SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Financial Statements and Other Financial Information

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Table of Contents

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

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries (collectively, Foundation) as of June 30, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries as of June 30, 2011 and 2010, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 13, 2011

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2011 and 2010

Assets	**2011**	**2010**
Current assets:		
Cash and cash equivalents	$ 40,283,644	40,342,845
Temporary investments	757,761	735,545
Investments limited or restricted as to use	4,245,009	2,978,971
Accounts receivable, net	31,201,580	29,117,328
Prepaid expenses and other current assets	6,910,597	7,085,461
Total current assets	83,398,591	80,260,150
Investments limited or restricted as to use, less current portion	140,398,317	123,263,426
Notes receivable	2,668,212	2,865,469
Property and equipment, net	198,683,576	190,946,694
Other assets	4,962,696	6,585,194
Total assets	$ 430,111,392	403,920,933
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt	$ 4,536,075	4,355,042
Current portion of obligations under capital leases	415,702	427,467
Accounts payable	8,584,590	7,293,981
Accrued salaries, wages, and employee benefits	20,560,659	19,218,715
Third-party payor settlements payable	2,055,490	3,871,279
Other accrued expenses	7,005,567	6,920,213
Total current liabilities	43,158,083	42,086,697
Long-term liabilities:		
Long-term debt, less current portion	114,104,923	109,555,839
Obligations under capitalized leases, less current portion	5,164,729	4,585,496
Self-insurance liabilities	6,593,021	4,688,915
Accrued pension liabilities	8,353,388	34,905,313
Other long-term liabilities	1,978,715	2,166,218
Total liabilities	179,352,859	197,988,478
Net assets:		
Unrestricted	240,204,189	196,455,886
Temporarily restricted	6,720,013	6,008,074
Permanently restricted	3,834,331	3,468,495
Total net assets	250,758,533	205,932,455
Total liabilities and net assets	$ 430,111,392	403,920,933

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2011 and 2010

		2011	2010
Unrestricted revenues, gains, and other support:			
Net patient service revenue	$	120,683,587	114,677,146
Residential and educational service revenue		129,056,371	127,186,460
Net assets released from restrictions used for operations		954,683	1,221,420
Realized gain on disposal of assets		—	19,100
Other revenue		22,749,954	21,621,637
Total unrestricted revenues, gains, and other support		273,444,595	264,725,763
Expenses:			
Salaries and wages		148,976,358	143,408,801
Employee benefits		36,605,919	34,096,512
Expendable supplies		15,429,466	15,200,481
Purchased services		38,374,096	38,104,502
Interest		3,927,742	3,892,519
Repairs and minor alterations		7,573,483	6,583,953
Depreciation and amortization		15,229,135	14,889,995
Provision for doubtful accounts		6,287,412	7,544,158
Realized loss on disposal of assets, net		46,857	—
Total expenses		272,450,468	263,720,921
Operating income		994,127	1,004,842
Other income:			
Investment income		2,293,975	2,329,920
Realized gain on investments, net		3,802,423	4,391,858
Change in unrealized gain on investments, net		14,023,212	6,086,719
Other		1,399,132	490,397
Total other income		21,518,742	13,298,894
Excess of revenues over expenses		22,512,869	14,303,736
Other changes in net assets:			
Net assets released from restrictions used for purchases of property and equipment		703,441	317,155
Pension liability adjustment		21,837,835	(10,998,679)
Capital grants		312,422	—
Impairment of goodwill		(1,618,264)	—
Reclassification of net assets		—	450,057
Increase in unrestricted net assets	$	43,748,303	4,072,269

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, 2011 and 2010

	2011	2010
Unrestricted net assets:		
Excess of revenues over expenses	$ 22,512,869	14,303,736
Other changes in net assets:		
Net assets released from restrictions used for purchases of property and equipment	703,441	317,155
Pension liability adjustment	21,837,835	(10,998,679)
Capital grant	312,422	—
Impairment of goodwill	(1,618,264)	—
Reclassification of net assets	—	450,057
Increase in unrestricted net assets	43,748,303	4,072,269
Temporarily restricted net assets:		
Gifts	1,643,244	925,577
Investment income	105,821	98,629
Net gain on investments	850,933	349,655
Net assets released from restrictions for operations	(954,683)	(1,221,420)
Net assets released from restrictions for purchases of property and equipment	(703,441)	(317,155)
Reclassification of net assets	(229,935)	(450,057)
Increase (decrease) in temporarily restricted net assets	711,939	(614,771)
Permanently restricted net assets:		
Gifts	51,800	1,500
Investment income	84,101	43,520
Reclassification of net assets	229,935	—
Increase in permanently restricted net assets	365,836	45,020
Increase in net assets	44,826,078	3,502,518
Net assets, beginning of year	205,932,455	202,429,937
Net assets, end of year	$ 250,758,533	205,932,455

See accompanying notes to consolidated financial statements.

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Increase in net assets	$ 44,826,078	3,502,518
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	15,229,135	14,889,995
Pension liability adjustment	(21,837,835)	10,998,679
Provision for doubtful accounts	6,287,412	7,544,158
Restricted gifts, net	(740,361)	294,343
Net realized gain on investments	(3,981,703)	(4,503,493)
Net unrealized loss on investments	(14,694,865)	(6,324,739)
Restricted investment income on restricted net assets	(189,922)	(142,149)
Impairment of goodwill	1,618,264	—
Unrealized gain on interest rate swaps	(190,823)	(57,430)
Net settlement on interest rate swaps	238,736	244,062
Loss (gain) on disposal of assets	46,857	(19,100)
Increase in accounts receivable, net	(8,371,664)	(8,471,095)
Decrease in prepaid expenses and other current assets	174,864	2,074,056
Increase in accounts payable and accrued expenses and other	2,721,227	736,151
Increase (decrease) increase in self-insurance liabilities	1,904,106	(21,547)
Decrease in third-party payor settlements payable	(1,815,789)	(454,255)
(Decrease) increase in accrued pension liability	(4,714,090)	6,070,202
Net cash provided by operating activities	16,509,627	26,360,356
Cash flows from investing activities:		
Purchases of property and equipment	(21,789,628)	(9,205,822)
Increase (decrease) in temporary investments	(22,216)	49,978
Increase in other assets	(230,845)	(779,999)
Decrease in notes receivable	197,257	16,293
Proceeds from sale of property and equipment	6,833	882,687
Decrease in investments limited or restricted as to use, net	465,561	2,991,405
Net settlement on interest rate swaps	(238,736)	(244,062)
Net cash used in investing activities	(21,611,774)	(6,289,520)
Cash flows from financing activities:		
Proceeds from debt	8,932,594	15,311,800
Payment of note payable	—	(16,900,000)
Payment of long-term debt principal	(4,202,477)	(3,428,113)
Payment on capital lease obligations	(427,532)	(384,509)
Restricted gifts, net	740,361	(294,343)
Net cash provided by (used in) financing activities	5,042,946	(5,695,165)
Net (decrease) increase in cash and cash equivalents	(59,201)	14,375,671
Cash and cash equivalents, beginning of year	40,342,845	25,967,174
Cash and cash equivalents, end of year	$ 40,283,644	40,342,845

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

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

Effective July 1, 2010, North Baltimore merged into Mosaic under a statutory merger in which Mosaic was the surviving corporation. All assets and liabilities of North Baltimore were recorded on Mosaic’s balance sheet at July 1, 2010. No consideration was exchanged in this transaction. Mosaic accounted for the North Baltimore transaction in accordance with ASC 805, *Business Combinations*. The assets and liabilities of North Baltimore were recorded at the carrying value as of the acquisition date because the two entities were under common control.

