation liability claims based on the estimates of the amount of reported losses together with a provision for losses incurred but not reported, the recommendations of an independent actuary, and management's judgment using its past experience and industry experience. Foundation offers employees a self-insured health plan. Foundation maintains an accrual for claims that have been incurred but not reported to the plan administrator. The accrued liability for claims incurred but not reported is based on the historical claim lag period and current payment trends of health insurance claims. The accrued liability for health claims is $1,807,000 and $1,654,000, respectively, as of June 30, 2012 and 2011. While management believes that the provision for claims on unemployment, workers' compensation, and employee health benefits is adequate, at June 30, 2012 and 2011, the ultimate liability may be significantly different than the estimates.

(15) Net Assets

Net assets at June 30 are summarized as follows:

		2012	2011
Unrestricted:			
Undesignated	$	120,580,614	136,624,054
Board-designated:			
Moses Sheppard bequest		34,417,237	34,660,130
Enoch Pratt bequest		21,949,940	22,104,847
Other		44,540,841	46,815,158
Total board-designated		100,908,018	103,580,135
Total unrestricted	$	221,488,632	240,204,189

Temporarily restricted net assets are available for the purposes of providing indigent care, health and educational programs, the purchase of property and equipment, and the repayment of debt. Permanently restricted net assets are restricted in perpetuity, the income from which is expendable to provide health and educational programs.

(16) Rate Setting Matters and Business and Credit Concentrations

Foundation provides healthcare services through its inpatient and outpatient care facilities located throughout Maryland. Foundation grants credit to patients and generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross/Blue Shield, health maintenance organizations (HMOs), and commercial insurance policies).

Net patient, residential and educational service revenue, by payor class, consisted of the following for the years ended June 30:

	2012	2011
Medicare	13%	12%
Medicaid	36	35
Commercial insurers and HMOs	15	17
Local government	20	20
Blue Cross/Blue Shield	11	10
Self-pay and other	5	6
	100%	100%

Foundation accepts all patients covered by the Medicare and Medicaid programs. These programs reimburse Foundation at amounts less than charges. The difference between the charges for healthcare services and the related reimbursement amounts for these and other third-party payors is as follows for the years ended June 30:

	2012	2011
Medicare	$ 12,847,963	13,218,295
Medicaid	12,654,844	12,436,918
Other third-party payors	7,784,930	7,275,304
	$ 33,287,737	32,930,517

Patient charges of the Health System (other than Medicare and Medicaid) are recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC), reviewed on an annual basis and adjusted prospectively giving effect to, among other things, the anticipated impact of inflation on operating expenses, variances between actual volume of patient services and the volume budgeted for such services, and variances between actual unit rates and approved unit rates during the previous rate year. Such rate adjustments are reflected in revenue of Health System in the subsequent rate year, which coincides with Health System's fiscal year.

The Foundation is reimbursed for certain services to their Medicare and Medicaid program beneficiaries based upon cost reimbursement methodologies. The Maryland Medicaid program's inpatient reimbursement methodology is a prospective payment system which is set at 84% of HSCRC rates. Medicaid outpatient services continue to be reimbursed on a cost report basis. Effective July 1, 2005, the Medicare program changed its reimbursement methodology to a prospective payment system, which occurred over a four-year transition period. Health System has received either the final settlement or the notice of final settlement on Medicare cost reports through June 30, 2011 and on Medicaid cost reports for all programs except the Taylor RTC through June 30, 2004. The Taylor RTC Medicaid cost report has been settled through June 30, 2002.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount. Management periodically reviews recorded amounts receivable from or payable to third-party payors and may adjust these balances as new information becomes available. In addition, revenue received under certain third-party agreements are subject to audit.

During 2012 and 2011, some of Foundation's prior year third-party cost reports were audited and settled, or tentatively settled, by third-party payors. Adjustments resulting from such audits and management reviews of unaudited years and open claims are reflected as adjustments to revenue in the year the adjustment becomes known. The effect of these adjustments was to increase net patient service revenue by $1.9 million and $950,000 during the years ended June 30, 2012 and June 2011, respectively. Although certain other prior year cost reports submitted to third-party payors remain subject to audit and retroactive adjustment, management does not expect any material adverse settlements.

