

**The First Hospital Foundation**

Financial Statements

December 31, 2011 and 2010

**Independent Auditors' Report****Board of Directors  
The First Hospital Foundation**

We have audited the accompanying statements of financial position of The First Hospital Foundation (the "Foundation") as of December 31, 2011 and 2010 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these 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 the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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 financial statements referred to above present fairly, in all material respects, the financial position of The First Hospital Foundation as of December 31, 2011 and 2010 and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*O'Connor Davies, LLP*

New York, New York  
June 4, 2012

## The First Hospital Foundation

### Statements of Financial Position

	December 31,	
	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 181,100	\$ 184,778
Due from grantee	46,000	-
Accounts receivable	-	2,537
Prepaid federal excise tax	6,000	-
Prepaid expenses	3,883	3,347
Due from investment custodian	1,656,061	800,000
Investments	34,494,064	37,813,117
Deposits	15,767	15,767
Furniture and equipment, net of accumulated depreciation of \$7,820 and \$5,512	<u>3,847</u>	<u>6,156</u>
	<u>\$ 36,406,722</u>	<u>\$ 38,825,702</u>
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities		
Accounts payable and accrued expenses	\$ 49,572	\$ 32,831
Grants payable	406,557	421,596
Deferred federal excise tax liability	<u>63,000</u>	<u>-</u>
Total Liabilities	519,129	454,427
Unrestricted net assets	<u>35,887,593</u>	<u>38,371,275</u>
	<u>\$ 36,406,722</u>	<u>\$ 38,825,702</u>

See notes to financial statements

## The First Hospital Foundation

### Statements of Activities

	Year Ended December 31,	
	2011	2010
<b>INVESTMENT REVENUE</b>		
Interest, dividends, and capital gain distributions	\$ 813,111	\$ 712,526
Net realized (loss) gain on investments	(95,638)	120,055
Net earnings from investments in partnerships	429,778	238,370
	1,147,251	1,070,951
Less investment advisory fees	58,577	54,928
Net Investment Revenue	1,088,674	1,016,023
<b>EXPENSES</b>		
Grants, net of rescinded grants of \$93,380 in 2011	1,413,032	1,416,610
Operations and governance	279,737	230,863
Federal excise tax expense	22,099	-
Unrelated business income tax expense	355	-
Total Expenses	1,715,223	1,647,473
Change in Net Assets Before Net Unrealized (Loss)		
Gain on Investments	(626,549)	(631,450)
Net unrealized (loss) gain on investments, net of deferred excise tax provision of \$63,000 in 2011	(1,857,133)	3,478,113
Change in Net Assets	(2,483,682)	2,846,663
<b>NET ASSETS</b>		
Beginning of year	38,371,275	35,524,612
End of year	\$ 35,887,593	\$ 38,371,275

## The First Hospital Foundation

### Statements of Cash Flows

	Year Ended December 31,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ (2,483,682)	\$ 2,846,663
Adjustments to reconcile change in net assets to net cash from operating activities		
Net realized loss (gain) on investments	95,638	(120,055)
Net unrealized loss (gain) on investments	1,794,133	(3,478,113)
Net earnings from investments in partnerships	(429,778)	(238,370)
Deferred federal excise tax expense	63,000	-
Depreciation	2,309	2,433
Net change in operating assets and liabilities		
Due from grantee	(46,000)	-
Accounts receivable	2,537	(2,537)
Prepaid federal excise tax	(6,000)	-
Prepaid expenses	(536)	(803)
Accounts payable and accrued expenses	16,741	1,946
Grants payable	(15,039)	(188,544)
Net Cash from Operating Activities	(1,006,677)	(1,177,380)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(8,131,247)	(7,550,082)
Proceeds from sale of investments	9,990,307	7,829,905
Due from investment custodian	(856,061)	928,238
Net Cash from Investing Activities	1,002,999	1,208,061
Net Change in Cash and Cash Equivalents	(3,678)	30,681
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of year	184,778	154,097
End of year	\$ 181,100	\$ 184,778
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash paid for federal excise tax on investment income	\$ 28,099	\$ -
Cash paid for federal unrelated business income taxes	1,355	-

See notes to financial statements

## **The First Hospital Foundation**

Notes to Financial Statements  
December 31, 2011 and 2010

### **1. Organization**

The First Hospital Foundation (the "Foundation") was established in 1997 as part of the merger agreement between the Pennsylvania Hospital and the Trustees of the University of Pennsylvania. In the spirit of Pennsylvania Hospital's historic mission, the First Hospital Foundation supports programs that improve the health of vulnerable and underserved populations in the Greater Philadelphia Region. The First Hospital Foundation has a secondary mission to support the preservation of the historic artifacts and memorials of Pennsylvania Hospital.