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, 2011 and 2010.

(b) Basis of Presentation

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

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

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

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

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

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

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

(c) Charity Care

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

(d) Cash and Cash Equivalents

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

(e) Temporary Investments

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

(f) Allowance for Doubtful Accounts

Foundation's policy is to write off all accounts that have been identified as uncollectible. An allowance for uncollectibles is recorded for accounts not yet written off that are anticipated to become uncollectible in future periods. Insurance coverage and credit information are obtained from patients when available. No collateral is obtained for accounts receivable. Accounts receivable from third-party payors have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

(g) Investments Limited as to Use

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

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

Investments are recorded at fair value. Foundation classifies its investment portfolio as trading securities with unrealized gains and losses included in other income, which is in the excess of revenues over expenses. Realized gains or losses are included in other income in the accompanying statements of operations. The investment portfolio is classified as current or noncurrent assets based on management's intention as to use.

Hedge funds 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 hedge fund 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

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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.

(h) Pledges

Pledges, less an allowance for uncollectible amounts, are recorded as receivables in the year the pledge is made unless the pledge carries conditions that have not been met. Conditional pledges are recorded as contributions when the conditions of the pledge have been satisfied. Pledges receivable are recorded at net realizable value which is calculated using a discount rate of 5% at June 30, 2011 and 2010.

(i) Property and Equipment

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

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

(j) Costs of Borrowing

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

(k) Estimated Self-Insurance Liability Claims

The estimated self-insured professional liability claims are reflected as a liability and include actuarially determined estimates of the ultimate costs for both reported claims and claims incurred but not reported. Costs under self-insurance programs for employee health benefits and workers' compensation include estimates for both reported claims and claims incurred but not reported, based on an evaluation of pending claims and past experience. These estimates are based on actuarial analysis of historical trends, claims asserted and reported incidents.

(l) Pension Benefits

Pension benefits are recorded in accordance with *Defined Benefit Plans-Pension* (ASC Subtopic 715-30), which requires the recognition of the funded status of pension plans within the accompanying balance sheets. As of June 30, 2011 and 2010, the funded status of the pension plan has been recorded within long-term liabilities.

(m) Patient Service Revenue

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

Foundation's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered, (note 15).

(n) Residential and Educational Service Revenue

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

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

(o) Investment Income

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

Investment income and realized gains and losses from all other investments are reported as other income, unless the income is restricted by donors that is reported as previously described above.

Unrealized gains and losses on trading securities are included as a component of other income (expense).

(p) 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.

(q) 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.

(r) 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.

(s) 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 net operating losses of $1.4 million, which expire at various dates through 2030. The Foundation’s deferred tax assets, including the asset related to its net operating losses, are fully reserved as they are not expected to be utilized. Foundation accounts for income taxes under ASC 740, *Income Taxes*.

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(t) 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.

(u) Derivative Instruments

Derivatives and Hedging – Overall (ASC Subtopic 815-10) establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. ASC Subtopic 815-10 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Foundation's interest rate swaps do not qualify for hedge accounting under the provisions of ASC Subtopic 815-10; therefore, Foundation has accounted for these derivative instruments as speculative derivative instruments with the change in the fair value reflected in other income (expense) in the consolidated statements of operations in the period of change. The net settlement payments made or received during the life of the swap are recorded as an increase or decrease to other income. See note 10.

(v) 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.

(w) Reclassifications

Certain reclassifications have been made to the prior year balances to conform to the current year presentation.

(2) New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06 (ASU 2010-06), *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends ASC Topic 820, *Fair Value Measurements and Disclosures*, to require a number of additional disclosures regarding fair value measurements. Effective in fiscal year 2010, ASU 2010-06 requires disclosure of the amounts of significant transfers between Level I and Level II investments and the reasons for such transfers, the reasons for any transfers in or out of Level III investments, and disclosure of the policy for determining when transfers among levels are recognized. ASU 2010-06 also clarified that disclosures should be provided for each class of assets and liabilities and clarified the requirement to disclose information about the valuation techniques and inputs used in estimating Level II and Level III measurements. Effective in fiscal year 2011, ASU 2010-06 also requires that information in the reconciliation of recurring Level III measurements about purchases, sales, issuances, and settlements be provided on a gross basis. The adoption of ASU 2010-06 only required additional disclosures and did not have an impact on the consolidated financial statements. Foundation did not have significant transfers between Levels, or Level III measurements, thus, no additional disclosures were necessary.

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

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

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24), which clarified that a healthcare entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The adoption of ASU 2010-24 is effective beginning July 1, 2011 and is not expected to have an impact on Foundation's consolidated financial statements.

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

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

(3) Charity Care and Community Services

Foundation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The following information measures the estimated level of charity care provided during the years ended June 30:

		2011	2010
Charges foregone, based upon established rates	$	4,360,616	8,200,330
Percentage of charges foregone to gross patient service revenue		1.97%	3.64%

In addition to the direct charity care noted above, 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:

		2011	2010
Medicare	$	13,218,295	13,342,097
Medicaid		12,436,918	11,817,667
Other third-party payors		7,275,304	7,566,346
	$	32,930,517	32,726,110

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.

(Continued)

(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 hedge funds, which are recorded under the equity method include the following at June 30:

	2011	2010
Board-designated, unrestricted:		
Portion of pooled investments	$ 114,464,869	96,099,110
Other investments	6,406,896	5,939,603
Held by trustees:		
Under self-insurance trusts	4,271,174	4,595,465
Under bond indentures	10,119,332	11,376,517
Donor-restricted:		
Temporarily restricted portion of pooled investments	2,295,497	1,801,509
Other temporarily restricted investments	3,251,227	2,961,698
Permanently restricted portion of pooled investments	3,185,889	2,904,154
Other permanently restricted investments	648,442	564,341
Total investments limited or restricted as to use	144,643,326	126,242,397
Current portion	4,245,009	2,978,971
Investments limited or restricted as to use, less current portion	$ 140,398,317	123,263,426

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:

	2011	2010
Board-designated unrestricted	$ 114,464,869	96,099,110
Temporarily restricted	2,295,497	1,801,509
Permanently restricted	3,185,889	2,904,154
Total	$ 119,946,255	100,804,773

