

**POTOMAC HEALTH FOUNDATION**

**FINANCIAL STATEMENTS**

**YEARS ENDED OCTOBER 31, 2012 AND 2011**

**POTOMAC HEALTH FOUNDATION  
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**CliftonLarsonAllen**

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## **INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Potomac Health Foundation  
Woodbridge, Virginia

We have audited the accompanying statements of financial position of the Potomac Health Foundation (Foundation) as of October 31, 2012 and 2011, 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Potomac Health Foundation as of October 31, 2012 and 2011, 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.

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

*CliftonLarsonAllen LLP*

**CliftonLarsonAllen LLP**

Arlington, Virginia

March 6, 2013



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**POTOMAC HEALTH FOUNDATION  
STATEMENTS OF FINANCIAL POSITION  
OCTOBER 31, 2012 AND 2011**

<b>ASSETS</b>	<b>2012</b>	<b>2011</b>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 123,621	\$ 200,204
Interest receivable	92,520	97,434
Settlement receivable - current	82,314	82,314
Prepaid expenses	7,185	5,495
Total current assets	305,640	385,447
<b>NONCURRENT ASSETS</b>		
Settlement receivable	527,493	612,277
Investments	94,534,121	89,713,995
Property and equipment, net of accumulated depreciation of \$9,468 and \$3,310	13,628	19,786
Total noncurrent assets	95,075,242	90,346,058
Total assets	\$ 95,380,882	\$ 90,731,505
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 115,138	\$ 146,472
Due to related parties	21,245	16,261
Grants payable	3,005,290	468,564
Federal excise tax payable	46,833	87,930
Total current liabilities	3,188,506	719,227
<b>OTHER LIABILITIES</b>		
Deferred federal excise taxes	55,550	49,193
Total liabilities	3,244,056	768,420
<b>NET ASSETS</b>		
Unrestricted net assets	92,136,826	89,963,085
Total liabilities and net assets	\$ 95,380,882	\$ 90,731,505

See accompanying Notes to Financial Statements.

**POTOMAC HEALTH FOUNDATION  
STATEMENTS OF ACTIVITIES  
YEARS ENDED OCTOBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
<b>REVENUE AND SUPPORT</b>		
Investment income, net	\$ 8,706,016	\$ 3,762,609
Public support	-	580
Total revenue and support	<u>8,706,016</u>	<u>3,763,189</u>
<b>EXPENSES</b>		
Program expense	6,201,994	4,789,110
Management and administrative	330,281	307,904
Total expenses	<u>6,532,275</u>	<u>5,097,014</u>
<b>CHANGE IN NET ASSETS</b>	2,173,741	(1,333,825)
<b>NET ASSETS, beginning of year</b>	<u>89,963,085</u>	<u>91,296,910</u>
<b>NET ASSETS, end of year</b>	<u>\$ 92,136,826</u>	<u>\$ 89,963,085</u>

*See accompanying Notes to Financial Statements.*

**POTOMAC HEALTH FOUNDATION  
STATEMENTS OF CASH FLOWS  
YEARS ENDED OCTOBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 2,173,741	\$ (1,333,825)
Adjustments to reconcile change in net assets to net cash		
Used by operating activities:		
Depreciation	6,158	3,310
Decrease in settlement receivable - noncash	84,784	82,314
Realized gains on investments	(1,700,606)	(1,713,411)
Unrealized (gains) losses on investments	(3,095,428)	779,324
Provision for deferred federal excise tax	6,357	(15,568)
Changes in assets and liabilities:		
Interest receivable	4,914	19,929
Prepaid expenses	(1,690)	(3,929)
Due from related parties	-	120,095
Accounts payable	(31,334)	34,033
Due to related parties	4,984	(127,499)
Grants payable	2,536,726	468,564
Federal excise tax payable	(41,097)	68,267
Net cash used by operating activities	<u>(52,491)</u>	<u>(1,618,396)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales of investments	60,252,128	52,307,333
Purchases of investments	<u>(60,276,220)</u>	<u>(50,838,072)</u>
Net cash (used)provided by investing activities	(24,092)	1,469,261
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Purchases of property and equipment	-	<u>(23,096)</u>
Net cash used by financing activities	<u>-</u>	<u>(23,096)</u>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	(76,583)	(172,231)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>200,204</u>	<u>372,435</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>\$ 123,621</u></u>	<u><u>\$ 200,204</u></u>

See accompanying Notes to Financial Statements.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization**

Potomac Health Foundation (the Foundation) was established as a result of the proceeds from the sale of Potomac Hospital Corporation to Sentara Healthcare, Inc. on December 1, 2009. The Foundation issues grants to institutions and organizations in the Foundation's community which qualify under IRS regulations as tax exempt and not private foundations as defined by the Internal Revenue Code.