### **2. Summary of Significant Accounting Policies**

#### ***Use of Estimates***

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### ***Basis of Presentation***

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor imposed restrictions. The Foundation's net assets are neither permanently nor temporarily restricted by donor imposed restrictions and are classified as unrestricted.

#### ***Cash and Cash Equivalents***

Cash and cash equivalents consist of short-term investments with initial maturities of three months or less at the time of purchase, except for those short-term investments managed in accordance with the Foundation's long-term investment strategy.

#### ***Fair Value Measurements***

The Foundation follows the Financial Accounting Standards Board (FASB) guidance on Fair Value Measurements which defines fair value and establishes a fair value hierarchy organized into three levels based upon the input assumptions used in pricing assets. Level 1 inputs have the highest reliability and are related to assets with unadjusted quoted prices in active markets. Level 2 inputs relate to assets with other than quoted prices in active markets which may include quoted prices for similar assets or liabilities or other inputs which can be corroborated by observable market data. Level 3 inputs are unobservable inputs and are used to the extent that observable inputs do not exist.

## **The First Hospital Foundation**

Notes to Financial Statements  
December 31, 2011 and 2010

### **2. Summary of Significant Accounting Policies (*continued*)**

#### ***Investments Valuation***

Investments are carried at fair value. The fair value of alternative investments has been estimated using the Net Asset Value (“NAV”) as reported by the management of the respective alternative investment fund. FASB guidance provides for the use of NAV as a “Practical Expedient” for estimating fair value of alternative investments. NAV reported by each alternative investment fund is used as a practical expedient to estimate the fair value of the Foundation’s interest therein and their classification within Level 2 or 3 is based on the Foundation’s ability to redeem its interest in the near term.

#### ***Investment Income Recognition***

Purchases and sales of securities are recorded on a trade-date basis. Realized and unrealized gains and losses are included in the determination of the change in net assets.

#### ***Investment Risks and Uncertainties***

Alternative Investments consist of non-traditional, not readily marketable investments, some of which may be structured as limited partnerships, venture capital funds, hedge funds, private equity funds, real estate funds and common trust funds. The underlying investments of such funds, whether invested in stock or other securities, are generally not currently traded in a public market and typically are subject to restrictions on resale. Values determined by investment managers and general partners of underlying securities that are thinly traded or not traded in an active market may be based on historical cost, appraisals, a review of the investees’ financial results, financial condition and prospects, together with comparisons to similar companies for which quoted market prices are available or other estimates that require varying degrees of judgment.

Because of the inherent uncertainty of valuations, the estimated fair values may differ significantly from the values that would have been used had a ready market for such investments existed or had such investments been liquidated, and those differences could be material.

#### ***Furniture and Equipment***

The Foundation follows the practice of capitalizing all expenditures for property, building and equipment with a cost in excess of \$1,000. Furniture and fixtures are carried at cost. Depreciation is computed using the straight-line method over the estimated useful life of the assets. The estimated useful lives range from three to five years.

#### ***Grants***

Unconditional grants are recorded when approved by the Board of Directors. Grants that are payable over future periods are recorded in the period the grant is first awarded when the recipient is subject only to routine performance requirements. Conditional grants are recognized when the conditions on which they depend are substantially met.

## The First Hospital Foundation

Notes to Financial Statements  
December 31, 2011 and 2010

### 2. Summary of Significant Accounting Policies *(continued)*

#### ***Accounting for Uncertainty in Income Taxes***

The Foundation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Management has determined that the Foundation had no uncertain tax positions that would require financial recognition. The Foundation is no longer subject to examinations by the applicable taxing jurisdictions for periods prior to 2008.

#### ***Reclassification***

Certain amounts from the 2010 financial statements were reclassified to conform to the 2011 presentation.

#### ***Subsequent Events***

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which is June 4, 2012.

### 3. Fair Value Measurements

The following are the classes and major categories of investments at December 31 grouped by the fair value hierarchy for those investments measured at fair value on a recurring basis:

Description	2011			Total
	Level 1	Level 2	Level 3	
Cash Equivalents	\$ 194,782	\$ -	\$ -	\$ 194,782
Fixed Income				
Bonds	3,361,567	-	-	3,361,567
U.S. Government and Foreign Government bonds	-	2,122,507	-	2,122,507
Equities				
Domestic Equities	4,129,069	-	-	4,129,069
International Equities	4,564,386	-	-	4,564,386
Commodities	1,290,611	-	-	1,290,611
Hedge Funds				
Large/Mid Cap Equity	-	9,378,397	-	9,378,397
Small Cap Equity	-	1,591,011	-	1,591,011
Funds of Funds	-	-	6,192,645	6,192,645
Private Equities - Funds of Funds	-	-	1,112,372	1,112,372
Real Estate Fund	-	-	556,717	556,717
	<u>\$ 13,540,415</u>	<u>\$ 13,091,915</u>	<u>\$ 7,861,734</u>	<u>\$ 34,494,064</u>

