SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Financial Statements and Supplementary Information

June 30, 2013 and 2012

(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 financial statements of Sheppard and Enoch Pratt Foundation, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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 consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 its subsidiaries as of June 30, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

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Emphasis of Matter

As discussed in notes 1(t) and 16 to the consolidated financial statements, in 2013, the Company adopted new accounting guidance, Accounting Standards Update 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*. Our opinion is not modified with respect to this matter.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information in Schedules 1-3 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 audit 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 4, 2013

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2013 and 2012

Assets		**2013**	**2012**
Current assets:			
Cash and cash equivalents	$	68,044,471	54,147,313
Investments limited or restricted as to use		1,428,589	1,604,768
Accounts receivable, net		30,215,679	24,754,559
Prepaid expenses and other current assets		8,568,670	8,870,715
Total current assets		108,257,409	89,377,355
Investments limited or restricted as to use, less current portion		142,934,636	131,580,950
Notes receivable		2,404,685	2,536,449
Property and equipment, net		215,706,906	193,949,514
Other assets		4,619,289	4,224,363
Total assets	$	473,922,925	421,668,631
Liabilities and Net Assets			
Current liabilities:			
Current maturities of long-term debt	$	5,096,527	3,853,787
Current portion of obligations under capital leases		572,098	490,359
Accounts payable		6,978,623	6,574,804
Accrued salaries, wages and employee benefits		24,248,708	19,291,316
Third-party payor settlements payable		371,024	2,377,636
Self-insurance liabilities		5,326,032	5,455,390
Other accrued expenses		4,288,961	3,608,049
Total current liabilities		46,881,973	41,651,341
Long-term liabilities:			
Long-term debt, less current portion		109,706,173	104,483,471
Obligations under capitalized leases, less current portion		4,754,669	5,208,697
Self-insurance liabilities		6,601,690	7,031,895
Accrued pension liabilities		13,562,166	28,018,605
Other long-term liabilities		3,070,022	2,366,692
Total liabilities		184,576,693	188,760,701
Net assets:			
Unrestricted		271,641,756	221,488,632
Temporarily restricted		13,801,222	7,520,212
Permanently restricted		3,903,254	3,899,086
Total net assets		289,346,232	232,907,930
Total liabilities and net assets	$	473,922,925	421,668,631

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2013 and 2012

	2013	2012
Unrestricted revenues, gains, and other support:		
Patient service revenue (net of allowances and discounts)	$ 127,018,323	125,614,102
Residential and educational service revenue (net of allowances)	154,346,371	130,711,349
Total net service revenue	281,364,694	256,325,451
Less provision for bad debts	1,902,617	2,166,140
Net service revenue less provision for bad debts	279,462,077	254,159,311
Net assets released from restrictions used for operations	1,508,260	904,793
Other revenue	37,779,307	24,762,043
Total unrestricted revenues, gains, and other support	318,749,644	279,826,147
Expenses:		
Salaries and wages	181,505,041	154,809,561
Employee benefits	37,827,358	34,920,258
Expendable supplies	19,165,452	16,202,992
Purchased services	43,645,625	40,264,646
Interest	2,568,829	4,473,131
Repairs and minor alterations	8,115,514	7,499,046
Depreciation and amortization	17,684,075	17,234,935
Realized loss on disposal of assets, net	30,824	9,190
Total expenses	310,542,718	275,413,759
Operating income	8,206,926	4,412,388
Other income (expense):		
Investment income	2,319,945	2,305,099
Realized gain on investments, net	6,533,386	2,152,390
Change in unrealized (loss) gain on investments, net	4,442,983	(5,339,334)
Inherent contribution	13,589,783	—
Loss on extinguishment of debt	—	(3,564,840)
Other	888,881	1,155,394
Total other income (expense)	27,774,978	(3,291,291)
Excess of revenues over expenses	35,981,904	1,121,097
Other changes in net assets:		
Net assets released from restrictions used for purchases of property and equipment	508,654	766,242
Pension liability adjustment	13,804,439	(20,942,001)
Capital grants	325,679	339,105
Reclassification of net assets	(467,552)	—
Increase (decrease) in unrestricted net assets	$ 50,153,124	(18,715,557)

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, 2013 and 2012

	2013	2012
Unrestricted net assets:		
Excess of revenues over expenses	$ 35,981,904	1,121,097
Other changes in net assets:		
Net assets released from restrictions used for purchases of property and equipment	508,654	766,242
Pension liability adjustment	13,804,439	(20,942,001)
Capital grants	325,679	339,105
Reclassification of net assets	(467,552)	—
Increase (decrease) in unrestricted net assets	50,153,124	(18,715,557)
Temporarily restricted net assets:		
Gifts and grants	3,655,433	2,563,734
Investment income	98,097	80,626
Net gain (loss) on investments	437,556	(112,484)
Net assets released from restrictions for operations	(1,508,260)	(904,793)
Net assets released from restrictions for purchases of property and equipment	(508,654)	(766,242)
Inherent contribution	3,639,286	—
Reclassification of net assets	467,552	(60,642)
Increase in temporarily restricted net assets	6,281,010	800,199
Permanently restricted net assets:		
Gifts	1,451	3,257
Investment income	2,717	856
Reclassification of net assets	—	60,642
Increase in permanently restricted net assets	4,168	64,755
Increase (decrease) in net assets	56,438,302	(17,850,603)
Net assets, beginning of year	232,907,930	250,758,533
Net assets, end of year	$ 289,346,232	232,907,930