**Basis of Accounting**

The financial statements of the Foundation have been prepared on the accrual basis of accounting, in compliance with U.S. generally accepted accounting principles.

**Income Taxes**

The Foundation is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. The Foundation has been classified by the Internal Revenue Service as a private foundation and pays Federal excise taxes on taxable investment income.

The Foundation evaluated its tax positions and determined that its positions are more-likely-than-not to be sustained on examination. The Foundation's tax returns are subject to review and examination by federal, state, and local authorities. Tax returns for the fiscal years ended after 2009 are open to examination by federal, state, and local authorities.

**Cash Equivalents**

The Foundation considers all highly liquid investments, which are to be used for current operations and which have a maturity of three months or less when purchased, to be cash equivalents. All other highly liquid instruments, which are to be used for the long-term purchases of the Foundation, are classified as investments.

**Accounts Receivable**

Accounts receivable are recorded at net realizable value. Management determined there was no allowance necessary for doubtful accounts for both years ended October 31, 2012 and 2011.

**Investments**

Investments consist of equity mutual funds, bond mutual funds, fixed income mutual funds, money market mutual funds and shares of partnerships. These investments are recorded in the accompanying financial statements at fair value. Interest, dividends and realized gains or losses are recorded when earned, based upon settlement date. Fluctuations in the fair value of the portfolio are recorded as unrealized gains or losses.

The Foundation has various investment vehicles where the carrying value fluctuates with the financial markets. As a result, the value of such investments as of the date of this report may be materially different than year-end values.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Fair Value of Financial Instruments**

**Fair Value Measurements**

The Foundation accounts for a significant portion of its financial instruments at fair value or considers fair value in their measurement. The Foundation accounts for certain financial assets and liabilities at fair value under various accounting literature.

**Fair Value Hierarchy**

The Foundation has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded on the statement of financial position are categorized based on the inputs to the valuation techniques as follows:

*Level 1* – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Foundation has the ability to access.

*Level 2* – Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include among others, quoted prices for similar assets or liabilities in active market or non-active market.

*Level 3* – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

**Property and Equipment**

Property and equipment are stated at cost. The cost and related accumulated depreciation of assets retired or otherwise disposed of or sold are removed from the accounts and any resulting gain or loss is recognized in the accompanying statement of activities. Acquisitions of property and equipment over \$1,000 with a useful life of greater than one year are capitalized. Repairs and maintenance are charged to expenses as incurred.

The straight-line method is used to depreciate the cost of furniture, fixtures and equipment over their estimated useful lives ranging from three to five years. Office improvements are being amortized on a straight-line basis over the shorter of the occupancy agreement period or the useful life of the improvements.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Net Assets**

Net assets are classified as unrestricted, temporarily restricted or permanently restricted based on the existence or absence of donor-imposed restrictions. The purpose of each net asset group and fund within the net asset group is as follows:

Unrestricted - Resources over which the Foundation has discretionary control. Designated amounts represent those revenues, which the Foundation has set aside for a particular purpose.

Temporarily Restricted - Those resources subject to donor-imposed restrictions, which will be satisfied by actions of the Foundation or passage of time. The items of this nature recorded in the Foundation's financial statements are related to funds collected by the Foundation to be used per the donors' requirements. The earnings on the temporarily restricted net assets are temporarily restricted for the purpose specified by the donor.

Permanently Restricted - Permanently restricted net assets generally result from assets donated for a specific purpose with a donor stipulation that the assets be preserved and not be sold, or from assets donated with donor stipulations that they be invested to provide a permanent source of income, e.g., endowment funds.

The Foundation currently has no permanently restricted net assets.

**Grants Payable**

Grant commitments are charged to operations at the time the grants are approved by the board of trustees. Grants are cancelled at the time of board of trustee action.

**Functional Allocation of Expenses**

The costs of providing the various programs and supporting services of the Foundation have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited based on the estimated staff time devoted to each area.

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

**Subsequent Events**

In preparing these financial statements, the Foundation has evaluated events and transactions for potential recognition or disclosure through March 6, 2013, the date the financial statements were available to be issued.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 2 CONCENTRATION OF RISK**

**Credit Risk**

Financial instruments that subject the Foundation to a concentration of credit risk consist of demand deposits placed with financial institutions which may, at times, exceed federally insured limits.

**Fair Value Risk**

The Foundation invests in a variety of investments. These investments are exposed to various risks, such as fluctuations in market value and credit risk. It is at least reasonably possible that changes in risks in the near term could materially affect investment balances and the amounts reported in the financial statements.