## The First Hospital Foundation

Notes to Financial Statements  
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### 3. Fair Value Measurements (*continued*)

Description	2010			
	Level 1	Level 2	Level 3	Total
Cash Equivalents	\$ 223,674	\$ -	\$ -	\$ 223,674
Fixed Income				
Bonds	3,275,125	-	-	3,275,125
U.S. Government and Foreign Government bonds	-	1,862,213	-	1,862,213
Equities				
Domestic Equities	4,262,606	-	-	4,262,606
International Equities	9,593,066	-	-	9,593,066
Commodities	1,799,882	-	-	1,799,882
Hedge Funds				
Large/Mid Cap Equity	-	6,745,845	-	6,745,845
Small Cap Equity	-	1,554,290	1,525,938	3,080,228
Funds of Funds	-	-	6,402,974	6,402,974
Private Equities - Funds of Funds	-	-	540,486	540,486
Real Estate Fund	-	-	27,018	27,018
	<u>\$ 19,154,353</u>	<u>\$ 10,162,348</u>	<u>\$ 8,496,416</u>	<u>\$ 37,813,117</u>

The following is a reconciliation of the beginning and ending balances for Level 3 investments during the years ended December 31:

	2011					
	Beginning of year	Transfers in/(out)	Purchases	Sales	Total realized and unrealized gain/(loss)	End of year
Hedge Funds - Small Cap Equity	\$ 1,525,938	\$ -	\$ -	\$ (1,656,061)	\$ 130,123	\$ -
Hedge Funds - Funds of Funds	6,402,974	-	-	-	(210,329)	6,192,645
Private Equities - Funds of Funds	540,486	-	544,126	-	27,760	1,112,372
Real Estate Fund	27,018	-	433,378	-	96,321	556,717
Total	<u>\$ 8,496,416</u>	<u>\$ -</u>	<u>\$ 977,504</u>	<u>\$ (1,656,061)</u>	<u>\$ 43,875</u>	<u>\$ 7,861,734</u>

  

	2010					
	Beginning of year	Transfers in/(out)	Purchases	Sales	Total realized and unrealized gain/(loss)	End of year
Hedge Funds - Small Cap Equity	\$ -	\$ 1,295,209	\$ -	\$ -	\$ 230,729	\$ 1,525,938
Hedge Funds - Funds of Funds	5,629,831	1,240,678	-	(1,000,000)	532,465	6,402,974
Private Equities - Funds of Funds	280,167	-	251,250	(19,136)	28,205	540,486
Real Estate Fund	-	-	50,000	(19,494)	(3,488)	27,018
Total	<u>\$ 5,909,998</u>	<u>\$ 2,535,887</u>	<u>\$ 301,250</u>	<u>\$ (1,038,630)</u>	<u>\$ 787,911</u>	<u>\$ 8,496,416</u>

Unrealized gains on alternative investments held at year end were \$43,875 and \$787,911 for 2011 and 2010, respectively.

## The First Hospital Foundation

Notes to Financial Statements  
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### 3. Fair Value Measurements *(continued)*

The Foundation's alternative investments contain redemption restrictions with required written notice. The following is a composition of redemption and lock-up provisions as of December 31, 2011:

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Hedge Funds - Large/Mid Cap Equities (a)	\$ 9,378,397	\$ -	Monthly - Quarterly	30 - 60 days
Hedge Funds - Small Cap Equities (b)	1,591,011	-	Quarterly - Annually	30 - 60 days
Hedge Funds - Funds of Funds (c)	6,192,645	-	1 - 3 years	60 - 100 days
Private Equities - Funds of Funds (d)	1,112,372	2,386,250	*	*
Real Estate Fund (e)	<u>556,717</u>	<u>507,250</u>	*	*
Total	<u>\$ 18,831,142</u>	<u>\$ 2,893,500</u>		

\* The private equities and real estate fund are illiquid assets.

- a. This category includes hedge fund investments in securities, commodity interest, other financial assets and mid cap materials. Investments occur either directly or indirectly through investment in other pooled investment vehicles, including common stocks and derivative stock index instruments such as options on stock indexes, stock index futures and option thereon, and stock index swap agreements. Investments in this category provide liquidity on monthly to quarterly basis and are not subject to acquisition lock-ups.
- b. This category includes hedge fund investments in small capital growth in a variety of areas such as US and global equities, bonds, notes and warrants. The investments in this category can be redeemed on a quarterly to annual basis.
- c. This category includes hedge fund investments with an objective to provide investors with maximum appreciation of capital while incurring reasonable risk by investing primarily in a diversified group of investment funds. The investments in this category can be redeemed on an annual basis and are subject of acquisition lock-ups from two to three years.
- d. This category includes private equity investments in domestic and international partnerships. These are long-term investments that cannot be redeemed at the discretion of the Foundation. Instead, distributions are received through the liquidation of the underlying assets of the funds. Management has estimated that the underlying assets of the funds will be liquidated in approximately 10 years.