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

		2011	2010
Cash and cash equivalents	$	4,608,023	808,333
Corporate bonds		12,285,804	12,154,453
Marketable equity securities		31,568,099	24,198,287
Mutual funds		51,237,640	46,361,020
Other (including hedge funds under equity method)		20,246,689	17,282,680
Total	$	119,946,255	100,804,773

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

		2011	2010
Cash and cash equivalents	$	1,366,992	1,709,127
Mutual funds		1,055,482	—
Real estate held for future development, at cost		3,031,370	3,038,410
Other		953,052	1,192,066
	$	6,406,896	5,939,603

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

		2011	2010
Cash and cash equivalents	$	192	6,663
Fixed income investments		3,598,614	3,605,066
Equity investments		672,368	983,736
	$	4,271,174	4,595,465

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

		2011	2010
Interest Fund	$	936,337	958,478
Debt Service Reserve Fund		5,956,692	5,978,249
Debt Service Principal Fund for 2003 Bonds		1,920,002	1,860,014
Prefunded Bonds, North Baltimore and Mosaic		1,177,894	2,459,863
Sinking Fund for Way Station Debt		128,407	119,913
	$	10,119,332	11,376,517

(Continued)

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

		2011	**2010**
Cash and cash equivalents	$	3,040,474	6,115,799
Fixed income investments		7,078,858	5,260,718
	$	10,119,332	11,376,517

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:

		2011	**2010**
Investment income:			
Unrestricted	$	2,271,774	2,329,920
Temporarily restricted		105,821	98,629
Permanently restricted		84,101	43,520
		2,461,696	2,472,069
Net realized gains on sales of investments:			
Unrestricted		3,785,369	4,385,609
Temporarily restricted		176,655	111,635
		3,962,024	4,497,244
Net unrealized gains on investments:			
Unrestricted		13,996,965	6,071,433
Temporarily restricted		671,653	238,020
Total unrealized gains		14,668,618	6,309,453
Total investment return on combined investment pool		21,092,338	13,278,766
Investment return on other unrestricted investments and cash and cash equivalents		527,757	602,945
Investment income on self-insurance trust assets		37,011	66,887
Total investment return	$	21,657,106	13,948,598

(Continued)

(5) Disclosures about Fair Value of Financial Instruments

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

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

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

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

(Continued)

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

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

The table below presents Foundation's investable assets and liabilities as of June 30, 2010, aggregated by the three-level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 11,596,497	—	—	11,596,497
Equities:				
Common stocks	23,357,018	—	—	23,357,018
Mutual funds	41,706,326	3,573,285	—	45,279,611
Other	938,061	—	—	938,061
Fixed income:				
Corporate bonds	—	14,491,602	—	14,491,602
Government issued bonds	—	8,916,144	—	8,916,144
Total assets	$ 77,597,902	26,981,031	—	104,578,933
Liabilities:				
Interest rate swap	$ —	(446,714)	—	(446,714)
Total liabilities	$ —	(446,714)	—	(446,714)

Certain of Foundation's equity mutual funds investments were transferred from Level 2 to Level 1 during fiscal 2011 due to the increased liquidity of the funds.

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

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

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

The carrying amount of cash and cash equivalents, accounts receivable, third-party payor settlements receivable or payable, other current assets, accounts payable, 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 2003 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 2003 Bonds is approximately $32,809,766 and $35,252,000 at June 30, 2011 and 2010, respectively. The carrying value for these bonds is $37,835,000 and $39,070,000 at June 30, 2011 and 2010, respectively. Due to the subjective nature of the terms of the Foundation's notes receivable and capital lease obligations, their fair values cannot be estimated.

(6) Temporarily Restricted Assets

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

	2011	2010
Pledges receivable, net of unamortized discount of $85,977 at June 30, 2011 and $130,000 at June 30, 2010	$ 946,001	1,563,423
Less allowance for uncollectible pledges	62,000	63,000
Net pledges receivable	884,001	1,500,423
Other investments	3,230,342	2,415,101
Portion of pooled investments (note 4)	2,295,497	1,801,509
Way Station restricted cash	164,915	204,624
Mosaic restricted investments	145,258	86,417
	$ 6,720,013	6,008,074

The net realizable value of the unconditional pledges receivable at June 30, 2011 was calculated using an average discount rate of 5%. The net present value of pledges receivable and the expected collection period at June 30, 2011 are as follows:

2012	$	594,738
2013		182,591
2014		106,423
2015		56,475
2016		5,774
	$	946,001

(7) Note Receivable

In connection with the land lease described in note 7, Investment Company provided a loan and a line of credit to the Maryland Economic Development Company (MEDCO) to help finance the development of university student housing located on the campus of Foundation. The unsecured term loan of $3.75 million is payable in equal quarterly installments between the initial repayment date (January 2004) and June 30, 2031. MEDCO repaid approximately $132,000 during the years ended June 30, 2011 and 2010, respectively, which resulted in an outstanding balance of $2,668,212 and $2,799,976 at June 30, 2011 and 2010, respectively. The loan bears interest at the rate of 12% per annum. Foundation has included approximately $335,000 and $347,000 of interest income from the loan in investment income during the fiscal years ended June 30, 2011 and 2010, respectively.

(8) Property and Equipment

Property and equipment at June 30 are summarized as follows:

		2011	2010
Land	$	19,744,689	10,453,832
Land improvements		7,584,934	8,708,454
Buildings and building improvements		239,641,581	231,501,539
Furniture and equipment		52,942,970	49,283,134
Vehicles		5,135,543	4,888,080
Construction in progress		4,266,560	2,708,234
		329,316,277	307,543,273
Less accumulated depreciation		130,632,701	116,596,579
	$	198,683,576	190,946,694

Assets under capital lease, at June 30, 2011 and 2010, of $7,626,566 and $6,631,630, respectively, were included in building and building improvements and furniture and equipment in the table above. Accumulated depreciation of assets under capital leases totaled $2,567,285 and $1,945,059 at June 30, 2011 and 2010, respectively.

Certain land, buildings, improvements, and equipment are pledged as collateral for the debt described in note 9.

Depreciation expense for the years ended June 30, 2011 and 2010 was $14,994,056 and $14,716,393, 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 2006 through 2010. A partial ground rent payment of $1,387,949 and $1,081,632 was accrued as a receivable at June 30, 2011 and 2010, respectively. As of June 30, 2011 and 2010, Foundation has recorded total ground rent receivable in prepaid expenses and other current assets in the accompanying consolidated balance sheets of $6,421,445 and $5,877,267, respectively, with a related reserve of $5,033,496 and $4,795,635, respectively.