**NOTE 3 INVESTMENTS**

Investments are recorded at fair value. Money market funds are stated at cost which approximates fair value. The estimated fair value is based on quoted market prices, except for alternative investments, for which quoted market prices are not available. The estimated fair value of certain alternative investments, such as interests in hedge funds and limited partnerships, is based on valuations provided by the external investment managers. The Foundation believes the carrying amount of these financial instruments is reasonable; however, because the alternative investments are not readily marketable, their estimated value is subject to uncertainty and may differ from the value used had a ready market for such investments existed. Such differences could be material.

Investments consisted of the following for the years end October 31:

	<b>2012</b>		<b>2011</b>	
	Cost	Market	Cost	Market
Mutual funds - bonds	\$ 36,928,446	\$ 38,995,513	\$ 36,931,087	\$ 37,797,988
Mutual funds - domestic equities	29,355,746	30,786,890	25,496,470	27,176,199
Limited partnerships and hedge funds	12,900,000	13,746,552	12,900,000	12,871,910
Mutual funds - international equities	9,583,227	10,793,508	11,926,821	11,867,898
Total mutual funds	<u>88,767,419</u>	<u>94,322,463</u>	<u>87,254,378</u>	<u>89,713,995</u>
Money market mutual funds	211,658	211,658	-	-
Total investments	<u>\$ 88,979,077</u>	<u>\$ 94,534,121</u>	<u>\$ 87,254,378</u>	<u>\$ 89,713,995</u>

Investment income for the years ending October 31 consisted of:

	<b>2012</b>	<b>2011</b>
Interest and dividends	\$ 4,221,488	\$ 3,162,695
Realized gains	1,700,606	1,713,411
Unrealized gain (losses)	3,095,428	(779,324)
Management fees	<u>(311,506)</u>	<u>(334,173)</u>
Total	<u>\$ 8,706,016</u>	<u>\$ 3,762,609</u>

Interest accrued on investments as of October 31, 2012 and 2011, was \$92,520 and \$97,434, respectively.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 4 FAIR VALUE MEASUREMENTS**

The following table presents the Foundation's fair value hierarchy for those assets measured at fair value on a recurring basis is as follows:

**October 31, 2012**

	Level 1	Level 2	Level 3	Total
Mutual funds - bonds	\$ 38,995,513	\$ -	\$ -	\$ 38,995,513
Mutual funds - domestic equities	30,786,890	-	-	30,786,890
Limited partnerships and hedge funds	-	13,746,552	-	13,746,552
Mutual funds - international equities	10,793,508	-	-	10,793,508
Total Mutual Funds	<u>\$ 80,575,911</u>	<u>\$ 13,746,552</u>	<u>\$ -</u>	<u>\$ 94,322,463</u>

**October 31, 2011**

	Level 1	Level 2	Level 3	Total
Mutual funds - bonds	\$ 37,797,988	\$ -	\$ -	\$ 37,797,988
Mutual funds - domestic equities	27,176,199	-	-	27,176,199
Limited partnerships and hedge funds	-	12,871,910	-	12,871,910
Mutual funds - international equities	11,867,898	-	-	11,867,898
Total mutual funds	<u>\$ 76,842,085</u>	<u>\$ 12,871,910</u>	<u>\$ -</u>	<u>\$ 89,713,995</u>

The following summarizes fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent) for the year ended October 31, 2012:

	Net Asset Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Limited partnerships	\$ 5,112,970	Quarterly	90 days
Hedge funds	8,633,582	Quarterly	30-90 days
	<u>\$ 13,746,552</u>		

The following summarizes fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent) for the year ended October 31, 2011:

	Net Asset Value	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Limited partnerships	\$ 4,601,443	Quarterly	90 days
Hedge funds	8,270,467	Quarterly	30-90 days
	<u>\$ 12,871,910</u>		

The fair value of the limited liability partnerships and hedge funds in this category has been estimated using the net asset value per share of the investments.

Investments in limited partnerships consist of funds placed with a core property fund seeking both current income and long-term capital appreciation and are organized to invest directly and indirectly in a diversified pool of private investment vehicles that invest in commercial real estate properties.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 4 FAIR VALUE MEASUREMENTS (CONTINUED)**

Hedge funds use a variety of strategies, including hedged equity, global trading, market neutral, long and short biased, event driven and global asset allocation. Hedge funds can invest in a wide variety of both public and private securities including equities, fixed income, commodities, private placements, currencies, real estate, loans, derivatives and special situation investments.

There are no unfunded future commitments at either October 31, 2011 or 2012.