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Increase (decrease) in net assets	$ 56,438,302	(17,850,603)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	17,684,075	17,234,935
Pension liability adjustment	(13,804,439)	20,942,001
Provision for doubtful accounts	1,902,617	2,166,140
Restricted gifts and grants, net	(2,148,624)	(1,662,198)
Net realized gain on investments	(6,787,299)	(2,228,214)
Net unrealized loss (gain) on investments	(4,626,626)	5,527,642
Restricted investment income on restricted net assets	(100,814)	(81,482)
Inherent contribution	(17,229,069)	—
Loss on extinguishment of debt	—	3,564,840
Unrealized gain and net settlements on interest rate swaps	(13,778)	(6,478)
Capital grant and loss on disposal of assets	(294,855)	(329,915)
Decrease (increase) in accounts receivable, net	(1,519,200)	4,280,881
Decrease (increase) in prepaid expenses and other current assets	481,690	(1,973,663)
Increase (decrease) in accounts payable and accrued expenses and other	2,843,911	(1,766,130)
Increase (decrease) in self-insurance liabilities	(559,563)	1,373,252
Increase (decrease) in third-party payor settlements payable	(2,006,612)	322,146
Decrease in accrued pension liability	(652,000)	(1,276,784)
Net cash provided by operating activities	29,607,716	28,236,370
Cash flows from investing activities:		
Purchases of property and equipment	(26,451,406)	(12,229,410)
Decrease (increase) in other assets	64,657	(454,085)
Proceeds from sale of property and equipment	167,282	3,545
Decrease in temporary investments	—	757,761
Decrease in notes receivable	131,764	131,763
Decrease in investments limited or restricted as to use, net	337,232	8,226,381
Cash acquired from acquisitions	3,414,063	—
Net settlement on interest rate swaps	(62,426)	17,043
Net cash used in investing activities	(22,398,834)	(3,547,002)
Cash flows from financing activities:		
Proceeds from debt and other liabilities	14,709,137	96,748,524
Payment of long-term debt principal	(10,628,445)	(108,701,182)
Payment of deferred financing costs	(284,948)	(89,164)
Payment on capital lease obligations	(372,289)	(446,075)
Capital grants	1,116,197	—
Restricted gifts and grants, net	2,148,624	1,662,198
Net cash provided by (used in) financing activities	6,688,276	(10,825,699)
Net increase in cash and cash equivalents	13,897,158	13,863,669
Cash and cash equivalents, beginning of year	54,147,313	40,283,644
Cash and cash equivalents, end of year	$ 68,044,471	54,147,313

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), Alliance, Inc. (Alliance), 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, Alliance, 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, 2013 and 2012.

(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.

 (Continued)

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) Allowance for Doubtful Accounts

Patient accounts receivable are reduced by allowances for bad debts. In evaluating the collectibility of accounts receivable, Foundation analyzes historical collections and write-offs and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for bad debts and provision for uncollectible accounts. Management regularly reviews its estimate and evaluates the sufficiency of the allowance for bad debts. Foundation analyzes contractual amounts due from patients who have third-party coverage and provides an allowance for doubtful accounts and a provision for bad debts. For patient accounts receivable associated with self-pay patients, which includes those patients without existing insurance coverage for a portion of the bill, Foundation records a significant provision for bad debts for patients that are unable or unwilling to pay for the portion of the bill representing their financial responsibility. Account balances are charged off against the allowance for doubtful accounts after all means of collection have been exhausted.

(f) Investments Limited or Restricted as to Use

Investments limited or restricted as to use, primarily recorded at fair value, represent assets that have been designated by the board of trustees for special purposes 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 or in a related investment account. 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 (expense), 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 (expense), 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 and the self-insurance trust 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.

(g) 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, 2013 and 2012.

(h) 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.

(i) 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.

(j) 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.

(k) Pension Benefits

Pension benefits are recorded in accordance with Accounting Standards Codification (ASC) Subtopic 715-30, *Defined Benefit Plans-Pension*, which requires the recognition of the funded status of pension plans within the accompanying balance sheets.

(l) 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).

(m) 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.

(n) 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.

(o) 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.

(p) 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.

(q) 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 $1.9 million for unrelated business activities, which expire at various dates through 2033. 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 Topic 740, *Income Taxes*.

(r) 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.

(s) 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

(t) New Accounting Pronouncements

In July 2011, the Financial Accounting Standards Board issued Accounting Standards Update (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*. The guidance is intended to provide financial statement users with greater transparency about a healthcare entity's net patient service revenue and related allowance for doubtful accounts. The guidance provides information to assist financial statement users in assessing an entity's sources of patient service revenue and related changes in its allowance for doubtful accounts. The guidance require certain healthcare entities 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, those healthcare entities are required to provide enhanced disclosures about their policies for recognizing revenue and assessing bad debts. The guidance also requires disclosures of patient service revenue (net of contractual allowances and discounts), as well as qualitative information about changes in the allowance for doubtful accounts. As permitted, Foundation adopted the guidance of ASU 2011-07 on July 1, 2012. As such Foundation reclassified the provision for uncollectible accounts of $1,902,617 and $2,166,140 for the years ended 2013 and 2012, respectively, from operating expenses to a reduction of patient service revenue in the statement of operations. Note 17 has been updated to reflect this change. In addition, the required disclosures related to the Foundation sources of patient service revenue and changes in the allowance for doubtful accounts can be found at note 16.

ASU No. 2011-04, *Fair Value Measurement (Topic 820)*, was issued in May 2011 and is effective for Foundation beginning on July 1, 2012. The ASU was largely the result of the collaboration efforts between the FASB and International Accounting Standards Board to create a common set of accounting standards around fair value measurements. The ASU was aimed at updating previous requirements already included within Topic 820, however, new considerations from including the following: expanded disclosures around the reporting entity's valuation policies and procedures, specifically what internal reporting procedures, frequency and methods for calibration of the assets or liabilities, back-testing, how the reporting entity assessed third party information, and other methods used to develop and substantiate unobservable inputs, tabular disclosure of all transfers between Levels 1 and 2 that are held at the end of the reporting period, and the reasons for such transfers and additional tabular disclosures for Level 3 assets, including the valuation technique used, quantification of unobservable inputs, and a sensitivity analysis of changes to unobservable inputs. Foundation adopted the guidance included in ASU 2011-04 on July 1, 2012. The adoption of this ASU did not have a significant impact on the consolidated financial statements.

(2) Acquisitions

Effective July 1, 2012, Foundation became the sole member of Alliance, Inc., a not-for-profit provider of outpatient, residential, and supported employment services for persons with disabilities. No consideration was exchanged in this transaction. The merger extends the geographic reach of Foundation and its Affiliates with respect to the continuum of care for rehabilitation, vocational and outpatient services.

Effective November 1, 2012, Health System completed a statutory merger with The Hannah More Center, Inc. (a special education school in Baltimore and Anne Arundel Counties). Health System was the surviving corporation. No consideration was exchanged in this transaction. The merger enhances Foundation's vocational programming and also expands its educational offerings to Anne Arundel County.

During the year ended June 30, 2013, Family Services, acquired, KHI Services, Inc., Support Center, Inc. and GUIDE Program, Inc. No consideration was exchanged in these transactions.