Patient accounts receivable are as follows at June 30:

		2012	2011
Patient accounts receivable	$	20,742,375	21,822,994
Residential and educational accounts receivable		14,729,326	16,245,421
		35,471,701	38,068,415
Less allowance for doubtful accounts		10,717,142	6,866,835
	$	24,754,559	31,201,580

(17) Functional Expenses

Members of Foundation provide healthcare and educational services to the patients which they serve. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows:

		2012	2011
Healthcare and educational services	$	241,295,320	234,066,476
General and administrative		36,284,579	35,418,291
	$	277,579,899	269,484,767

(18) Certain Significant Risks and Uncertainties

Foundation provides psychiatric healthcare services in the State of Maryland. Foundation and other healthcare providers are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes

(Continued)

- Lawsuits alleging malpractice or other claims

Such inherent risks require the use of certain management estimates in the preparation of Foundation's consolidated financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of Foundation's revenues and Foundation's operations are subject to a variety of other federal, state, and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on Foundation.

Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on Foundation.

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments, and the government has aggressively increased enforcement of Medicare and Medicaid anti-fraud and abuse laws. Foundation's compliance with these laws and regulations is subject to periodic governmental review, which could result in enforcement actions unknown or unasserted at this time. The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self-referral laws (STARK law and regulation). Recent federal initiatives have prompted a national review of federally funded healthcare programs. In addition, the federal government and many states have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the U.S. healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to health care providers and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over the next decade. This federal healthcare reform legislation did not affect either the 2012 or the 2011 consolidated financial statements.

(19) Endowment Net Assets

Foundation's endowments consist of both individual donor-restricted funds established for a variety of purposes and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

(a) Interpretation of Relevant Law

Foundation has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Foundation classifies its permanently restricted net assets as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund

(2) The purposes of Foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

(5) The expected total return from income and the appreciation of investments

(6) Other resources of Foundation

(7) The investment policies of Foundation

(b) Net Asset Classification by Type of Endowment as of June 30, 2012

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	—	3,899,086	3,899,086
Board-designated endowment funds	100,908,018	—	—	100,908,018
	$ 100,908,018	—	3,899,086	104,807,104

Changes in endowment net assets for the year ended June 30, 2012:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets beginning of year	$ 103,580,135	—	3,834,331	107,414,466
Investment return:				
Investment income	2,134,051	—	—	2,134,051
Net appreciation (realized and unrealized gains and losses)	(2,622,168)	—	856	(2,621,312)
Total investment return	(488,117)	—	856	(487,261)
Contributions	—		63,899	63,899
Appropriation of endowment assets for expenditure	(2,184,000)	—	—	(2,184,000)
	$ 100,908,018	—	3,899,086	104,807,104

(c) Net Asset Classification by Type of Endowment as of June 30, 2011

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	—	3,834,331	3,834,331
Board-designated endowment funds	103,580,135	—	—	103,580,135
	$ 103,580,135	—	3,834,331	107,414,466

Changes in endowment net assets for the year ended June 30, 2011:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets beginning of year	$	90,592,142	—	3,468,495	94,060,637
Investment return:					
Investment income		2,128,091	—	—	2,128,091
Net appreciation (realized and unrealized gains and losses)		14,786,638	—	84,101	14,870,739
Total investment return		16,914,729	—	84,101	16,998,830
Contributions		—	—	281,735	281,735
Appropriation of endowment assets for expenditure		(3,926,736)	—	—	(3,926,736)
	$	103,580,135	—	3,834,331	107,414,466

(d) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires Foundation to retain as a fund of perpetual duration as a result of unfavorable market fluctuations.

(e) Investment Strategies

Foundation has adopted policies for corporate investments, including endowment assets that seek to maximize risk-adjusted returns with preservation of principal. Endowment assets include those assets of donor-restricted funds that Foundation must hold in perpetuity or for a donor-specified period(s). The endowment assets are invested in a manner that is intended to hold a mix of investment assets designed to meet the objectives of the account. Foundation expects its endowment funds, over time, to provide an average rate of return that generates earnings to achieve the endowment purpose.

To satisfy its long-term rate-of-return objectives, Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Foundation employs a diversified asset allocation structure to achieve its long-term return objectives within prudent risk constraints.