(9) Other Assets

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

		2011	2010
Goodwill	$	—	2,663,300
Deferred financing costs		3,242,547	3,524,894
Other intangible assets		1,307,000	1,307,000
Cash surrender value of life insurance and other		2,330,864	2,027,192
		6,880,411	9,522,386
Accumulated amortization		(1,917,715)	(2,937,192)
	$	4,962,696	6,585,194

(10) Long-Term Debt

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

		2011	2010
Maryland Health and Higher Education Facilities Authority (MHHEFA) Revenue Bonds, Series 2003	$	80,910,000	82,770,000
MHHEFA Series D pooled loan program		4,760,000	4,939,999
Maryland Industrial Development Financing Authority Revenue Bonds, Series C		255,000	495,000
Mortgages on real estate		8,054,976	8,583,827
Bank financing agreement		22,932,594	14,000,000
Other debt		1,355,000	2,726,187
		118,267,570	113,515,013
Plus unamortized bond premium		373,428	395,868
		118,640,998	113,910,881
Less current portion		4,536,075	4,355,042
	$	114,104,923	109,555,839

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, bear interest semiannually at fixed rates ranging from 2.8% to 5.3%. The Series A Bonds are subject to annual mandatory sinking fund requirements commencing in 2029 through 2037. The Series B Bonds are subject to annual mandatory principal requirements commencing in 2007 through 2028. Principal payments vary in increasing amounts from $600,000 with the final installment of $3,425,000 in 2028. The Series B Bonds were originally issued as auction rate securities. Pursuant to the original governing documents, in February 2008, Foundation elected to convert the Series B Bonds from auction rate securities to variable rate demand bonds backed by a $43,547,000 five-year bank letter of credit which expires on July 1, 2013. The amount of Series B Bonds outstanding at June 30, 2011 and 2010 was $43,075,000 and $43,700,000, respectively. Draws under the letter of credit would be repayable over a five-year term, with the first payment 366 days from the draw date. The effective interest rate on the debt for 2011 and 2010 was approximately 0.6% and 0.7%, respectively.

The Series 2003 Bonds are secured by a trust indenture and Obligated Group has granted MHHEFA a security interest in its revenues. The Series B Bonds are also insured by a financial guaranty insurance policy issued by a commercial insurance company. The Series 2003 Bonds, the letter of credit and the financial guaranty insurance policy require Obligated Group to satisfy certain measures of financial performance as long as the Series 2003 Bonds are outstanding.

In September 2006, Mosaic and North Baltimore Center jointly 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 that previously merged with Mosaic) and for certain renovations and equipment purchases. The variable rate bonds, which are supported by a bank letter of credit, which expires in November 2012, are being amortized over 20 years. The effective interest rate on this debt was approximately 3.6% for 2011 and 2010. The defeased debt, which was repaid in August 2011, is included in “other” debt in the table presented above and bore interest at an effective rate of 8.5% in 2011 and 2010.

In December 2009, Obligated Group entered into a financing agreement with Bank of America for up to $30,000,000 to refinance the Bank Note and to provide funds for the potential purchase of land for future expansion in Howard County, Maryland. The term of the agreement is through December 2014. Interest is payable monthly at 65.00% of the Interbank Offered Rate (LIBOR) plus 1.55%. The rate of interest on the debt was approximately 1.67% at June 30, 2011. As of June 30, 2011, $22,932,594 has been drawn under this agreement and the proceeds, combined with an equity contribution, were used to refinance the Bank Note and to purchase 44 acres of undeveloped land in October 2010 for future expansion. No additional funds are available to be drawn on this Bank Note. Foundation is required to satisfy certain measures of financial performance as long as the loan is outstanding. Foundation was in compliance with such financial covenants as of June 30, 2011.

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

Way Station has a mortgage on two properties in the Frederick, Maryland area with a total outstanding balance of $652,445 and $669,434 at June 30, 2011 and 2010, with interest rates of 4.25% and 2.00% and maturity dates of 2019 and 2031. In addition, Way Station has a noninterest bearing loan due in 2023 and is secured by a lien on one of its properties. As of June 30, 2011 and 2010, the outstanding balance was $56,000 and $61,000, respectively.

Family Services has mortgages on 18 properties in the Gaithersburg, Maryland area with a total outstanding balance of $4,918,724 and $5,194,991 at June 30, 2011 and 2010, respectively, with interest rates ranging from 4.2% to 7.0%, and maturity dates ranging from August 2010 to December 1, 2039.

Mosaic has mortgages on 23 properties in the Baltimore County and Carroll County areas with a total outstanding balance of $2,483,807 and $2,658,139 at June 30, 2011 and 2010, respectively, with interest rates ranging from 0.0% to 8.5%, and maturity dates ranging from 2014 to 2038.

In addition, Family Services had a variable rate line of credit with Bank of America in the amount of $400,000 which is secured by certain assets of Family Services. At June 30, 2010, Family Services had an outstanding balance of $175,000. Family Services paid off the line in 2011 and no longer has the line of credit with Bank of America.

In addition, Mosaic has a variable rate line of credit with Bank of America in the amount of $1,000,000 which is secured by certain assets of Mosaic. At June 30, 2011 and 2010, Mosaic had an outstanding balance of $174,000.

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

2012	$ 4,536,075
2013	7,841,562
2014	3,075,635
2015	3,075,325
2016	3,150,685
2017 and thereafter	96,588,288
	$ 118,267,570

Interest payments were $3,571,319 and $3,353,434 in 2011 and 2010.

(11) Other Financial Instruments

On July 1, 2002, Family Services entered into an interest rate swap with the notional amount of $2,400,000 and a term of 20 years to fix the interest rate on its bonds at 4.16% over the life of the swap. The interest rate swap does not qualify for hedge accounting under the provisions of ASC Subtopic 815-10. Family Services paid approximately $71,561 and $71,019 during 2011 and 2010, respectively, in settlements to the counterparty that have been recorded as other income in the consolidated statements of operations.

On September 26, 2006, Mosaic and North Baltimore Center entered into an interest rate swap in conjunction with the issuance of MHHEFA Series D Bonds with the notional amount of $5,420,000 and a term of five years to fix the interest rate at 3.6%. The interest rate swap does not qualify for hedge accounting under the provisions of ASC Subtopic 815-10. Mosaic and North Baltimore Center paid approximately $167,175 and $173,043 during 2011 and 2010, respectively, in settlements to the counterparty that have been recorded as other income in the consolidated statements of operations.

As of June 30, 2011 and 2010, the aggregate fair value of the interest rate swaps outstanding was $275,891 and $466,714, respectively. Such amounts are recorded as a component of other long-term liabilities in the accompanying consolidated balance sheets. Changes in fair value of interest rate swaps of approximately $190,823 and $57,430, respectively, have been recorded as a component of other income in the accompanying consolidated statements of operations and changes in net assets for 2011 and 2010, respectively.

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, 2011 and 2010, the net present value of the estimated remaining payments of approximately $621,000 and $652,000, respectively, have been recorded as an other long-term liability.