The fair value of the assets and liabilities acquired as of the transaction dates are as follows:

	Alliance	Hannah More	Family Services Acquistions	Total
Current assets	$ 6,113,390	1,141,131	2,185,446	9,439,967
Noncurrent assets (primarily PP&E)	7,185,093	3,205,955	2,938,182	13,329,230
Total assets	13,298,483	4,347,086	5,123,628	22,769,197
Current liabilities	(1,705,008)	(1,656,889)	(587,563)	(3,949,460)
Noncurrent liabilities	(893,959)	—	(696,709)	(1,590,668)
Total liabilities	(2,598,967)	(1,656,889)	(1,284,272)	(5,540,128)
Temporarily restricted net assets	(3,486,917)	(152,369)	—	(3,639,286)
Inherent contribution	$ 7,212,599	2,537,828	3,839,356	13,589,783

The proforma combined financial results of Foundation giving the effect of the foregoing acquisitions, for the years ended June 30, 2013 and 2012 are provided below. Such proforma information has been prepared assuming that acquisitions occurred as of July 1, 2011:

	2013	2012
Operating revenues	$ 324,419,527	320,553,248
Operating expenses	316,086,466	316,807,611
Operating income	8,333,061	3,745,637
Nonoperating income (loss)	27,774,978	(3,291,291)
Excess of revenues over expenses	$ 36,108,039	454,346

(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, 2013 and June 30, 2012 was $7,235,960 and $6,406,558, respectively.

(Continued)

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:

		2013	2012
Board-designated, unrestricted:			
Portion of pooled investments	$	123,830,092	112,579,192
Other investments		6,501,682	6,282,133
Held by trustees:			
Under self-insurance trusts		4,170,952	4,204,037
Donor-restricted:			
Temporarily restricted portion of pooled investments		2,424,840	2,102,994
Other temporarily restricted investments		3,532,405	4,118,276
Permanently restricted portion of pooled investments		3,251,238	3,249,789
Other permanently restricted investments		652,016	649,297
Total investments limited or restricted as to use		144,363,225	133,185,718
Current portion		1,428,589	1,604,768
Investments limited or restricted as to use, less current portion	$	142,934,636	131,580,950

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:

		2013	2012
Board-designated unrestricted	$	123,830,092	112,579,192
Temporarily restricted		2,424,840	2,102,994
Permanently restricted		3,251,238	3,249,789
Total	$	129,506,170	117,931,975

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

		2013	2012
Cash and cash equivalents	$	5,319,867	2,940,772
Corporate bonds		12,667,489	12,189,553
Marketable equity securities		14,544,998	29,795,345
Mutual funds		77,515,701	52,390,654
Other (primarily alternative investments under equity method)		19,458,115	20,615,651
Total	$	129,506,170	117,931,975

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

		2013	2012
Cash and cash equivalents	$	1,233,743	941,746
Mutual funds		1,490,585	1,375,283
Real estate held for future development, at cost		3,024,071	3,024,329
Other		753,283	940,775
	$	6,501,682	6,282,133

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

		2013	2012
Cash and cash equivalents	$	571,051	605,391
Fixed income investments		3,599,901	3,598,646
	$	4,170,952	4,204,037

A Foundation trustee serves as an investment manager for a portion of the investment portfolio totaling approximately $13,000,000 as of June 30, 2013 and June 30, 2012.

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:

		2013	2012
Investment income:			
Unrestricted	$	2,319,945	2,305,099
Temporarily restricted		98,097	80,626
Permanently restricted		2,717	856
		2,420,759	2,386,581
Net realized gains on sales of investments:			
Unrestricted		6,533,386	2,152,390
Temporarily restricted		253,913	75,824
		6,787,299	2,228,214
Net unrealized (losses) gains on investments:			
Unrestricted		4,442,983	(5,339,334)
Temporarily restricted		183,643	(188,308)
Total unrealized (losses) gains		4,626,626	(5,527,642)
Total investment (loss) income		13,834,684	(912,847)
Investment income on other unrestricted investments and cash and cash equivalents		804,123	816,672
Investment income on self-insurance trust assets		500	633
Total investment (losses) income	$	14,639,307	(95,542)

(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

(Continued)

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, 2013, aggregated by the three-level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 9,694,013	—	—	9,694,013
Equities:				
Common stocks	13,928,442	—	—	13,928,442
Mutual funds	80,162,033	—	—	80,162,033
Other	792,720	—	—	792,720
Fixed income:				
Collateralized mortgage obligations	—	1,592,720	—	1,592,720
Corporate bonds	—	10,552,684	—	10,552,684
Government issued bonds	—	3,798,218	—	3,798,218
Total assets	$ 104,577,208	15,943,622	—	120,520,830
Liabilities:				
Interest rate swap	$ —	(210,214)	—	(210,214)
Total liabilities	$ —	(210,214)	—	(210,214)

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 obligations	—	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)

Foundation did not have significant transfers between Levels, or Level 3 measurements, thus, no additional disclosures were necessary.

Foundation's Level 1 securities primarily consist of common stock, 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 collateralized mortgage obligations, 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, 2013 and 2012 was approximately $33,195,000 and $34,032,000, 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 assets consist of the following at June 30:

		2013	2012
Pledges receivable, net of unamortized discount of $ 32,000 at June 30, 2013 and $64,000 at June 30, 2012	$	767,103	1,013,346
Less allowance for uncollectible pledges		18,000	40,000
Net pledges receivable		749,103	973,346
Other investments (primarily property)		7,094,874	1,458,657
Portion of pooled investments (note 4)		2,424,840	2,102,994
Restricted cash and investments		3,532,405	2,985,215
	$	13,801,222	7,520,212

The net realizable value of the unconditional pledges receivable at June 30, 2013 was calculated using an average discount rate of 3%. The net present value of pledges receivable and the expected collection period at June 30, 2013 are as follows:

2014	$	390,956
2015		255,435
2016		71,810
2017		48,902
	$	767,103

(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 each of the years ended June 30, 2013 and 2012, which resulted in an outstanding balance of $2,404,685 and $2,536,449 at June 30, 2013 and 2012, respectively. The loan bears interest at the rate of 12% per annum. Foundation has included approximately $299,000 and $315,000 of interest income from the loan in investment income during the fiscal years ended June 30, 2013 and 2012, respectively.

