

The First Hospital Foundation

Financial Statements

December 31, 2012 and 2011

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

We have audited the accompanying financial statements of the The First Hospital Foundation which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The First Hospital Foundation as of December 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

O'Connor Davies, LLP

June 3, 2013

O'CONNOR DAVIES, LLP

665 Fifth Avenue, New York, NY 10022 | Tel: 212.286.2600 | Fax: 212.286.4080 | www.odpkf.com

The First Hospital Foundation

Statements of Financial Position

	December 31,	
	2012	2011
ASSETS		
Cash and cash equivalents	\$ 60,758	\$ 181,100
Due from grantee	-	46,000
Prepaid federal excise tax	22,500	6,000
Prepaid expenses	3,408	3,883
Due from investment custodian	4,387,442	1,656,061
Investments	35,170,006	34,494,064
Deposits	15,767	15,767
Furniture and equipment, net of accumulated depreciation of \$10,003 and \$7,820	<u>1,664</u>	<u>3,847</u>
	<u>\$ 39,661,545</u>	<u>\$ 36,406,722</u>
 LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 39,794	\$ 49,572
Grants payable	331,750	406,557
Deferred federal excise tax liability	<u>97,000</u>	<u>63,000</u>
Total Liabilities	468,544	519,129
Unrestricted net assets	<u>39,193,001</u>	<u>35,887,593</u>
	<u>\$ 39,661,545</u>	<u>\$ 36,406,722</u>

See notes to financial statements

The First Hospital Foundation

Statements of Activities

	Year Ended	
	December 31,	
	<u>2012</u>	<u>2011</u>
INVESTMENT REVENUE		
Interest, dividends, and capital gain distributions	\$ 627,959	\$ 813,111
Net realized gain (loss) on investments	2,397,017	(95,638)
Net earnings from investments in partnerships	<u>235,637</u>	<u>429,778</u>
	3,260,613	1,147,251
Less investment advisory fees	<u>57,866</u>	<u>58,577</u>
Net Investment Revenue	3,202,747	1,088,674
EXPENSES		
Grants, net of rescinded grants of \$9,460 and \$93,380 in 2012 and 2011.	1,399,800	1,413,032
Operations and governance	346,866	279,737
Federal excise tax expense	30,500	22,099
Unrelated business income tax expense	-	<u>355</u>
Total Expenses	<u>1,777,166</u>	<u>1,715,223</u>
Change in Net Assets Before Net Unrealized Gain (Loss) on Investments	1,425,581	(626,549)
Net unrealized gain (loss) on investments, net of deferred excise tax provision of \$34,000 and \$63,000 in 2012 and 2011	<u>1,879,827</u>	<u>(1,857,133)</u>
Change in Net Assets	3,305,408	(2,483,682)
NET ASSETS		
Beginning of year	<u>35,887,593</u>	<u>38,371,275</u>
End of year	<u>\$ 39,193,001</u>	<u>\$ 35,887,593</u>

The First Hospital Foundation

Statements of Cash Flows

	Year Ended December 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 3,305,408	\$ (2,483,682)
Adjustments to reconcile change in net assets to net cash from operating activities		
Net realized (gain) loss on investments	(2,397,017)	95,638
Net unrealized (gain) loss on investments	(1,913,827)	1,794,133
Net earnings from investments in partnerships	(235,637)	(429,778)
Deferred federal excise tax expense	34,000	63,000
Depreciation	2,185	2,309
Net change in operating assets and liabilities		
Due from grantee	46,000	(46,000)
Accounts receivable	-	2,537
Prepaid federal excise tax	(16,500)	(6,000)
Prepaid expenses	475	(536)
Accounts payable and accrued expenses	(9,778)	16,741
Grants payable	(74,807)	(15,039)
Net Cash from Operating Activities	(1,259,498)	(1,006,677)
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(11,731,555)	(8,131,247)
Proceeds from sale of investments	15,602,092	9,990,307
Due from investment custodian	(2,731,381)	(856,061)
Net Cash from Investing Activities	1,139,156	1,002,999
Net Change in Cash and Cash Equivalents	(120,342)	(3,678)
 CASH AND CASH EQUIVALENTS		
Beginning of year	181,100	184,778
End of year	\$ 60,758	\$ 181,100
 SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for federal excise tax on investment income	\$ 47,000	\$ 28,099
Cash paid for federal unrelated business income taxes	-	1,355

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

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

Basis of Presentation and Use of Estimates

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which 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. Accordingly actual results could differ from those estimates.

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.

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.

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

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

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.

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 December 31, 2009.

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

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

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 3, 2013.

3. Fair Value Measurements

The Foundation has invested in several commingled funds and fund of funds. The underlying assets in these funds can span many categories listed below. The Foundation uses its best efforts to categorize each of its investments in a fund or a fund of fund basis to the class that represents in the Foundation's estimation the majority of the assets for a particular investment.