Foundation monitors the endowment funds returns and appropriates average returns for use. In establishing this practice, Foundation considered the long-term expected return on its endowment. This is consistent with Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(Continued)

(20) Subsequent Events

Subsequent events were evaluated through October 8, 2012, the date of issuance for Foundation's audited financial statements as of and for the year ended June 30, 2012.

Effective July 1, 2012, Foundation completed a statutory merger with Alliance, Inc., a not-for-profit provider of outpatient, residential, and supported employment services for persons with disabilities. These transactions will be accounted for under purchase accounting. No consideration was exchanged in this transaction. Alliance, Inc. has approximately $23 million in revenues and $8 million of net assets.

Health System entered into a Letter of intent to merge with The Hannah More Center, Inc., under a statutory merger in which Health System will be the surviving corporation. The effective date of the merger is expected to be November 1, 2012. No consideration is expected to be exchanged in this transaction. The Hannah More Center is a special education school located in Baltimore County, Maryland with approximately $9 million in revenues and $3 million of net assets.

SUPPLEMENTARY INFORMATION

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Balance Sheet Information

June 30, 2012

Assets	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated group combining eliminations	Combined obligated group subtotal
Current assets:						
Cash and cash equivalents	$ 142,761	46,445,283	—	422,839	—	47,010,883
Investments limited or restricted as to use	38,571	517,181	—	—	—	555,752
Accounts receivable, net	—	19,086,654	—	981,513	—	20,068,167
Due from affiliates	—	1,200,631	3,729,226	59,910	(4,425,812)	563,955
Prepaid expenses and other current assets	—	5,807,670	—	436,688	—	6,244,358
Total current assets	181,332	73,057,419	3,729,226	1,900,950	(4,425,812)	74,443,115
Investments limited or restricted as to use, less current portion	926,339	33,028,504	95,900,824	—	—	129,855,667
Interest in net assets of Foundation	—	77,143	—	—	(77,143)	—
Notes receivable	—	—	2,536,449	—	—	2,536,449
Property and equipment, net	—	160,998,041	—	—	—	160,998,041
Other assets	—	2,644,604	503,875	—	—	3,148,479
	$ 1,107,671	269,805,711	102,670,374	1,900,950	(4,502,955)	370,981,751
Liabilities and Net Assets						
Current liabilities:						
Current maturities of long-term debt	$ —	2,882,544	—	—	—	2,882,544
Current portion of obligations under capital leases	—	490,359	—	—	—	490,359
Accounts payable	—	4,346,551	—	516,012	—	4,862,563
Accrued salaries, wages, and employee benefits	—	12,396,588	—	2,117,082	—	14,513,670
Third-party payor settlements payable	—	2,377,636	—	—	—	2,377,636
Due to affiliates	105,391	3,946,991	1,412,078	262,052	(4,425,812)	1,300,700
Self-insurance liabilities	—	4,668,968	—	249,985	—	4,918,953
Other accrued expenses	—	1,715,106	350,279	251,930	—	2,317,315
Total current liabilities	105,391	32,824,743	1,762,357	3,397,061	(4,425,812)	33,663,740
Long-term liabilities:						
Long-term debt, less current portion	—	93,148,449	—	—	—	93,148,449
Obligations under capitalized leases, less current portion	—	5,208,697	—	—	—	5,208,697
Self-insurance liabilities	—	6,733,445	—	—	—	6,733,445
Accrued pension liabilities	—	24,756,823	—	3,261,782	—	28,018,605
Other long-term liabilities	588,469	—	—	—	—	588,469
Total liabilities	693,860	162,672,157	1,762,357	6,658,843	(4,425,812)	167,361,405
Net assets (deficit):						
Unrestricted	37,369	98,882,216	100,908,017	(4,757,893)	—	195,069,709
Temporarily restricted	77,144	5,001,550	—	—	(77,143)	5,001,551
Permanently restricted	299,298	3,249,788	—	—	—	3,549,086
Total net assets	413,811	107,133,554	100,908,017	(4,757,893)	(77,143)	203,620,346
	$ 1,107,671	269,805,711	102,670,374	1,900,950	(4,502,955)	370,981,751

See accompanying independent auditors' report.