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

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

ASC Subtopic 715-30, *Defined Benefit Plans-Pension*, requires Foundation to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan in the accompanying consolidated balance sheets, with a corresponding adjustment to unrestricted net assets. The pension liability adjustment to unrestricted net assets represents the change in net unrecognized actuarial losses and unrecognized prior service costs that have not yet been recognized as part of excess (deficiency) 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, 2011 and 2010. 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, 2011	Amounts recognized in unrestricted net assets at June 30, 2010
Net prior service cost	$	670,848	893,118	1,629,890
Net actuarial loss		—	13,499,125	34,600,188
Total	$	670,848	14,392,243	36,230,078

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

The Plan's change in benefit obligations, the change in plan assets, current funded status and the components of net periodic pension cost as of and for the years ended June 30, 2011 and 2010 are as follows:

		2011	2010
Accumulated benefit obligation at the end of the year	$	129,076,789	126,280,732
Changes in benefit obligations:			
Projected benefit obligation at the beginning of the year	$	141,062,746	115,374,087
Service cost		5,226,615	4,544,847
Interest cost		7,576,711	7,387,992
Actuarial (gain) loss		(6,908,915)	17,791,837
Benefits paid		(6,699,860)	(4,036,017)
Projected benefit obligation at the end of the year		140,257,297	141,062,746
Changes in plan assets:			
Fair value of plan assets at beginning of the year		106,157,433	97,537,655
Actual return on plan assets		21,446,336	12,655,795
Contributions to the plan		11,000,000	—
Benefits paid		(6,699,860)	(4,036,017)
Fair value of plan assets at end of the year		131,903,909	106,157,433
Funded status	$	(8,353,388)	(34,905,313)

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

		2011	2010
Service cost	$	5,226,615	4,544,847
Interest cost		7,576,711	7,387,992
Expected return on plan assets		(9,030,927)	(7,627,552)
Amortization of prior service cost		736,772	736,772
Amortization of net loss		1,776,739	1,028,143
Net pension expense	$	6,285,910	6,070,202

The following table presents the weighted average assumptions used to determine benefit obligations and net periodic benefit expense for the Plan for 2011 and 2010:

	2011	2010
Discount rates (benefit obligation)	5.67%	5.50%
Discount rates (benefit expense)	5.50	6.50
Rate of compensation increase	4.00	4.00
Expected long-term return on plan assets	8.00	8.00

(Continued)

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

In developing the expected long-term rate of return on assets assumption, Foundation considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This process resulted in the selection of the 8% assumption.

(b) Investment Policy and Objectives

The investment policy and objectives are established by the trustees of Foundation. The plan objectives include maintaining fully funded status and maximizing returns 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 reviews fund performance and asset allocation at each quarterly meeting. The percentage allocation to each asset class may vary depending upon market conditions.

A Foundation trustee serves as an investment manager for a portion of the pension portfolio and investment portfolio totaling approximately $30,900,000 and $29,800,000 as of June 30, 2011 and 2010, respectively.

(c) Plan Assets

Foundation’s pension plan weighted average asset allocations at the measurement dates of June 30, 2011 and 2010 by asset category are as follows:

	Target allocation	2011	2010
Equity securities	60%	64%	69%
Debt securities	20	7	15
Cash and cash equivalents	—	18	4
Other (including alternative investments)	20	11	12
	100%	100%	100%

Foundation’s Board of Directors authorizes and approves investment activity for which the different investment managers are responsible for making specific investment decisions. 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 investments are invested in accordance with its overall investment policies at June 30, 2011 and 2010. Subsequent to June 30, 2011, Foundation adopted a Liability Driven Investing approach to managing plan assets with a goal of achieving and maintaining funded status while better matching bond duration with plan liabilities.

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, 2011 aggregated by the three level valuation hierarchy:

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

The table below presents Foundation's pension plan investable assets as of June 30, 2010 aggregated by the three level valuation hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 4,289,110	—	—	4,289,110
Common stocks	24,399,959	—	—	24,399,959
Other equities	899,327	—	—	899,327
Mutual funds	42,163,934	5,383,553	—	47,547,487
Government-issued bonds	—	1,712,286	—	1,712,286
Corporate bonds	—	14,636,723	—	14,636,723
Alternative investments	—	8,892,292	3,780,249	12,672,541
Total assets	$ 71,752,330	30,624,854	3,780,249	106,157,433

Certain of the Foundation's equity mutual fund investments were transferred from Level 2 to Level 1 during fiscal 2011 due to the increased liquidity of the funds.

Foundation's pension plan invests in six alternative investments, which are primarily hedge fund of funds and private equity funds. Such investments are typically carried at estimated fair value. Foundation uses the practical expedient to report the net asset values of these funds as an estimate of fair value. Most of the funds have not had changes in the redemption policies during fiscal year 2011, and the policies range primarily from 30 days to 90 days. Determination of fair value is performed on a quarterly basis by the General Partner(s) of the funds. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for these investments existed.

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

		Alternative investments
Balance as of June 30, 2010	$	3,780,249
Additions:		
Contributions/purchases		2,176,200
Disbursements:		
Withdrawals/sales		(1,456,639)
Net change in value		719,561
Balance as of June 30, 2011	$	4,499,810

(d) Contributions

Foundation contributed approximately $11 million to its pension plan for the year ended June 30, 2011 (none in 2010). The Foundation expects to contribute $5 million to its pension plan for the fiscal year ended June 30, 2012.

(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:

2012	$	5,410,025
2013		6,043,584
2014		6,628,797
2015		7,195,937
2016		7,747,901
2017 – 2021		45,118,490

The expected benefits to be paid are based on the same assumptions used to measure Foundation benefit obligation at June 30, 2011.

Effective July 1, 2006, Foundation elected to not allow employees hired on or after July 1, 2006 to participate in either the defined benefit pension plan or the current employees' thrift plan. Instead, such employees participate in a new employees' thrift plan. The new employee's thrift plan expense was approximately $1,326,000 and $1,158,000 in 2011 and 2010, 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 contributions to the thrift plan in 2011 and 2010.

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 (1) basic hospital, surgical and diagnostic benefits and (2) administrative expenses. The life, accident, and health plan expense was approximately $9,569,346 in 2011 and $8,658,000 in 2010.

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, 2011 and 2010, these subsidiaries contributed approximately $414,415 and $254,000, 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, 2011 that have initial or remaining lease terms in excess of one year for each of the years ending June 30:

2012	$	3,718,748
2013		2,638,313
2014		1,908,240
2015		1,628,640
2016		1,124,402
Thereafter		3,018,890
Total minimum lease payments	$	14,037,233

Rent expense was approximately $6,160,777 and $5,963,117 in 2011 and 2010, 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 2011 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.

The following is a schedule of future minimum lease payments under capital leases as of June 30, 2011.

2012	$	700,629
2013		680,136
2014		704,180
2015		695,062
2016		345,115
Thereafter		5,044,819
Total minimum lease payments		8,169,941
Less amount representing interest		2,589,510
Present value of net minimum lease payments		5,580,431
Less obligations under capital leases, current portion		415,702
Obligations under capital leases, less current portion	$	5,164,729

(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 $672,560 and $990,399 at June 30, 2011 and 2010, respectively. The related claims liabilities of $6,593,021 and $4,688,915 as of June 30, 2011 and 2010, 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, 2011 and 2010; however, the ultimate liability may differ significantly.