## The First Hospital Foundation

Notes to Financial Statements  
December 31, 2011 and 2010

### 3. Fair Value Measurements *(continued)*

- e. This category includes a real estate fund that invests indirectly in a partnership that primarily invests in real estate investments acquired in secondary market transactions. The partnership may also originate investments by contributing capital into existing ownership entities holding real property or engage in privately negotiated transactions or other means of pursuing an investment, and may engage in investments directly or indirectly, through subsidiaries, partnership interest, joint ventures or otherwise. These are long-term investments that cannot be redeemed at the discretion of the Foundation. Instead, distributions are received through the liquidation of the underlying assets of the funds. Management has estimated that the underlying assets of the funds will be liquidated in approximately 8 years.

Investment advisory fees amounted to \$58,577 and \$54,928 for 2011 and 2010, and are not included with professional fees in the statements of activities. Realized gain (loss) on investments, allocation of net earnings (losses) from investments in partnerships, and unrealized gain (loss) on alternative investments are reduced (increased) by the management and performance fee charged by the respective individual funds.

### 4. Federal Excise Taxes

Effective January 1, 2011, the Foundation's tax status has changed from a public charity to a non-operating private foundation as defined under Section 509(a) of the Internal Revenue Code. The Foundation is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code, and is subject to a Federal excise tax of 2% on its net investment income, as defined, for tax purposes. However, the excise tax is reduced to 1% if certain conditions are met. For 2011 the Foundation's rate was 2%. The Foundation has met its minimum distribution requirement.

Deferred taxes principally arise from difference between the cost and fair value of investments at year end.

### 5. Unrelated Business Income Tax

The Foundation is subject to tax on its unrelated business income from business activities of alternative investments.

### 6. Grants Payable

The following summarizes changes in grants in 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Balance at beginning of year	\$ 421,596	\$ 610,140
Grants authorized	1,506,412	1,416,610
Grants paid	(1,474,071)	(1,605,154)
Prior year multi-year grant rescinded	<u>(47,380)</u>	<u>-</u>
Balance at end of year	<u>\$ 406,557</u>	<u>\$ 421,596</u>

## The First Hospital Foundation

Notes to Financial Statements  
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### 6. Grants Payable (*continued*)

Unpaid grants approved by the Directors as of December 31 are as follows:

	<u>2011</u>	<u>2010</u>
Within one year	\$ 326,426	\$ 421,596
Beyond one year	<u>80,131</u>	<u>-</u>
	<u>\$ 406,557</u>	<u>\$ 421,596</u>

### 7. Natural Expenses by Object Classification

The costs of providing various program services and other activities of the Foundation have been summarized on a functional basis in the statement of activities. A summary of the administrative expenses by natural type of disbursement is presented below:

	<u>2011</u>	<u>2010</u>
Administrative fees	\$ 162,599	\$ 129,357
Insurance	5,297	5,619
Professional fees	69,172	58,592
Rent	10,647	10,838
Dues and subscriptions	7,050	7,050
Office expenses	15,916	11,213
Depreciation	2,309	2,433
Miscellaneous expense	<u>6,747</u>	<u>5,761</u>
	<u>\$ 279,737</u>	<u>\$ 230,863</u>

### 8. Related Party Transactions

During 2011 and 2010, the Foundation outsourced employment services to an organization, of which a Foundation Board Director is the executive director. Under the terms of the agreement, the Foundation has provided a security deposit in the amount of \$15,000 which will be retained by the organization without the payment of interest. The security deposit is refundable to the Foundation upon termination of the agreement. Outsourced employment services amounted to \$162,599 and \$129,357 for 2011 and 2010, respectively, which is reported in operations and governance in the statement of activities.

## **The First Hospital Foundation**

Notes to Financial Statements  
December 31, 2011 and 2010

### **9. Concentration of Credit Risk**

The Foundation's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of cash, cash equivalents and investments. The Foundation places its cash and cash equivalents with what it believes to be quality financial institutions. The Foundation invests in equity, fixed income, and alternative investments. The Foundation routinely assesses the diversification and financial strength of its cash and investment portfolio. As a consequence, concentrations of credit risk are limited.

### **10. Lease Commitment**

Effective May 17, 2010, the Foundation entered into an operating lease agreement to sublease office space. The lease term expires November 30, 2012.

Future minimum rental payments to be made under the lease for 2012 are \$11,126.

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