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Balance Sheet Information

June 30, 2012

Assets	Family Services Agency, Inc.	Mosaic Community Services, Inc.	Turning Point of Washington County, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Current assets:						
Cash and cash equivalents	$ 859,800	3,069,874	577,190	2,629,566	—	54,147,313
Investments limited or restricted as to use	—	247,910	—	801,106	—	1,604,768
Accounts receivable, net	1,093,561	2,083,806	—	1,509,025	—	24,754,559
Due from affiliates	39,022	172,698	42,139	217,000	(1,034,814)	—
Prepaid expenses and other current assets	267,369	855,281	—	1,503,707	—	8,870,715
Total current assets	2,259,752	6,429,569	619,329	6,660,404	(1,034,814)	89,377,355
Investments limited or restricted as to use, less current portion	—	1,725,288	—	1,082,535	(1,082,540)	131,580,950
Interest in net assets of Foundation	—	—	—	—	—	—
Notes receivable	—	—	—	—	—	2,536,449
Property and equipment, net	6,892,511	12,738,788	945,003	12,375,171	—	193,949,514
Other assets	65,082	164,341	—	846,461	—	4,224,363
	$ 9,217,345	21,057,986	1,564,332	20,964,571	(2,117,354)	421,668,631
Liabilities and Net Assets						
Current liabilities:						
Current maturities of long-term debt	$ 589,318	358,579	—	23,346	—	3,853,787
Current portion of obligations under capital leases	—	—	—	—	—	490,359
Accounts payable	321,938	691,832	—	698,471	—	6,574,804
Accrued salaries, wages, and employee benefits	854,523	2,050,988	—	1,872,135	—	19,291,316
Third-party payor settlements payable	—	—	—	—	—	2,377,636
Due to affiliates	56,059	173,376	—	322,128	(1,852,263)	—
Self-insurance liabilities	—	274,615	—	261,822	—	5,455,390
Other accrued expenses	431,041	307,696	—	551,997	—	3,608,049
Total current liabilities	2,252,879	3,857,086	—	3,729,899	(1,852,263)	41,651,341
Long-term liabilities:						
Long-term debt, less current portion	4,085,506	6,587,008	—	662,508	—	104,483,471
Obligations under capitalized leases, less current portion	—	—	—	—	—	5,208,697
Self-insurance liabilities	—	—	—	298,450	—	7,031,895
Accrued pension liabilities	—	—	—	—	—	28,018,605
Other long-term liabilities	286,456	695,777	—	1,061,081	(265,091)	2,366,692
Total liabilities	6,624,841	11,139,871	—	5,751,938	(2,117,354)	188,760,701
Net assets (deficit):						
Unrestricted	2,592,504	9,320,205	1,564,332	12,941,882	—	221,488,632
Temporarily restricted	—	247,910	—	2,270,751	—	7,520,212
Permanently restricted	—	350,000	—	—	—	3,899,086
Total net assets	2,592,504	9,918,115	1,564,332	15,212,633	—	232,907,930
	$ 9,217,345	21,057,986	1,564,332	20,964,571	(2,117,354)	421,668,631

See accompanying independent auditors' report.