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	2012			
	Level 1	Level 2	Level 3	Total
Cash Equivalents	\$ 386,703	\$ -	\$ -	\$ 386,703
Fixed Income Funds				
Bonds	4,264,267	-	-	4,264,267
U.S. Government and Foreign Government bonds	-	2,009,231	-	2,009,231
Equity Funds				
U.S. Small Cap Equity	1,061,116	-	-	1,061,116
U.S. Large Cap Equity	2,584,638	-	-	2,584,638
International Equities	6,043,139	-	-	6,043,139
Commodities	1,203,344	-	-	1,203,344
Hedge Funds				
Large/Mid Cap Equity	-	10,083,897	-	10,083,897
Small Cap Equity	-	981,720	-	981,720
Funds of Funds	-	-	3,633,931	3,633,931
Private Equities - Funds of Funds	-	-	1,510,940	1,510,940
Real Estate Funds	-	-	1,407,080	1,407,080
	<u>\$ 15,543,207</u>	<u>\$ 13,074,848</u>	<u>\$ 6,551,951</u>	<u>\$ 35,170,006</u>

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

3. Fair Value Measurements *(continued)*

Description	2011			Total
	Level 1	Level 2	Level 3	
Cash Equivalents	\$ 194,782	\$ -	\$ -	\$ 194,782
Fixed Income Funds				
Bonds	3,361,567	-	-	3,361,567
U.S. Government and Foreign Government bonds	-	2,122,507	-	2,122,507
Equity Funds				
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 following is a reconciliation of the beginning and ending balances for Level 3 investments during the years ended December 31:

	2012				
	Beginning of year	Purchases	Sales	Total realized and unrealized gain/(loss)	End of year
Hedge Funds - Funds of Funds	\$ 6,192,645	\$ -	\$ (3,187,442)	\$ 628,728	\$ 3,633,931
Private Equities - Funds of Funds	1,112,372	340,184	-	58,384	1,510,940
Real Estate Funds	556,717	842,526	(128,606)	136,443	1,407,080
Total	<u>\$ 7,861,734</u>	<u>\$ 1,182,710</u>	<u>\$ (3,316,048)</u>	<u>\$ 823,555</u>	<u>\$ 6,551,951</u>
	2011				
	Beginning of year	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>\$ 977,504</u>	<u>\$ (1,656,061)</u>	<u>\$ 43,875</u>	<u>\$ 7,861,734</u>

Net unrealized gains (losses) on alternative investments held at year end were \$314,955 and \$(45,978) for 2012 and 2011, respectively.

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

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, 2012:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Hedge Funds - Large/Mid Cap Equity (a)	\$ 10,083,897	\$ -	Monthly - Quarterly	30 - 60 days
Hedge Funds - Small Cap Equity (b)	981,720	-	Monthly	30 days
Hedge Funds - Funds of Funds (c)	3,633,931	-	1 - 2 years	60 - 95 days
Private Equities - Funds of Funds (d)	1,510,940	1,726,679	*	*
Real Estate Funds (e)	1,407,080	724,097	*	*
Total	<u>\$ 17,617,568</u>	<u>\$ 2,450,776</u>		

* The private equity and real estate funds 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 a hedge fund investment with an objective to invest in value oriented small and mid-sized equity securities and to identify companies that are trading at reasonable valuations. The investment in this category can be redeemed on a monthly 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, 2012 and 2011

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 \$57,866 and \$58,577 for 2012 and 2011, 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. The Foundation's rate was 1% for 2012 and 2% for 2011. The Foundation has met its minimum distribution requirement.

Deferred excise 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 payable in 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	\$ 406,557	\$ 421,596
Grants authorized	1,399,800	1,506,412
Grants paid	(1,474,607)	(1,474,071)
Prior year multi-year grant rescinded	<u>-</u>	<u>(47,380)</u>
Balance at end of year	<u>\$ 331,750</u>	<u>\$ 406,557</u>

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

6. Grants Payable (*continued*)

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

	<u>2012</u>	<u>2011</u>
Within one year	\$ 331,750	\$ 326,426
Beyond one year	-	80,131
	<u>\$ 331,750</u>	<u>\$ 406,557</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>2012</u>	<u>2011</u>
Administrative fees	\$ 240,038	\$ 162,599
Insurance	5,302	5,297
Professional fees	61,589	69,172
Rent	11,130	10,647
Dues and subscriptions	3,525	7,050
Office expenses	13,467	15,916
Depreciation	2,185	2,309
Miscellaneous expense	9,630	6,747
	<u>\$ 346,866</u>	<u>\$ 279,737</u>

8. Related Party Transactions

During 2012 and 2011, 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 \$240,038 and \$162,599 for 2012 and 2011, respectively, which is reported in operations and governance in the statement of activities.

The First Hospital Foundation

Notes to Financial Statements
December 31, 2012 and 2011

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 sublease agreement for its office space. The lease term expired November 30, 2012. An extension agreement was signed on November 29, 2012 which extends the term until May 31, 2014.

Future minimum rental payments to be made under the lease are as follows:

2013	\$	11,388
2014		<u>4,745</u>
	\$	<u>16,133</u>

* * * * *