

POTOMAC HEALTH FOUNDATION

FINANCIAL STATEMENTS

YEARS ENDED OCTOBER 31, 2014 AND 2013

**POTOMAC HEALTH FOUNDATION
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Potomac Health Foundation
Woodbridge, Virginia

We have audited the accompanying financial statements of Potomac Health Foundation (Foundation) as of October 31, 2014 and 2013, and the related statements of financial position, 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 Potomac Health Foundation as of October 31, 2014 and 2013, 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.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses on page 14 are presented for purposes of additional analysis and are 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

Arlington, Virginia
February 20, 2015

**POTOMAC HEALTH FOUNDATION
STATEMENTS OF FINANCIAL POSITION
OCTOBER 31, 2014 AND 2013**

ASSETS	2014	2013
CURRENT ASSETS		
Cash and cash equivalents	\$ 337,890	\$ 247,722
Interest receivable	31,648	54,843
Settlement receivable - current	97,168	101,650
Prepaid expenses	6,417	25,548
Federal excise tax overpayment applied	16,994	-
Total current assets	<u>490,117</u>	<u>429,763</u>
NONCURRENT ASSETS		
Settlement receivable	350,199	431,166
Investments	102,569,934	100,443,660
Property and equipment, net of accumulated depreciation of \$23,014 and \$17,070	10,549	16,493
Total noncurrent assets	<u>102,930,682</u>	<u>100,891,319</u>
 Total assets	 <u><u>\$ 103,420,799</u></u>	 <u><u>\$ 101,321,082</u></u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	\$ 130,098	\$ 117,848
Due to related parties	10,621	13,769
Grants payable	1,391,995	987,370
Federal excise tax payable	-	5,008
Total current liabilities	<u>1,532,714</u>	<u>1,123,995</u>
OTHER LIABILITIES		
Deferred federal excise taxes	<u>102,977</u>	<u>94,566</u>
 Total liabilities	 1,635,691	 1,218,561
NET ASSETS		
Unrestricted net assets	<u>101,785,108</u>	<u>100,102,521</u>
 Total liabilities and net assets	 <u><u>\$ 103,420,799</u></u>	 <u><u>\$ 101,321,082</u></u>

See accompanying Notes to Financial Statements.

**POTOMAC HEALTH FOUNDATION
STATEMENTS OF ACTIVITIES
YEARS ENDED OCTOBER 31, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
REVENUE AND SUPPORT		
Investment income, net	\$ 6,958,086	\$ 10,439,684
Public support	100	-
Total revenue and support	<u>6,958,186</u>	<u>10,439,684</u>
EXPENSES		
Program expense	4,986,436	2,150,416
Management and administrative	289,163	323,573
Total expenses	<u>5,275,599</u>	<u>2,473,989</u>
CHANGES IN NET ASSETS	1,682,587	7,965,695
UNRESTRICTED NET ASSETS, beginning of year	<u>100,102,521</u>	<u>92,136,826</u>
UNRESTRICTED NET ASSETS, end of year	<u><u>\$ 101,785,108</u></u>	<u><u>\$ 100,102,521</u></u>

See accompanying Notes to Financial Statements.

**POTOMAC HEALTH FOUNDATION
STATEMENTS OF CASH FLOWS
YEARS ENDED OCTOBER 31, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	\$ 1,682,587	\$ 7,965,695
Adjustments to reconcile changes in net assets to net cash used in operating activities:		
Depreciation	5,944	7,602
Decrease in settlement receivable - noncash	85,449	76,991
Realized gains on investments	(1,998,779)	(4,084,605)
Unrealized gains on investments	(841,087)	(3,901,606)
Provision for deferred federal excise tax	8,411	39,016
Changes in assets and liabilities:		
Interest receivable	23,195	37,677
Prepaid expenses	19,131	(18,363)
Federal excise tax receivable	(16,994)	-
Accounts payable	12,250	2,710
Due to related parties	(3,148)	(7,476)
Grants payable	404,625	(2,017,920)
Federal excise tax payable	(5,008)	(41,825)
Net cash used in operating activities	<u>(623,424)</u>	<u>(1,942,104)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of investments	24,506,913	59,823,693
Purchases of investments	<u>(23,793,321)</u>	<u>(57,747,021)</u>
Net cash provided by investing activities	713,592	2,076,672
CASH FLOWS FROM FINANCING ACTIVITIES		
Purchases of property and equipment	-	(10,467)
Net cash used in financing activities	<u>-</u>	<u>(10,467)</u>
INCREASE IN CASH AND CASH EQUIVALENTS	90,168	124,101
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>247,722</u>	<u>123,621</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 337,890</u></u>	<u><u>\$ 247,722</u></u>

See accompanying Notes to Financial Statements.