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Operations Information

Year ended June 30, 2012

	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated group combining eliminations	Combined obligated group subtotal
Unrestricted revenues, gains, and other support:						
Net patient service revenue	$ —	112,501,564	—	13,112,538	—	125,614,102
Residential and educational service revenue	—	68,306,664	—	—	—	68,306,664
Net assets released from restrictions used for operations	—	808,687	—	—	—	808,687
Other revenue	—	12,435,861	—	14,383,139	(13,148,729)	13,670,271
Total unrestricted revenues, gains, and other support	—	194,052,776	—	27,495,677	(13,148,729)	208,399,724
Expenses:						
Salaries and wages	—	93,504,511	—	19,472,420	—	112,976,931
Employee benefits	—	23,094,413	—	2,848,915	—	25,943,328
Expendable supplies	—	12,550,432	—	242	—	12,550,674
Purchased services	3,327	34,161,259	—	6,842,657	(13,400,024)	27,607,219
Interest	—	3,879,491	—	—	—	3,879,491
Repairs and minor alterations	—	5,768,508	—	—	—	5,768,508
Depreciation and amortization	—	14,677,370	—	—	—	14,677,370
Provision for doubtful accounts	—	1,258,298	—	252,358	—	1,510,656
Realized loss on disposal of assets, net	—	18,614	—	—	—	18,614
Total expenses	3,327	188,912,896	—	29,416,592	(13,400,024)	204,932,791
Operating income (loss)	(3,327)	5,139,880	—	(1,920,915)	251,295	3,466,933
Other income (expense):						
Investment income	—	396,215	2,134,050	—	(251,295)	2,278,970
Realized gain on investments, net	—	369,586	1,764,416	—	—	2,134,002
Change in unrealized (loss) gain on investments, net	—	(909,506)	(4,381,885)	—	—	(5,291,391)
Loss on extinguishment of debt	—	(3,564,840)	—	—	—	(3,564,840)
Other	—	1,226,645	(4,700)	—	—	1,221,945
Total other income (expense)	—	(2,481,900)	(488,119)	—	(251,295)	(3,221,314)
Excess (deficiency) of revenues over expenses	(3,327)	2,657,980	(488,119)	(1,920,915)	—	245,619
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	718,910	—	—	—	718,910
Transfer from (to) affiliates	—	2,084,000	(2,184,000)	—	—	(100,000)
Pension liability adjustment	—	(20,942,001)	—	—	—	(20,942,001)
Capital grants	—	—	—	—	—	—
Increase (decrease) in unrestricted net assets	$ (3,327)	(15,481,111)	(2,672,119)	(1,920,915)	—	(20,077,472)

See accompanying independent auditors’ report.

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Operations Information

Year ended June 30, 2012

	Family Services Agency, Inc.	Mosaic Community Services, Inc.	Turning Point of Washington County, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Unrestricted revenues, gains, and other support:						
Net patient service revenue	$ —	—	—	—	—	125,614,102
Residential and educational service revenue	14,545,408	28,879,647	—	18,979,630	—	130,711,349
Net assets released from restrictions used for operations	—	15,058	—	81,048	—	904,793
Other revenue	717,429	5,082,858	106,731	6,294,341	(1,109,587)	24,762,043
Total unrestricted revenues, gains, and other support	15,262,837	33,977,563	106,731	25,355,019	(1,109,587)	281,992,287
Expenses:						
Salaries and wages	7,428,790	18,804,951	—	15,598,889	—	154,809,561
Employee benefits	2,800,533	3,133,374	—	3,043,023	—	34,920,258
Expendable supplies	869,909	1,549,365	—	1,233,044	—	16,202,992
Purchased services	2,873,523	7,377,722	106,731	3,398,522	(1,099,071)	40,264,646
Interest	201,248	359,907	—	36,485	(4,000)	4,473,131
Repairs and minor alterations	197,480	1,007,496	—	532,078	(6,516)	7,499,046
Depreciation and amortization	494,356	1,438,070	39,760	585,379	—	17,234,935
Provision for doubtful accounts	484,287	66,314	—	104,883	—	2,166,140
Realized loss on disposal of assets, net	(520)	(8,904)	—	—	—	9,190
Total expenses	15,349,606	33,728,295	146,491	24,532,303	(1,109,587)	277,579,899
Operating income (loss)	(86,769)	249,268	(39,760)	822,716	—	4,412,388
Other income (expense):						
Investment income	—	—	2,367	23,762	—	2,305,099
Realized gain on investments, net	—	—	—	18,388	—	2,152,390
Change in unrealized (loss) gain on investments, net	—	—	—	(47,943)	—	(5,339,334)
Loss on extinguishment of debt	—	—	—	—	—	(3,564,840)
Other	(116,407)	49,856	—	—	—	1,155,394
Total other income (expense)	(116,407)	49,856	2,367	(5,793)	—	(3,291,291)
Excess (deficiency) of revenues over expenses	(203,176)	299,124	(37,393)	816,923	—	1,121,097
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	—	—	47,332	—	766,242
Transfer from (to) affiliates	—	100,000	—	—	—	—
Pension liability adjustment	—	—	—	—	—	(20,942,001)
Capital grants	317,505	21,600	—	—	—	339,105
Increase (decrease) in unrestricted net assets	$ 114,329	420,724	(37,393)	864,255	—	(18,715,557)

See accompanying independent auditors’ report.