Health System and Physicians are also self-insured for unemployment claims and have established a letter of credit arrangement of approximately $1,208,000 in 2011 and $1,207,000 in 2010 in accordance with the requirements of the Maryland Department of Employment and Training. Also, Foundation is self-insured for workers' compensation claims up to $450,000. Investments of approximately $3,599,000 and $3,605,000 at June 30, 2011 and 2010, respectively, 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 $2,867,360 and $2,009,618 as of June 30, 2011 and 2010, respectively, are recorded in the accompanying consolidated balance sheets. Foundation records

(Continued)

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. Health claims under this plan are paid by Foundation as they are submitted to the health plan administrator. Foundation maintains an accrual for claims that have been incurred but not reported to the plan administrator. The accrued liability for claims incurred but not reported is based on the historical claim lag period and current payment trends of health insurance claims. The accrued liability for health claims is $1,654,000 and $1,705,000, respectively, as of June 30, 2011 and 2010. While management believes that the provision for claims on unemployment, workers' compensation, and employee health benefits is adequate, at June 30, 2011 and 2010, the ultimate liability may be significantly different than the estimates.

(15) Net Assets

Net assets at June 30 are summarized as follows:

	2011	2010
Unrestricted:		
Undesignated	$ 136,624,054	105,863,744
Board-designated:		
Moses Sheppard bequest	34,660,130	28,877,128
Enoch Pratt bequest	22,104,847	18,417,418
Other	46,815,158	43,297,596
Total board-designated	103,580,135	90,592,142
Total unrestricted	$ 240,204,189	196,455,886

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

(16) Rate Setting Matters and Business and Credit Concentrations

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

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

	2011	**2010**
Medicare	12%	13%
Medicaid	35	38
Commercial insurers and HMOs	17	16
Local government	20	18
Blue Cross/Blue Shield	10	8
Self-pay and others	6	7
	100%	100%

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. Effective July 1, 2001, the Maryland Medicaid program changed its reimbursement methodology to a prospective payment system for psychiatric inpatient services. 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, 2010 and on Medicaid cost reports for all programs except the Taylor RTC through June 30, 2004. The Taylor RTC Medicaid cost report has been settled through June 30, 2002.

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

During 2011, some of Foundation's prior year third-party cost reports were audited and settled, or tentatively settled, by third-party payors. Adjustments resulting from such audits and management reviews of unaudited years and open claims are reflected as adjustments to revenue in the year the adjustment becomes known. The effect of these adjustments was to increase net patient service revenue by $950,000 during the year ended June 30, 2011. 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.

Accounts receivable are as follows at June 30:

	2011	2010
Patient accounts receivable	$ 21,822,994	21,321,573
Residential and educational accounts receivable	16,245,421	15,388,656
	38,068,415	36,710,229
Less allowance for doubtful accounts	6,866,835	7,592,901
	$ 31,201,580	29,117,328

(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:

	2011	2010
Healthcare and educational services	$ 237,032,177	229,437,450
General and administrative	35,418,291	34,283,471
	$ 272,450,468	263,720,921

(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. 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.

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self-referral laws (STARK law and regulation). Recent federal initiatives have prompted a national review of federally funded healthcare programs. In addition, the federal government and many states have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the U.S. healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to health care providers and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over the next decade. This federal healthcare reform legislation did not affect either the 2011 or the 2010 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 (deficit) classification by type of endowment as of June 30, 2011

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

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

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

(c) ***Net asset (deficit) classification by type of endowment as of June 30, 2010***

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	—	3,468,495	3,468,495
Board-designated endowment funds	90,592,142	—	—	90,592,142
	$ 90,592,142	—	3,468,495	94,060,637

Changes in endowment net assets for the year ended June 30, 2010:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets beginning of year	$ 82,245,839	—	3,423,475	85,669,314
Investment return:				
Investment income	2,121,363	—	—	2,121,363
Net appreciation (realized and unrealized gains and losses)	8,879,620	—	43,520	8,923,140
Total investment return	11,000,983	—	43,520	11,044,503
Contributions	—	—	1,500	1,500
Appropriation of endowment assets for expenditure	(2,654,680)	—	—	(2,654,680)
	$ 90,592,142	—	3,468,495	94,060,637

(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. These deficiencies resulted from 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.

(20) Subsequent Events

Subsequent events were evaluated through October 13, 2011, the date of issuance for Foundation's audited financial statements as of and for the year ended June 30, 2011. Foundation did not have any subsequent events that were required to be recognized or disclosed during this period.

OTHER SUPPLEMENTARY INFORMATION

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

Independent Auditors' Report on Supplementary Information

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

We have audited and reported separately herein on the consolidated financial statements of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries as of and for the years ended June 30, 2011 and 2010.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements of Sheppard and Enoch Pratt Foundation, Inc. and subsidiaries taken as a whole. The supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

KPMG LLP

October 13, 2011

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Balance Sheet Information

June 30, 2011

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	$ 81,934	29,762,754	—	1,844,296	—	31,688,984
Temporary investments	—	—	—	—	—	—
Investments limited or restricted as to use	44,402	2,445,283	—	—	—	2,489,685
Accounts receivable, net	—	24,487,384	—	1,140,400	—	25,627,784
Due from affiliates	—	1,578,780	3,904,575	60,865	(4,925,812)	618,408
Prepaid expenses and other current assets	—	3,948,173	—	268,255	—	4,216,428
Total current assets	126,336	62,222,374	3,904,575	3,313,816	(4,925,812)	64,641,289
Investments limited or restricted as to use, less current portion	1,000,082	39,771,683	98,222,161	—	—	138,993,926
Interest in net assets of Foundation	—	123,850	—	—	(123,850)	—
Notes receivable	—	—	2,668,212	—	—	2,668,212
Property and equipment, net	—	168,876,989	—	—	—	168,876,989
Other assets	—	3,827,094	521,250	—	—	4,348,344
	$ 1,126,418	274,821,990	105,316,198	3,313,816	(5,049,662)	379,528,760
Liabilities and Net Assets						
Current liabilities:						
Current maturities of long-term debt	$ —	2,297,785	—	—	—	2,297,785
Current portion of obligations under capital leases	—	384,800	—	—	—	384,800
Accounts payable	—	6,659,495	—	533,747	—	7,193,242
Accrued salaries, wages, and employee benefits	—	12,522,075	—	2,211,570	—	14,733,645
Third-party payor settlements payable	—	2,055,490	—	—	—	2,055,490
Due to affiliates	41,239	3,906,575	1,370,160	687,032	(4,925,812)	1,079,194
Other accrued expenses	—	4,836,660	365,902	201,263	—	5,403,825
Total current liabilities	41,239	32,662,880	1,736,062	3,633,612	(4,925,812)	33,147,981
Long-term liabilities:						
Long-term debt, less current portion	—	101,918,237	—	—	—	101,918,237
Obligations under capitalized leases, less current portion	—	5,164,729	—	—	—	5,164,729
Self-insurance liabilities	—	6,593,021	—	—	—	6,593,021
Accrued pension liabilities	—	5,836,206	—	2,517,182	—	8,353,388
Other long-term liabilities	621,101	—	—	—	—	621,101
Total liabilities	662,340	152,175,073	1,736,062	6,150,794	(4,925,812)	155,798,457
Net assets (deficit):						
Unrestricted	40,696	114,363,327	103,580,136	(2,836,978)	—	215,147,181
Temporarily restricted	123,850	5,097,701	—	—	(123,850)	5,097,701
Permanently restricted	299,532	3,185,889	—	—	—	3,485,421
Total net assets	464,078	122,646,917	103,580,136	(2,836,978)	(123,850)	223,730,303
	$ 1,126,418	274,821,990	105,316,198	3,313,816	(5,049,662)	379,528,760