(8) Property and Equipment

Property and equipment at June 30 are summarized as follows:

	2013	2012
Land	$ 21,455,718	20,329,215
Land improvements	8,361,445	7,966,561
Buildings and building improvements	276,860,543	246,629,938
Furniture and equipment	62,202,013	55,185,791
Vehicles	6,998,073	5,357,084
Construction in progress	15,084,385	4,463,795
	390,962,177	339,932,384
Less accumulated depreciation	175,255,271	145,982,870
	$ 215,706,906	193,949,514

Assets under capital lease, at June 30, 2013 and 2012, of $8,159,229 and $8,032,728, respectively, were included in building and building improvements and furniture and equipment in the table above. Accumulated depreciation of assets under capital leases totaled $3,712,365 and $3,066,878 at June 30, 2013 and 2012, 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, 2013 and 2012 was $17,667,192 and $17,219,029, 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 2008 through 2013. Partial ground rent payments of $2,118,333 and $1,842,074 were accrued as a receivable at June 30, 2013 and 2012, respectively. As of June 30, 2013 and 2012, Foundation has recorded total ground rent receivable in other assets in the accompanying consolidated balance sheets of $7,410,467 and $6,838,965, respectively, with a related reserve of $5,292,134 and $4,996,891, respectively.

(9) Other Assets

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

	2013	2012
Workers' compensation excess insurance receivable	$ 121,392	298,450
Deferred financing costs	488,704	118,981
Intangible assets	1,601,300	1,307,000
Cash surrender value of life insurance and other	2,731,585	2,847,033
Interest in net assets of Hannah Moore Foundation	152,369	—
	5,095,350	4,571,464
Accumulated amortization	(476,061)	(347,101)
	$ 4,619,289	4,224,363

(10) Long-Term Debt

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

	2013	2012
Maryland Health and Higher Educational Facilities Authority (MHHEFA) Revenue Bonds, Series 2012	$ 93,148,449	96,030,993
MHHEFA Series D pooled loan program	4,365,000	4,570,000
MHHEFA Revenue Bond	7,134,408	—
Bank note	1,685,281	557,202
Mortgages on real estate	8,255,524	7,128,063
Other debt	214,038	51,000
	114,802,700	108,337,258
Less current portion	5,096,527	3,853,787
	$ 109,706,173	104,483,471

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. Both Series A and Series B debt were 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 a bank 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 with an original 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 with an original principal amount of $62,182,000 bearing interest at 77% of the sum of 1 month LIBOR plus 1.1% (1% at June 30, 2013). 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 the bank 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. At June 30, 2013 and 2012, the interest rate on this debt was approximately 0.2%.

On May 2, 2013, MHHEFA issued $7,200,000 bank-qualified tax exempt revenue bonds for the purpose of reimbursing Way Station for certain capital expenditures associated with the acquisition and development of 2 properties in Frederick, Maryland, a property in Hagerstown, Maryland, and a property in Columbia, Maryland. The bonds were purchased by a bank and Way Station is required to make payments over 15 years with a fixed interest rate of 2.645%. As part of the same transaction, the same bank loaned Way Station $1,700,000 in a taxable term loan payable over 15 years, at a fixed interest rate of 3.305%. The tax exempt and taxable terms loans are secured by a deed of trust covering six of the Company's properties in Frederick, Hagerstown, and Columbia, Maryland and these loans require Way Station to satisfy certain measures of financial performance as long as the loans are outstanding. The bank has also provided a $1,000,000 line of credit which bears interest at one-month LIBOR plus 1.5%. At June 30, 2013, there were no borrowings against the line of credit. The Company is limited in additional borrowings, which can occur without the bank's consent.

Alliance has 15 mortgages on properties in Baltimore and Harford counties with a total outstanding balance of $946,474 as of June 30, 2013, with interest rates ranging from 4% to 7.53% and maturity dates ranging from December 2013 through September 2031.

As of June 30, 2012, Way Station had a bank note on a property in the Frederick, Maryland area with a total outstanding balance of $557,202, an interest rate of 4.25% and a maturity date of 2019. In addition, Way Station had a noninterest bearing loan due in 2023 secured by a lien on one of its properties with an outstanding balance of $51,000. Both balances were repaid in 2013.

Way Station also has a mortgage on a property in the Frederick, Maryland area with a total outstanding balance of $74,311 and $77,651 at June 30, 2013 and 2012, respectively, with an interest rate of 2% and a maturity date of 2031.

Family Services has mortgages on 20 properties (15 as of June 30, 2012) in the Gaithersburg, Maryland area with a total outstanding balance of $4,984,536 and $4,674,825 at June 30, 2013 and 2012, respectively, with interest rates ranging from 1.5% to 7%, and maturity dates ranging from August 2012 to December 1, 2039. During 2013, Family Services acquired 5 additional mortgages as a result of its acquisitions of the GUIDE Program, Inc. and KHI Services, Inc.

During 2013, Family Services acquired three 0% interest rate auto loans as a result of its acquisition of the GUIDE Program, Inc. As of June 30, 2013, there is an outstanding balance of $82,808. Family Services also has a variable rate line of credit in the amount of $750,000, which is secured by certain of its assets. As of June 30, 2013, there was an outstanding balance of $83,788 on this line of credit.

Mosaic has mortgages on 22 properties in the Baltimore County and Carroll County areas with a total outstanding balance of $2,250,203 and $2,375,587 at June 30, 2013 and 2012 respectively, with interest rates ranging from 0% to 8.5%, and maturity dates ranging from March 2014 to May 2038. Mosaic also has three 0% three year vehicle financing loans as of June 30, 2013 with outstanding balances of $47,442.

In addition, Mosaic has a variable rate line of credit with a bank in the amount of $1,000,000 which is secured by certain assets of Mosaic. Mosaic had no outstanding balance on the line of credit as of June 2013 and 2012.

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

2014	$ 5,096,527
2015	9,523,509
2016	4,134,979
2017	4,259,452
2018	4,205,886
2019 and thereafter	87,582,347
	$ 114,802,700

Interest payments were $2,285,122 and $3,631,483 in 2013 and 2012, respectively.