**NOTE 5 FEDERAL TAXES AND DISTRIBUTION REQUIREMENTS**

**Federal Excise and Income Taxes**

The Foundation is subject to a 2% excise tax (reduced to 1% if certain requirements are met) on its net investment income. Net investment income principally includes income from investments and net realized capital gains (net capital losses, however, are not deductible). The Foundation was subject to the 1% rate in 2012. The federal excise and income tax return for the Foundation for 2012 is subject to examination by the Internal Revenue Service.

Deferred federal excise taxes based on the 1% rate are computed on the differences between the carrying value and tax basis of the Foundation's investments.

The composition of the federal excise tax provision for the years ended October 31 is as follows:

	<b>2012</b>	<b>2011</b>
Federal excise tax payable	\$ 46,833	\$ 87,930
Deferred federal excise taxes	55,550	49,193
	\$ 102,383	\$ 137,123

**Distribution Requirements**

The Foundation is subject to distribution requirements of the Internal Revenue Code. Accordingly, it must distribute, within one year after the end of each fiscal year, 5% of the fair market value of its investment assets. Qualifying distributions are determined on a cash basis and include grant payment and certain other expenses incurred by the Foundation.

**POTOMAC HEALTH FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
OCTOBER 31, 2012 AND 2011**

**NOTE 6 SETTLEMENT RECEIVABLE**

On December 1, 2009, Potomac Hospital Foundation (now doing business as Potomac Health Foundation), Sentara Healthcare, Inc. (Sentara) and Potomac Hospital Corporation (Hospital) entered into an affiliation agreement. The agreement stipulates that Sentara will provide to the Foundation office space and a clerical staff person free of charge for ten years starting on the date of the agreement. As of October 31, 2012, the balance of the receivable was \$609,807, consisting of \$252,538 in in-kind rent and \$357,269 in donated services. The balance of the receivable for the year ended October 31, 2011 was \$694,591. During the year ended October 31, 2012, \$82,314 was utilized by the Foundation and recognized as expense in the Statement of Activities. Long-term settlement receivables consist of the following in-kind pledges:

2013 - 2017	\$	411,570
Thereafter		<u>198,237</u>
		609,807
Less: current portion		<u>82,314</u>
	\$	<u><u>527,493</u></u>

**NOTE 7 ESCROW**

On December 1, 2009, the Foundation, Sentara, and the Hospital entered into an affiliation agreement. As a result, the assets of the Hospital were transferred to Sentara. Sentara subsequently transferred \$86,500,000 to the Foundation. In addition, \$5,500,000 was escrowed to be available for claims against the Hospital that originated prior to the date of the agreement. The Foundation is currently unable to determine the amount of the escrow that will remain for the Foundation's usage. Therefore, no contingent gain has been recorded on the accompanying financial statements.

**NOTE 8 RELATED PARTY TRANSACTIONS**

During the years ended October 31, 2012 and 2011, the Foundation incurred \$246,734 and \$77,571, respectively, of expense for employees leased from Sentara. As of October 31, 2012 and 2011, \$21,245 and \$16,261, respectively, was due to Sentara from the Foundation.

**SUPPLEMENTAL INFORMATION**

**POTOMAC HEALTH FOUNDATION  
SCHEDULES OF FUNCTIONAL EXPENSES  
YEARS ENDED OCTOBER 31, 2012 AND 2011**

	<b>2012</b>			<b>2011</b>		
	Program	Administrative and Management	Total	Program	Administrative and Management	Total
Grants and scholarships	\$ 6,057,850	\$ -	\$ 6,057,850	\$ 4,685,637	\$ -	\$ 4,685,637
Payroll	76,349	168,475	244,824	52,339	153,274	205,613
Taxes and fees	14,293	41,757	56,050	18,420	53,942	72,362
Payroll - benefits	16,797	37,064	53,861	6,936	14,646	21,582
Professional fees	6,724	29,082	35,806	7,964	23,322	31,286
Occupancy	8,372	24,460	32,832	8,114	23,762	31,876
Professional development	4,352	8,466	12,818	2,057	4,532	6,589
Technology	6,068	5,555	11,623	1,716	3,725	5,441
Meetings	3,527	2,748	6,275	386	11,529	11,915
Depreciation	1,570	4,588	6,158	843	2,467	3,310
Travel	2,980	2,710	5,690	1,313	5,755	7,068
Other expense	2,165	2,608	4,773	831	3,469	4,300
Insurance	947	2,768	3,715	2,554	7,481	10,035
	<u>\$ 6,201,994</u>	<u>\$ 330,281</u>	<u>\$ 6,532,275</u>	<u>\$ 4,789,110</u>	<u>\$ 307,904</u>	<u>\$ 5,097,014</u>