(Continued)

Schedule 1

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Balance Sheet Information

June 30, 2011

Assets	North Baltimore Center, 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	$ —	742,494	2,682,180	8,557	5,161,429	—	40,283,644
Temporary investments	—	—	189,566	568,195	—	—	757,761
Investments limited or restricted as to use	—	—	1,323,152	—	432,172	—	4,245,009
Accounts receivable, net	—	1,465,121	2,926,934	—	1,181,741	—	31,201,580
Due from affiliates	—	68,778	222,570	42,138	2,928	(954,822)	—
Prepaid expenses and other current assets	—	243,322	818,301	—	1,632,546	—	6,910,597
Total current assets	—	2,519,715	8,162,703	618,890	8,410,816	(954,822)	83,398,591
Investments limited or restricted as to use, less current portion	—	—	1,404,391	—	1,076,682	(1,076,682)	140,398,317
Interest in net assets of Foundation	—	—	—	—	—	—	—
Notes receivable	—	—	—	—	—	—	2,668,212
Property and equipment, net	—	6,873,550	13,161,409	984,763	8,786,865	—	198,683,576
Other assets	—	62,147	53,977	—	498,228	—	4,962,696
	$ —	9,455,412	22,782,480	1,603,653	18,772,591	(2,031,504)	430,111,392
Liabilities and Net Assets							
Current liabilities:							
Current maturities of long-term debt	$ —	316,691	1,640,729	—	280,870	—	4,536,075
Current portion of obligations under capital leases	—	30,902	—	—	—	—	415,702
Accounts payable	—	362,151	704,892	—	324,305	—	8,584,590
Accrued salaries, wages, and employee benefits	—	893,438	2,954,490	—	1,979,086	—	20,560,659
Third-party payor settlements payable	—	—	—	—	—	—	2,055,490
Due to affiliates	—	18,192	223,591	1,928	425,508	(1,748,413)	—
Other accrued expenses	—	519,212	271,030	—	811,500	—	7,005,567
Total current liabilities	—	2,140,586	5,794,732	1,928	3,821,269	(1,748,413)	43,158,083
Long-term liabilities:							
Long-term debt, less current portion	—	4,602,033	6,902,078	—	682,575	—	114,104,923
Obligations under capitalized leases, less current portion	—	—	—	—	—	—	5,164,729
Self-insurance liabilities	—	—	—	—	—	—	6,593,021
Accrued pension liabilities	—	—	—	—	—	—	8,353,388
Other long-term liabilities	—	234,618	692,021	—	714,066	(283,091)	1,978,715
Total liabilities	—	6,977,237	13,388,831	1,928	5,217,910	(2,031,504)	179,352,859
Net assets (deficit):							
Unrestricted	—	2,478,175	8,899,481	1,601,725	12,077,627	—	240,204,189
Temporarily restricted	—	—	145,258	—	1,477,054	—	6,720,013
Permanently restricted	—	—	348,910	—	—	—	3,834,331
Total net assets	—	2,478,175	9,393,649	1,601,725	13,554,681	—	250,758,533
	$ —	9,455,412	22,782,480	1,603,653	18,772,591	(2,031,504)	430,111,392

See accompanying independent auditors' report.

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Operations Information

Year ended June 30, 2011

	Sheppard and Enoch Pratt Foundation, Inc.	Sheppard Pratt Health System, Inc.	Sheppard Pratt Investment, Inc.	Sheppard Pratt Physicians, P.A.	Obligated group combining eliminations	Combined obligated group subtotal
Unrestricted revenues, gains, and other support:						
Net patient service revenue	$ —	106,329,467	—	14,354,120	—	120,683,587
Residential and educational service revenue	—	65,295,714	—	—	—	65,295,714
Net assets released from restrictions used for operations	—	677,284	—	—	—	677,284
Other	—	9,425,257	—	14,866,098	(12,860,869)	11,430,486
Total unrestricted revenues, gains, and other support	—	181,727,722	—	29,220,218	(12,860,869)	198,087,071
Expenses:						
Salaries and wages	—	87,689,897	—	18,340,182	—	106,030,079
Employee benefits	—	23,990,562	—	3,388,198	—	27,378,760
Expendable supplies	—	12,047,489	—	382	—	12,047,871
Purchased services	20,673	32,091,072	—	6,696,698	(13,116,784)	25,691,659
Interest	—	3,067,718	—	—	—	3,067,718
Repairs and minor alterations	—	5,880,734	—	—	—	5,880,734
Depreciation and amortization	—	12,610,627	—	—	—	12,610,627
Provision for doubtful accounts	—	3,256,318	—	1,672,836	—	4,929,154
Loss on disposal of assets	—	5,642	—	—	—	5,642
Total expenses	20,673	180,640,059	—	30,098,296	(13,116,784)	197,642,244
Operating income (loss)	(20,673)	1,087,663	—	(878,078)	255,915	444,827
Other income (expense):						
Investment income	—	399,599	2,128,090	—	(255,915)	2,271,774
Realized gains on sale of investments	—	813,591	2,971,778	—	—	3,785,369
Change in net unrealized gain on trading securities	—	2,381,527	11,615,438	—	—	13,996,965
Other	—	1,077,511	199,424	—	—	1,276,935
Total other income (expense)	—	4,672,228	16,914,730	—	(255,915)	21,331,043
Excess (deficiency) of revenues over expenses	(20,673)	5,759,891	16,914,730	(878,078)	—	21,775,870
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	611,766	—	—	—	611,766
Transfer to affiliates	—	3,616,736	(3,926,736)	—	—	(310,000)
Pension liability adjustment	—	21,837,835	—	—	—	21,837,835
Capital grants	—	—	—	—	—	—
Impairment of goodwill	—	(1,618,264)	—	—	—	(1,618,264)
Increase (decrease) in unrestricted net assets	$ (20,673)	30,207,964	12,987,994	(878,078)	—	42,297,207

(Continued)