(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, 2013 and 2012, the net present value of the estimated remaining payments of approximately $563,000 and $588,500, 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, 2013 and 2012. 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, 2013	Amounts recognized in unrestricted net assets at June 30, 2012
Net prior service cost	$	47,481	175,106	222,270
Net actuarial loss		645,368	21,354,699	35,111,974
Total	$	692,849	21,529,805	35,334,244

During 2013, the Plan was amended to permanently allow certain vested terminated participants to take a lump sum payment of Plan benefits not previously available as a lump sum in lieu of a deferred monthly benefit. This offer will be available to terminating participants with a vested benefit value of less than $25,000. Also, during 2013, a one-time opportunity was offered for participants who terminated employment previously with a benefit value of less than $25,000 to take the lump sum. As a result of these changes, Foundation made lump sum payments of approximately $733,000 in 2013.

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, are as follows:

		2013	2012
Accumulated benefit obligation at the end of the year	$	152,657,029	156,222,066
Changes in benefit obligations:			
Projected benefit obligation at the beginning of the year	$	169,860,669	140,257,297
Service cost		5,364,140	4,681,155
Interest cost		7,749,167	7,848,392
Actuarial loss (gain)		(10,995,221)	22,079,499
Benefits paid		(6,253,506)	(5,005,674)
Projected benefit obligation at the end of the year		165,725,249	169,860,669
Changes in plan assets:			
Fair value of plan assets at beginning of the year		141,842,064	131,903,909
Actual return on plan assets		10,574,525	9,943,829
Contributions to the plan		6,000,000	5,000,000
Benefits paid		(6,253,506)	(5,005,674)
Fair value of plan assets at end of the year		152,163,083	141,842,064
Funded status	$	(13,562,166)	(28,018,605)

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

		2013	2012
Service cost	$	5,364,140	4,681,155
Interest cost		7,749,167	7,848,392
Expected return on plan assets		(10,220,365)	(9,502,193)
Amortization of prior service cost		47,481	670,848
Amortization of net loss		2,407,894	25,014
Net pension expense	$	5,348,317	3,723,216

(Continued)

The following table presents the weighted average assumptions used to determine benefit obligations and net periodic benefit expense for the Plan for 2013 and 2012:

	2013	**2012**
Discount rates (benefit obligation)	5.11%	4.64%
Discount rates (benefit expense)	4.64	5.67
Rate of compensation increase	4.00	4.00
Expected long-term return on plan assets	7.10	7.10

(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%.

(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, 2013 and 2012.

(Continued)

(c) Plan Assets

Foundation's pension plan weighted average asset allocations at the measurement dates of June 30, 2013 and 2012 by asset category are as follows:

	Target allocation	2013	2012
Equity securities	46%	45%	45%
Debt securities	54	52	51
Cash and cash equivalents	—	1	1
Other (including private equity/ real estate funds)	—	2	3
	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, 2013 aggregated by the three level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 651,473	—	—	651,473
Collective trusts-equity	—	68,646,740	—	68,646,740
Collective trusts – fixed income	—	79,263,531	—	79,263,531
Private equity and real estate funds	—	—	3,601,339	3,601,339
Total assets	$ 651,473	147,910,271	3,601,339	152,163,083

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 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, 2013. 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 carried at their 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 2013, 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.

(Continued)

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, 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
Additions:		
Contributions/purchases		304,024
Disbursements:		
Withdrawals/sales		(999,388)
Realized gain (loss)		(15,139)
Net unrealized gains/(losses)		419,915
Net change		(290,588)
Balance as of June 30, 2013	$	3,601,339

(d) Contributions

Foundation contributed approximately $6 million to its pension plan for the year ended June 30, 2013 ($5 million in 2012). The Foundation expects to contribute $5 million to its pension plan during the fiscal year ended June 30, 2014.

(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:

2014	$	6,562,000
2015		7,251,000
2016		8,002,000
2017		8,753,000
2018		9,447,000
2019 – 2023		56,243,000

The expected benefits to be paid are based on the same assumptions used to measure Foundation benefit obligation at June 30, 2013.

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 $2,064,347 and $1,840,000 in 2013 and 2012, 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 2013 and 2012.

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 $6,973,655 in 2013 and $9,163,952 in 2012.

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, 2013 and 2012, these subsidiaries contributed approximately $424,740 and $390,451, 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, 2013 that have initial or remaining lease terms in excess of one year for each of the years ending June 30:

2014	$	4,057,781
2015		2,528,509
2016		1,562,795
2017		1,426,254
2018		1,299,257
Thereafter		5,837,937
Total minimum lease payments	$	16,712,533

Rent expense was approximately $6,755,014 and $5,323,426 in 2013 and 2012, 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, 2013.

2014	$	825,925
2015		819,183
2016		458,098
2017		471,842
2018		476,598
Thereafter		4,369,921
Total minimum lease payments		7,421,567
Less amount representing interest		2,094,800
Present value of net minimum lease payments		5,326,767
Less obligations under capital leases, current portion		572,098
Obligations under capital leases, less current portion	$	4,754,669

(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 approximately $571,000 and $605,000 at June 30, 2013 and 2012, respectively. The related claims liabilities of approximately $6,480,000 and $6,733,000 as of June 30, 2013 and 2012, 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, 2013 and 2012; 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.

(Continued)

Health System and Physicians are also self-insured for unemployment claims and have established a letter of credit arrangement of approximately $1,319,990 in 2013 and $1,227,000 in 2012 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, 2013 and 2012 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 approximately $4,033,000 and $3,947,000 as of June 30, 2013 and 2012, 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 approximately $1,415,000 and $1,807,000, respectively, as of June 30, 2013 and 2012.

While management believes that the provision for claims on unemployment, workers' compensation, and employee health benefits is adequate, at June 30, 2013 and 2012, the ultimate liability may be significantly different than the estimates.

(15) Net Assets

Net assets at June 30 are summarized as follows:

	2013	2012
Unrestricted:		
Undesignated	$ 161,540,300	120,580,614
Board-designated:		
Moses Sheppard bequest	38,109,781	34,417,237
Enoch Pratt bequest	24,304,842	21,949,940
Other	47,686,833	44,540,841
Total board-designated	110,101,456	100,908,018
Total unrestricted	$ 271,641,756	221,488,632

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

(Continued)

(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:

	2013	2012
Medicare	9%	13%
Medicaid	39	36
Commercial insurers and HMOs	13	15
Local government	20	20
Blue Cross/Blue Shield	10	11
Self-pay and other	9	5
	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:

	2013	2012
Medicare	$ 10,316,689	12,847,963
Medicaid	7,199,056	12,654,844
Other third-party payors	7,335,953	7,784,930
	$ 24,851,698	33,287,737

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 94% of HSCRC rates effective July 1, 2012 and 84% prior. 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, 2005. The Taylor RTC Medicaid cost report has been settled through June 30, 2004.