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Changes in Net Assets Information

Year ended June 30, 2012

	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated group combining eliminations	Combined obligated group subtotal
Unrestricted net assets:						
Excess (deficiency) of revenues over expenses	$ (3,327)	2,657,980	(488,119)	(1,920,915)	—	245,619
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	718,910	—	—	—	718,910
Transfer from (to) affiliates	—	2,084,000	(2,184,000)	—	—	(100,000)
Change in unrealized gains and losses for pension liabilities	—	(20,942,001)	—	—	—	(20,942,001)
Capital grant	—	—	—	—	—	—
Increase (decrease) in unrestricted net assets	(3,327)	(15,481,111)	(2,672,119)	(1,920,915)	—	(20,077,472)
Temporarily restricted net assets:						
Gifts and grants	(5,707)	1,556,170	—	—	—	1,550,463
Investment income	—	78,219	—	—	—	78,219
Net gain (loss) on investments	—	(112,484)	—	—	—	(112,484)
Interest in net assets of Foundation	—	(46,707)	—	—	46,707	—
Transfer from (to) subsidiaries	(40,999)	16,890	—	—	—	(24,109)
Net assets released from restrictions	—	(1,527,597)	—	—	—	(1,527,597)
Reclassification of net assets	—	(60,642)	—	—	—	(60,642)
Increase (decrease) in temporarily restricted net assets	(46,706)	(96,151)	—	—	46,707	(96,150)
Permanently restricted net assets:						
Gifts	—	3,257	—	—	—	3,257
Investment income	(234)		—	—	—	(234)
Reclassification of net assets	—	60,642	—	—	—	60,642
Increase (decrease) in permanently restricted net assets	(234)	63,899	—	—	—	63,665
Increase (decrease) in net assets	(50,267)	(15,513,363)	(2,672,119)	(1,920,915)	46,707	(20,109,957)
Net assets (deficit), beginning of year	464,078	122,646,917	103,580,136	(2,836,978)	(123,850)	223,730,303
Net assets (deficit), end of year	$ 413,811	107,133,554	100,908,017	(4,757,893)	(77,143)	203,620,346

See accompanying independent auditors' report.

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Changes in Net Assets Information

Year ended June 30, 2012

	Family Services Agency, Inc.	Mosaic Community Services, Inc.	Turning Point of Washington County, Inc.	Way Station, Inc.	Consolidating eliminations	Consolidated totals
Unrestricted net assets:						
Excess (deficiency) of revenues over expenses	$ (203,176)	299,124	(37,393)	816,923	—	1,121,097
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	—	—	47,332	—	766,242
Transfer from (to) affiliates	—	100,000	—	—	—	—
Change in unrealized gains and losses for pension liabilities	—	—	—	—	—	(20,942,001)
Capital grant	317,505	21,600	—	—	—	339,105
Increase (decrease) in unrestricted net assets	114,329	420,724	(37,393)	864,255	—	(18,715,557)
Temporarily restricted net assets:						
Gifts and grants	—	106,259	—	907,012	—	2,563,734
Investment income	—	2,407	—	—	—	80,626
Net gain (loss) on investments	—	—	—	—	—	(112,484)
Interest in net assets of Foundation	—	—	—	—	—	—
Transfer from (to) subsidiaries	—	9,044	—	15,065	—	—
Net assets released from restrictions	—	(15,058)	—	(128,380)	—	(1,671,035)
Reclassification of net assets	—	—	—	—	—	(60,642)
Increase (decrease) in temporarily restricted net assets	—	102,652	—	793,697	—	800,199
Permanently restricted net assets:						
Gifts	—	—	—	—	—	3,257
Investment income	—	1,090	—	—	—	856
Reclassification of net assets	—	—	—	—	—	60,642
Increase (decrease) in permanently restricted net assets	—	1,090	—	—	—	64,755
Increase (decrease) in net assets	114,329	524,466	(37,393)	1,657,952	—	(17,850,603)
Net assets (deficit), beginning of year	2,478,175	9,393,649	1,601,725	13,554,681	—	250,758,533
Net assets (deficit), end of year	$ 2,592,504	9,918,115	1,564,332	15,212,633	—	232,907,930

See accompanying independent auditors' report.