Schedule 2

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Operations Information

Year ended June 30, 2011

	North Baltimore Center, 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:							
Net patient service revenue	$ —	—	—	—	—	—	120,683,587
Residential and educational service revenue	—	15,178,005	30,404,687	—	18,177,965	—	129,056,371
Net assets released from restrictions used for operations	—	—	15,739	—	261,660	—	954,683
Other	—	154,198	5,388,504	123,400	6,757,136	(1,103,770)	22,749,954
Total unrestricted revenues, gains, and other support	—	15,332,203	35,808,930	123,400	25,196,761	(1,103,770)	273,444,595
Expenses:							
Salaries and wages	—	7,669,174	19,991,322	—	15,285,783	—	148,976,358
Employee benefits	—	2,758,068	3,311,010	—	3,158,081	—	36,605,919
Expendable supplies	—	1,044,699	1,166,881	—	1,170,015	—	15,429,466
Purchased services	—	2,553,841	7,888,382	123,400	3,204,068	(1,087,254)	38,374,096
Interest	—	204,429	606,208	1,678	51,709	(4,000)	3,927,742
Repairs and minor alterations	—	225,412	991,430	—	488,423	(12,516)	7,573,483
Depreciation and amortization	—	492,470	1,537,725	39,940	548,373	—	15,229,135
Provision for doubtful accounts	—	423,665	839,427	—	95,166	—	6,287,412
Loss on disposal of assets	—	31,386	9,829	—	—	—	46,857
Total expenses	—	15,403,144	36,342,214	165,018	24,001,618	(1,103,770)	272,450,468
Operating income (loss)	—	(70,941)	(533,284)	(41,618)	1,195,143	—	994,127
Other income (expense):							
Investment income	—	—	—	3,071	19,130	—	2,293,975
Realized gains on sale of investments	—	—	—	—	17,054	—	3,802,423
Change in net unrealized gain on trading securities	—	—	—	—	26,247	—	14,023,212
Other	—	(30,879)	153,076	—	—	—	1,399,132
Total other income (expense)	—	(30,879)	153,076	3,071	62,431	—	21,518,742
Excess (deficiency) of revenues over expenses	—	(101,820)	(380,208)	(38,547)	1,257,574	—	22,512,869
Other changes in net assets:							
Net assets released from restrictions used for purchases of property and equipment	—	—	—	—	91,675	—	703,441
Transfer to affiliates	(349,724)	—	659,724	—	—	—	—
Pension liability adjustment	—	—	—	—	—	—	21,837,835
Capital grants	—	259,622	52,800	—	—	—	312,422
Impairment of goodwill	—	—	—	—	—	—	(1,618,264)
Increase (decrease) in unrestricted net assets	$ (349,724)	157,802	332,316	(38,547)	1,349,249	—	43,748,303

See accompanying independent auditors' report.

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Changes in Net Assets Information

Year ended June 30, 2011

	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	$ (20,673)	5,759,891	16,914,730	(878,078)	—	21,775,870
Other changes in net assets:						
Net assets released from restrictions used for purchases of property and equipment	—	611,766	—	—	—	611,766
Transfer from (to) subsidiaries	—	3,616,736	(3,926,736)	—	—	(310,000)
Pension liability adjustments	—	21,837,835	—	—	—	21,837,835
Capital grants	—	—	—	—	—	—
Impairment of goodwill	—	(1,618,264)	—	—	—	(1,618,264)
Increase (decrease) in unrestricted net assets	(20,673)	30,207,964	12,987,994	(878,078)	—	42,297,207
Temporarily restricted net assets:						
Gifts	26,199	1,150,543	—	—	—	1,176,742
Investment income	—	105,821	—	—	—	105,821
Net gain on investments	—	848,308	—	—	—	848,308
Interest in net assets of Foundation	—	(76,358)	—	—	76,358	—
Transfer from (to) subsidiaries	(102,557)	90,055	—	—	—	(12,502)
Net assets released from restrictions	—	(1,289,049)	—	—	—	(1,289,049)
Reclassification of net assets	—	(229,935)	—	—	—	(229,935)
Increase (decrease) in temporarily restricted net assets	(76,358)	599,385	—	—	76,358	599,385
Permanently restricted net assets:						
Gifts	—	51,800	—	—	—	51,800
Investment income	84,151	—	—	—	—	84,151
Reclassification of net assets	—	229,935	—	—	—	229,935
Increase (decrease) in permanently restricted net assets	84,151	281,735	—	—	—	365,886
Increase (decrease) in net assets	(12,880)	31,089,084	12,987,994	(878,078)	76,358	43,262,478
Net assets (deficit), beginning of year	476,958	91,557,833	90,592,142	(1,958,900)	(200,208)	180,467,825
Net assets (deficit), end of year	$ 464,078	122,646,917	103,580,136	(2,836,978)	(123,850)	223,730,303

(Continued)

Schedule 3

SHEPPARD AND ENOCH PRATT FOUNDATION, INC. AND SUBSIDIARIES

Supplementary Statement of Changes in Net Assets Information

Year ended June 30, 2011

	North Baltimore Center, 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 (deficiency) of revenues over expenses	$ —	(101,820)	(380,208)	(38,547)	1,257,574	—	22,512,869
Other changes in net assets:							
Net assets released from restrictions used for purchases of property and equipment	—	—	—	—	91,675	—	703,441
Transfer from (to) subsidiaries	(349,724)	—	659,724	—	—	—	—
Pension liability adjustments	—	—	—	—	—	—	21,837,835
Capital grants	—	259,622	52,800	—	—	—	312,422
Impairment of goodwill	—	—	—	—	—	—	(1,618,264)
Increase (decrease) in unrestricted net assets	(349,724)	157,802	332,316	(38,547)	1,349,249	—	43,748,303
Temporarily restricted net assets:							
Gifts	—	—	59,454	—	407,048	—	1,643,244
Investment income	—	—	—	—	—	—	105,821
Net gain on investments	—	—	2,625	—	—	—	850,933
Interest in net assets of Foundation	—	—	—	—	—	—	—
Transfer from (to) subsidiaries	—	—	12,502	—	—	—	—
Net assets released from restrictions	—	—	(15,739)	—	(353,336)	—	(1,658,124)
Reclassification of net assets	—	—	—	—	—	—	(229,935)
Increase (decrease) in temporarily restricted net assets	—	—	58,842	—	53,712	—	711,939
Permanently restricted net assets:							
Gifts	—	—	—	—	—	—	51,800
Investment income	—	—	(50)	—	—	—	84,101
Reclassification of net assets	—	—	—	—	—	—	229,935
Increase (decrease) in permanently restricted net assets	—	—	(50)	—	—	—	365,836
Increase (decrease) in net assets	(349,724)	157,802	391,108	(38,547)	1,402,961	—	44,826,078
Net assets (deficit), beginning of year	349,724	2,320,373	9,002,541	1,640,272	12,151,720	—	205,932,455
Net assets (deficit), end of year	$ —	2,478,175	9,393,649	1,601,725	13,554,681	—	250,758,533

See accompanying independent auditors' report.