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 2013 and 2012, 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 approximately $762,000 and $1.9 million during the years ended June 30, 2013 and 2012, 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:

		2013	2012
Patient accounts receivable, net of contractuals	$	25,430,097	26,419,652
Residential and educational accounts receivable, net of contractuals		11,951,195	6,940,039
Less allowance for doubtful accounts		7,165,613	8,605,132
Patient accounts receivable, net	$	30,215,679	24,754,559

The activity in the allowance for bad debts is summarized as follows for the years ended June 30:

		2013	2012
Beginning Balance July 1	$	8,605,132	8,685,694
Provisions for bad debts		1,902,617	2,166,140
Less writeoffs		(3,342,136)	(2,246,702)
Ending Balance as of June 30	$	7,165,613	8,605,132

(Continued)

(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:

		2013	2012
Healthcare and educational services	$	276,614,112	239,129,180
General and administrative		33,928,606	36,284,579
	$	310,542,718	275,413,759

(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
- 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.

(Continued)

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 healthcare 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 2013 or the 2012 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, 2013

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	—	3,903,254	3,903,254
Board-designated endowment funds	110,101,456	—	—	110,101,456
	$ 110,101,456	—	3,903,254	114,004,710

Changes in endowment net assets for the year ended June 30, 2013:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets beginning of year	$ 100,908,018	—	3,899,086	104,807,104
Investment return:				
Investment income	2,125,625	—	—	2,125,625
Net appreciation (realized and unrealized gains and losses)	8,879,813	—	2,717	8,882,530
Total investment return	11,005,438	—	2,717	11,008,155
Contributions	—	—	1,451	1,451
Appropriation of endowment assets for expenditure	(1,812,000)	—	—	(1,812,000)
	$ 110,101,456	—	3,903,254	114,004,710

(c) 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

(Continued)

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

(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

Foundation has evaluated all events and transactions from the balance sheet date through October 4, 2013, the date at which the financial statements were issued, and determined there are no other items to be recognized or disclosed.

SUPPLEMENTARY INFORMATION

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2013

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	$ 328,076	51,812,022	—	1,192,566	—	53,332,664
Investments limited or restricted as to use	298,565	—	—	—	—	298,565
Accounts receivable, net	—	20,228,096	—	711,410	—	20,939,506
Due from affiliates	—	1,392,335	3,546,016	61,781	(4,387,789)	612,343
Prepaid expenses and other current assets	—	4,810,547	—	273,498	—	5,084,045
Total current assets	626,641	78,243,000	3,546,016	2,239,255	(4,387,789)	80,267,123
Investments limited or restricted as to use, less current portion	8,644,928	27,231,306	105,217,817	—	—	141,094,051
Interest in net assets of Foundation	—	7,867,028	—	—	(7,867,028)	—
Notes receivable	—	—	2,404,685	—	—	2,404,685
Property and equipment, net	—	166,044,885	—	—	—	166,044,885
Other assets	—	3,038,267	486,500	—	—	3,524,767
Total assets	$ 9,271,569	282,424,486	111,655,018	2,239,255	(12,254,817)	393,335,511
Liabilities and Net Assets						
Current liabilities:						
Current maturities of long-term debt	$ —	3,082,299	—	—	—	3,082,299
Current portion of obligations under capital leases	—	543,811	—	—	—	543,811
Accounts payable	—	4,739,480	—	533,937	—	5,273,417
Accrued salaries, wages and employee benefits	—	15,431,054	—	2,705,268	—	18,136,322
Third-party payor settlements payable	—	371,024	—	—	—	371,024
Due to affiliates	293,879	3,769,389	1,218,909	316,614	(4,176,358)	1,422,433
Self-insurance liabilities	—	4,630,419	—	210,767	—	4,841,186
Other accrued expenses	211,432	1,951,991	334,653	162,289	(211,431)	2,448,934
Total current liabilities	505,311	34,519,467	1,553,562	3,928,875	(4,387,789)	36,119,426
Long-term liabilities:						
Long-term debt, less current portion	—	90,066,150	—	—	—	90,066,150
Obligations under capitalized leases, less current portion	—	4,664,888	—	—	—	4,664,888
Self-insurance liabilities	—	6,480,298	—	—	—	6,480,298
Accrued pension liabilities	—	9,230,784	—	4,331,382	—	13,562,166
Other long-term liabilities	563,018	—	—	—	—	563,018
Total liabilities	1,068,329	144,961,587	1,553,562	8,260,257	(4,387,789)	151,455,946
Net assets (deficit):						
Unrestricted	34,196	129,443,502	110,101,456	(6,021,002)	—	233,558,152
Temporarily restricted	4,615,790	8,019,397	—	—	(7,867,028)	4,768,159
Permanently restricted	3,553,254	—	—	—	—	3,553,254
Total net assets	8,203,240	137,462,899	110,101,456	(6,021,002)	(7,867,028)	241,879,565
Total liabilities and net assets	$ 9,271,569	282,424,486	111,655,018	2,239,255	(12,254,817)	393,335,511

(Continued)