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

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 2011 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 the years ended October 31, 2014 and 2013.

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.

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

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, 2014 AND 2013**

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.

The Foundation currently has no temporarily or 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.

Use of 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 February 20, 2015, the date the financial statements were available to be issued.

Reclassifications

Certain reclassifications have been made to the October 31, 2013 financial statements in order to present them in conformity with the October 31, 2014 financial statements. These reclassifications had no net effect on net assets as previously reported.

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

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. Mutual funds are valued at the last sales price, or if there is no sale and the market is still considered active, at the last transaction price before year end. 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 ended October 31:

	2014		2013	
	Cost	Market	Cost	Market
Mutual funds - bonds	\$ 34,492,584	\$ 34,809,310	\$ 31,250,908	\$ 31,685,519
Mutual funds - domestic equities	27,240,457	31,376,416	29,176,949	33,320,361
Mutual funds - international equities	17,883,904	20,412,619	17,453,994	20,561,437
Limited partnerships	9,300,000	12,120,461	9,300,000	10,825,058
Hedge funds	3,355,294	3,851,128	3,805,158	4,051,285
Total investments	<u>\$ 92,272,239</u>	<u>\$ 102,569,934</u>	<u>\$ 90,987,009</u>	<u>\$ 100,443,660</u>

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

NOTE 3 INVESTMENTS (CONTINUED)

Investment income for the years ending October 31 consisted of:

	<u>2014</u>	<u>2013</u>
Interest and dividends	\$ 4,507,265	\$ 2,803,881
Realized gains	1,998,779	4,084,605
Unrealized gain	841,087	3,901,606
Management fees	(389,045)	(350,408)
Total	<u>\$ 6,958,086</u>	<u>\$ 10,439,684</u>

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, 2014

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Mutual funds - bonds	\$ 34,809,310	\$ -	\$ -	\$ 34,809,310
Mutual funds - domestic equities	31,376,416	-	-	31,376,416
Mutual funds - international equities	20,412,619	-	-	20,412,619
Limited partnerships	-	-	12,120,461	12,120,461
Hedge funds	-	-	3,851,128	3,851,128
Total investments	<u>\$ 86,598,345</u>	<u>\$ -</u>	<u>\$ 15,971,589</u>	<u>\$ 102,569,934</u>

October 31, 2013

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Mutual funds - bonds	\$ 31,685,519	\$ -	\$ -	\$ 31,685,519
Mutual funds - domestic equities	33,320,361	-	-	33,320,361
Mutual funds - international equities	20,561,437	-	-	20,561,437
Limited partnerships	-	-	10,825,058	10,825,058
Hedge funds	-	449,865	3,601,420	4,051,285
Total investments	<u>\$ 85,567,317</u>	<u>\$ 449,865</u>	<u>\$ 14,426,478</u>	<u>\$ 100,443,660</u>

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

NOTE 4 FAIR VALUE MEASUREMENTS (CONTINUED)

Level 3 assets are valued using the income approach. Fair values for assets in level 3 are calculated using assumptions about discounted cash flow and other present value techniques. There were no changes in the valuation techniques during the years ended October 31, 2014 and 2013. The following table provides a summary of changes in fair value of the Foundation's investments classified as Level 3 for the year ended October 31, 2014 and 2013:

	<u>SEI Core Property Fund, LP</u>	<u>SEI Special Situations Fund LTD</u>
Balance as of November 1, 2012	\$ 5,112,970	\$ 4,309,342
Unrealized and realized gains	712,088	292,078
Purchases/(Distributions)	<u>5,000,000</u>	<u>(1,000,000)</u>
Balance as of October 31, 2013	10,825,058	3,601,420
Unrealized and realized gains	1,295,403	249,708
Purchases/(Distributions)	-	-
Balance as of October 31, 2014	<u>\$ 12,120,461</u>	<u>\$ 3,851,128</u>

In September 2009, guidance was issued under the ASC Topic - Fair Value Measurements and Disclosures, which clarified the fair value level classification for entities that calculate net asset value per share or its equivalent. The guidance states that "if a reporting entity has the ability to redeem its investment with the investee at net asset value per share (or its equivalent) at the measurement date, the fair value measurement of the investment shall be categorized as a Level 2 fair value measurement."

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, 2014:

	<u>Net Asset Value</u>	<u>Redemption Frequency (If Currently Eligible)</u>	<u>Redemption Notice Period</u>
SEI Core Property Fund, LP	\$ 12,120,461	Quarterly	65 days
SEI Special Situations Fund LTD	3,851,128	Semi-annually	95 days

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, 2013:

	<u>Net Asset Value</u>	<u>Redemption Frequency (If Currently Eligible)</u>	<u>Redemption Notice Period</u>
SEI Core Property Fund, LP	\$ 10,825,058	Quarterly	65 days
SEI Special Situations Fund LTD	3,601,420	Semi-annually	95 days
SEI Offshore Opp II Class F Escrow	449,865	Quarterly	30-90 days

Investments in limited partnership 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 investment vehicles that invest in commercial real estate properties.

**POTOMAC HEALTH FOUNDATION
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2014 AND 2013**

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, 2014 or 2013.

NOTE 5 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 office space and a clerical staff person free of charge to the Foundation for ten years starting on the date of the agreement. For the years ended October 31, 2014 and 2013, \$85,449 and \$76,991, respectively, were utilized by the Foundation and recognized as expense in the statements of activities. Settlement receivables are expected to be collected as follows:

2015 - 2019	\$	447,367
Less: current portion		97,168
	\$	<u>350,199</u>

NOTE 6 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 2014 and 2013.

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.

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, 2014 AND 2013**

NOTE 7 RELATED PARTY TRANSACTION

The Foundation leases employees from Sentara in addition to the receipt of in-kind office space and clerical staff support through the affiliation agreement (Note 5). During the years ended October 31, 2014 and 2013, the Foundation incurred expenses of \$126,740 and \$241,756, respectively, for payroll and benefits for employees leased from Sentara. As of October 31, 2014 and 2013, \$10,621 and \$13,769, respectively, was due to Sentara.

NOTE 8 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.

**POTOMAC HEALTH FOUNDATION
SCHEDULES OF FUNCTIONAL EXPENSES
YEARS ENDED OCTOBER 31, 2014 AND 2013**

	2014			2013		
	Program	Administrative and Management	Total	Program	Administrative and Management	Total
Grants and scholarships	\$ 4,800,435	\$ -	\$ 4,800,435	\$ 2,001,191	\$ -	\$ 2,001,191
Payroll	99,465	145,617	245,082	71,463	162,087	233,550
Taxes and fees	24,450	36,535	60,985	16,665	48,689	65,354
Payroll - benefits	18,747	31,025	49,772	15,967	35,659	51,626
Professional fees	335	37,880	38,215	6,226	31,377	37,602
Occupancy	13,965	20,867	34,832	8,623	25,194	33,817
Technology	9,403	4,138	13,541	8,126	6,165	14,272
Professional development	9,265	1,530	10,795	7,130	2,855	9,985
Meetings	2,212	4,194	6,406	7,044	1,846	8,891
Depreciation	2,383	3,561	5,944	1,938	5,664	7,602
Other expense	2,117	1,743	3,860	1,104	1,376	2,500
Travel	2,803	795	3,598	4,395	1,071	5,465
Insurance	856	1,278	2,134	544	1,590	2,134
	<u>\$ 4,986,436</u>	<u>\$ 289,163</u>	<u>\$ 5,275,599</u>	<u>\$ 2,150,416</u>	<u>\$ 323,573</u>	<u>\$ 2,473,989</u>