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2013

Assets	Alliance, Inc.	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	$ 2,072,286	1,435,133	2,745,629	1,380,339	7,078,420		68,044,471
Investments limited or restricted as to use	125,066	—	346,784	—	658,174	—	1,428,589
Accounts receivable, net	3,990,430	1,991,783	2,035,685	—	1,258,275	—	30,215,679
Due from affiliates	—	1,234	36,174	42,139	217,000	(908,890)	—
Prepaid expenses and other current assets	255,187	573,158	1,154,213	—	1,502,067	—	8,568,670
Total current assets	6,442,969	4,001,308	6,318,485	1,422,478	10,713,936	(908,890)	108,257,409
Investments limited or restricted as to use, less current portion	—	—	1,840,585	—	1,198,588	(1,198,588)	142,934,636
Interest in net assets of Foundation	—	—	—	—	—	—	—
Notes receivable	—	—	—	—	—	—	2,404,685
Property and equipment, net	7,036,468	9,666,173	12,738,642	471,511	20,089,634	(340,407)	215,706,906
Other assets	49,246	28,806	179,100	—	837,370	—	4,619,289
Total assets	$ 13,528,683	13,696,287	21,076,812	1,893,989	32,839,528	(2,447,885)	473,922,925
Liabilities and Net Assets							
Current liabilities:							
Current maturities of long-term debt	$ 82,278	988,105	495,719	—	448,126	—	5,096,527
Current portion of obligations under capital leases	—	—	28,287	—	—	—	572,098
Accounts payable	499,087	456,324	548,904	—	200,891	—	6,978,623
Accrued salaries, wages and employee benefits	534,498	1,454,231	2,201,755	—	1,921,902	—	24,248,708
Third-party payor settlements payable	—	—	—	—	—	—	371,024
Due to affiliates	—	32,610	180,877	—	149,670	(1,785,590)	—
Self-insurance liabilities	—	—	138,215	—	346,631	—	5,326,032
Other accrued expenses	933,746	289,169	270,778	—	446,949	(100,615)	4,288,961
Total current liabilities	2,049,609	3,220,439	3,864,535	—	3,514,169	(1,886,205)	46,881,973
Long-term liabilities:							
Long-term debt, less current portion	864,195	4,163,027	6,166,927	—	8,445,874	—	109,706,173
Obligations under capitalized leases, less current portion	—	—	89,781	—	—	—	4,754,669
Self-insurance liabilities	—	—	—	—	121,392	—	6,601,690
Accrued pension liabilities	—	—	—	—	—	—	13,562,166
Other long-term liabilities	86,308	210,252	701,036	—	1,755,681	(246,273)	3,070,022
Total liabilities	3,000,112	7,593,718	10,822,279	—	13,837,116	(2,132,478)	184,576,693
Net assets (deficit):							
Unrestricted	7,041,654	6,102,569	9,535,683	1,591,437	14,152,668	(340,407)	271,641,756
Temporarily restricted	3,486,917	—	368,850	302,552	4,849,744	25,000	13,801,222
Permanently restricted	—	—	350,000	—	—	—	3,903,254
Total net assets	10,528,571	6,102,569	10,254,533	1,893,989	19,002,412	(315,407)	289,346,232
Total liabilities and net assets	$ 13,528,683	13,696,287	21,076,812	1,893,989	32,839,528	(2,447,885)	473,922,925

See accompanying independent auditors' report.

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2013

	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:						
Patient service revenue (net of allowances and discounts)	$ —	114,685,337	—	12,332,986	—	127,018,323
Residential and educational service revenue	—	74,231,849	—	—	—	74,231,849
Total net service revenue	—	188,917,186	—	12,332,986	—	201,250,172
Less provision for bad debts	—	762,152	—	275,339	—	1,037,491
Net service revenue less provision for bad debts	—	188,155,034	—	12,057,647	—	200,212,681
Net assets released from restrictions used for operations	—	1,007,761	—	—	—	1,007,761
Other revenue	—	12,035,205	—	14,519,397	(13,262,947)	13,291,655
Total unrestricted revenues, gains, and other support	—	201,198,000	—	26,577,044	(13,262,947)	214,512,097
Expenses:						
Salaries and wages	—	99,970,050	—	20,030,798	—	120,000,848
Employee benefits	—	22,155,031	—	3,272,102	—	25,427,133
Expendable supplies	—	12,481,338	—	94	—	12,481,432
Purchased services	3,173	34,586,799	—	5,837,050	(13,497,022)	26,930,000
Interest	—	1,944,266	—	109	—	1,944,375
Repairs and minor alterations	—	5,979,690	—	—	—	5,979,690
Depreciation and amortization	—	14,094,960	—	—	—	14,094,960
Realized loss on disposal of assets, net	—	28,554	—	—	—	28,554
Total expenses	3,173	191,240,688	—	29,140,153	(13,497,022)	206,886,992
Operating income (loss)	(3,173)	9,957,312	—	(2,563,109)	234,075	7,625,105
Other income (expense):						
Investment income	—	403,571	2,125,625	—	(234,075)	2,295,121
Realized gain on investments, net	—	1,132,189	5,343,912	—	—	6,476,101
Change in unrealized (loss) gain on investments, net	—	757,939	3,577,516	—	—	4,335,455
Inherent contribution	—	2,537,828	—	—	—	2,537,828
Other	—	930,495	(41,614)	—	—	888,881
Total other income (expense)	—	5,762,022	11,005,439	—	(234,075)	16,533,386
Excess (deficiency) of revenues over expenses	(3,173)	15,719,334	11,005,439	(2,563,109)	—	24,158,491
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	465,677	—	—	—	465,677
Transfer from (to) affiliates	—	512,000	(1,812,000)	1,300,000	—	—
Pension liability adjustment	—	13,804,439	—	—	—	13,804,439
Capital grants	—	59,836	—	—	—	59,836
Reclassification of net assets	—	—	—	—	—	—
Increase (decrease) in unrestricted net assets	$ (3,173)	30,561,286	9,193,439	(1,263,109)	—	38,488,443

(Continued)

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2013

	Alliance, Inc.	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:							
Patient service revenue (net of allowances and discounts)	$ —	—	—	—	—	—	127,018,323
Residential and educational service revenue	13,435,237	18,439,456	28,328,887	—	19,910,942	—	154,346,371
Total net service revenue	13,435,237	18,439,456	28,328,887	—	19,910,942	—	281,364,694
Less provision for bad debts	32,101	374,412	363,704	—	94,909	—	1,902,617
Net service revenue less provision for bad debts	13,403,136	18,065,044	27,965,183	—	19,816,033	—	279,462,077
Net assets released from restrictions used for operations	—	—	37,380	—	463,119	—	1,508,260
Other revenue	13,843,073	193,629	4,929,773	85,092	6,460,864	(1,024,779)	37,779,307
Total unrestricted revenues, gains, and other support	27,246,209	18,258,673	32,932,336	85,092	26,740,016	(1,024,779)	318,749,644
Expenses:							
Salaries and wages	16,926,392	9,501,723	18,522,882	—	16,553,196	—	181,505,041
Employee benefits	2,847,739	3,264,288	3,035,030	—	3,253,168	—	37,827,358
Expendable supplies	2,795,013	1,068,655	1,550,682	—	1,269,670	—	19,165,452
Purchased services	3,829,032	3,875,723	6,982,110	83,400	2,970,139	(1,024,779)	43,645,625
Interest	73,961	210,843	235,801	—	103,849	—	2,568,829
Repairs and minor alterations	286,373	290,364	965,073	—	594,014	—	8,115,514
Depreciation and amortization	658,644	618,986	1,515,413	14,001	782,071	—	17,684,075
Realized loss on disposal of assets, net	—	4,280	(2,010)	(340,407)	—	340,407	30,824
Total expenses	27,417,154	18,834,862	32,804,981	(243,006)	25,526,107	(684,372)	310,542,718
Operating income (loss)	(170,945)	(576,189)	127,355	328,098	1,213,909	(340,407)	8,206,926
Other income:							
Investment income	—	—	—	1,559	23,265	—	2,319,945
Realized gain on investments, net	—	—	—	—	57,285	—	6,533,386
Change in unrealized gain on investments, net	—	15,955	53,223	—	38,350	—	4,442,983
Inherent contribution	7,212,599	3,839,356	—	—	—	—	13,589,783
Other	—	—	—	—	—	—	888,881
Total other income	7,212,599	3,855,311	53,223	1,559	118,900	—	27,774,978
Excess of revenues over expenses	7,041,654	3,279,122	180,578	329,657	1,332,809	(340,407)	35,981,904
Other changes in net assets:							
Net assets released from restrictions used for purchases of property and equipment	—	—	—	—	42,977	—	508,654
Transfer from (to) affiliates	—	—	—	—	—	—	—
Pension liability adjustment	—	—	—	—	—	—	13,804,439
Capital grants	—	230,943	34,900	—	—	—	325,679
Reclassification of net assets	—	—	—	(302,552)	(165,000)	—	(467,552)
Increase (decrease) in unrestricted net assets	$ 7,041,654	3,510,065	215,478	27,105	1,210,786	(340,407)	50,153,124

See accompanying independent auditors' report.

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2013

	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	$ (3,173)	15,719,334	11,005,439	(2,563,109)	—	24,158,491
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	465,677	—	—	—	465,677
Transfer from (to) affiliates	—	512,000	(1,812,000)	1,300,000	—	—
Pension liability adjustment	—	13,804,439	—	—	—	13,804,439
Capital grants	—	59,836	—	—	—	59,836
Reclassification of net assets	—	—	—	—	—	—
Increase (decrease) in unrestricted net assets	(3,173)	30,561,286	9,193,439	(1,263,109)	—	38,488,443
Temporarily restricted net assets:						
Gifts and grants	10,000	605,932	—	—	—	615,932
Investment income	—	89,848	—	—	—	89,848
Net gain on investments	—	423,896	—	—	—	423,896
Interest in net assets of Foundation	—	7,789,885	—	—	(7,789,885)	—
Transfer from (to) affiliates	4,528,646	(4,570,645)	—	—	—	(41,999)
Net assets released from restrictions	—	(1,473,438)	—	—	—	(1,473,438)
Inherent contribution	—	152,369	—	—	—	152,369
Reclassification of net assets	—	—	—	—	—	—
Increase (decrease) in temporarily restricted net assets	4,538,646	3,017,847	—	—	(7,789,885)	(233,392)
Permanently restricted net assets:						
Gifts	—	1,451	—	—	—	1,451
Investment income	2,717	—	—	—	—	2,717
Transfer from (to) affiliates	3,251,239	(3,251,239)	—	—	—	—
Reclassification of net assets	—	—	—	—	—	—
Increase (decrease) in permanently restricted net assets	3,253,956	(3,249,788)	—	—	—	4,168
Increase (decrease) in net assets	7,789,429	30,329,345	9,193,439	(1,263,109)	(7,789,885)	38,259,219
Net assets (deficit), beginning of year	413,811	107,133,554	100,908,017	(4,757,893)	(77,143)	203,620,346
Net assets (deficit), end of year	$ 8,203,240	137,462,899	110,101,456	(6,021,002)	(7,867,028)	241,879,565

See accompanying independent auditors' report.

(Continued)

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2013

	Alliance, Inc.	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 of revenues over expenses	$ 7,041,654	3,279,122	180,578	329,657	1,332,809	(340,407)	35,981,904
Other changes in net assets:							
Net assets released from restrictions used for purchases of property and equipment	—	—	—	—	42,977	—	508,654
Transfer from (to) affiliates	—	—	—	—	—	—	—
Pension liability adjustment	—	—	—	—	—	—	13,804,439
Capital grants	—	230,943	34,900	—	—	—	325,679
Reclassification of net assets	—	—	—	(302,552)	(165,000)	—	(467,552)
Increase (decrease) in unrestricted net assets	7,041,654	3,510,065	215,478	27,105	1,210,786	(340,407)	50,153,124
Temporarily restricted net assets:							
Gifts and grants	—	—	124,569	—	2,914,932	—	3,655,433
Investment income	—	—	8,249	—	—	—	98,097
Net gain on investments	—	—	13,660	—	—	—	437,556
Interest in net assets of Foundation	—	—	—	—	—	—	—
Transfer from affiliates	—	—	11,842	—	5,157	25,000	—
Net assets released from restrictions	—	—	(37,380)	—	(506,096)	—	(2,016,914)
Inherent contribution	3,486,917	—	—	—	—	—	3,639,286
Reclassification of net assets	—	—	—	302,552	165,000	—	467,552
Increase in temporarily restricted net assets	3,486,917	—	120,940	302,552	2,578,993	25,000	6,281,010
Permanently restricted net assets:							
Gifts	—	—	—	—	—	—	1,451
Investment income	—	—	—	—	—	—	2,717
Transfer from (to) affiliates	—	—	—	—	—	—	—
Reclassification of net assets	—	—	—	—	—	—	—
Increase in permanently restricted net assets	—	—	—	—	—	—	4,168
Increase in net assets	10,528,571	3,510,065	336,418	329,657	3,789,779	(315,407)	56,438,302
Net assets, beginning of year	—	2,592,504	9,918,115	1,564,332	15,212,633	—	232,907,930
Net assets, end of year	$ 10,528,571	6,102,569	10,254,533	1,893,989	19,002,412	(315,407)	289,346,232

See accompanying independent auditors' report.