# ALIVE HOSPICE, INC.

## FINANCIAL STATEMENTS
December 31, 2012 and 2011

ALIVE HOSPICE, INC.
Nashville, Tennessee

FINANCIAL STATEMENTS
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CONTENTS

# INDEPENDENT AUDITOR'S REPORT

Board of Directors
Alive Hospice, Inc.
Nashville, Tennessee

***Report on the Financial Statements***

We have audited the accompanying financial statements of Alive Hospice, Inc. (the "Organization") which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of operations and changes in net assets 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.

***Auditor's 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 auditor's 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.

(Continued)

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Alive Hospice, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

South Bend, Indiana
May 23, 2013

ALIVE HOSPICE, INC.
STATEMENTS OF FINANCIAL POSITION
December 31, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $ 7,835,887 | $ 6,936,266 |
| Accounts receivable, net | 2,607,925 | 2,637,877 |
| Pledges receivable, net | 288,297 | 217,133 |
| Prepaid expenses | 336,140 | 387,830 |
| Assets held for sale | - | 290,000 |
| Other current assets | 80,501 | 64,922 |
| Total current assets | 11,148,750 | 10,534,028 |
| Pledges receivable | 37,442 | 45,105 |
| Investments | 1,860,478 | 1,726,865 |
| Property and equipment, net | 10,702,255 | 11,435,869 |
| Goodwill | 554,293 | 554,293 |
| | $ 24,303,218 | $ 24,296,160 |
| **LIABILITIES AND NET ASSETS** | | |
| Current liabilities | | |
| Current maturities of long-term debt | $ 280,000 | $ 240,000 |
| Accounts payable | 767,794 | 1,113,692 |
| Accrued expenses | 1,348,291 | 1,664,783 |
| Total current liabilities | 2,396,085 | 3,018,475 |
| Long-term debt, less current maturities | - | 280,000 |
| Net assets | | |
| Unrestricted | | |
| Undesignated | 19,380,266 | 18,853,285 |
| Board designated | 405,200 | 376,444 |
| Total unrestricted net assets | 19,785,466 | 19,229,729 |
| Temporarily restricted | 965,560 | 624,389 |
| Permanently restricted | 1,156,107 | 1,143,567 |
| Total net assets | 21,907,133 | 20,997,685 |
| | $ 24,303,218 | $ 24,296,160 |

See accompanying notes to financial statements.

ALIVE HOSPICE, INC.
STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
Years ended December 31, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| **Unrestricted net assets** | | |
| Revenue | | |
| Net patient service revenue | $ 30,731,318 | $ 30,145,731 |
| Contributions and fundraising | 1,129,952 | 1,304,316 |
| Investment income | 18,611 | 22,680 |
| Net realized gains on investments | 8,674 | 2,243 |
| Other revenue | 85,056 | 27,389 |
| Net assets released from restriction used for operations | 240,653 | 138,036 |
| Total operating revenue | 32,214,264 | 31,640,395 |
| Operating expenses | | |
| Salaries and wages | 15,307,945 | 14,650,647 |
| Employee benefits | 2,908,074 | 2,822,772 |
| Contract labor | 1,418,018 | 914,761 |
| Purchased services | 3,121,267 | 3,656,159 |
| Pharmacy and medical supplies | 3,318,663 | 3,340,723 |
| Occupancy and equipment | 1,973,427 | 1,951,768 |
| Other | 2,519,112 | 2,568,661 |
| Depreciation | 900,749 | 1,089,303 |
| Provision for uncollectible accounts | 168,700 | 284,368 |
| Interest | 36,768 | 62,767 |
| Total operating expenses | 31,672,723 | 31,341,929 |
| Change in unrestricted net assets from operations | 541,541 | 298,466 |
| **Non-operating revenue and expenses** | | |
| Net unrealized gains (losses) on investments | 14,196 | (25,630) |
| Change in unrestricted net assets | 555,737 | 272,836 |
| **Temporarily restricted net assets** | | |
| Contributions | 429,783 | 366,563 |
| Investment income | 28,322 | 34,108 |
| Net realized and unrealized gains (losses) on investments | 123,719 | (58,003) |
| Net assets released from restriction used for operations | (240,653) | (138,036) |
| Change in temporarily restricted net assets | 341,171 | 204,632 |
| **Permanently restricted net assets** | | |
| Contributions | 12,540 | 14,927 |
| Change in permanently restricted net assets | 12,540 | 14,927 |
| **Change in net assets** | 909,448 | 492,395 |
| Net assets at beginning of year | 20,997,685 | 20,505,290 |
| **Net assets at end of year** | $ 21,907,133 | $ 20,997,685 |

See accompanying notes to financial statements.

ALIVE HOSPICE, INC.
STATEMENTS OF CASH FLOWS
Years ended December 31, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Change in net assets | $ 909,448 | $ 492,395 |
| Adjustments to reconcile change in net assets to net cash from operating activities | | |
| Depreciation | 900,749 | 1,089,303 |
| (Gain) loss on disposal of property and equipment | (9,900) | 6,809 |
| Net realized and unrealized (gains) losses on investments | (146,589) | 81,390 |
| Provision for uncollectible accounts | 168,700 | 284,368 |
| Restricted contributions received | (12,540) | (14,927) |
| Donated property | - | (290,000) |
| Changes in assets and liabilities | | |
| Accounts receivable | (138,748) | 350,318 |
| Pledges receivable | (63,501) | (101,104) |
| Prepaid expenses | 51,690 | (119,059) |
| Other current assets | (15,579) | (1,509) |
| Accounts payable | (345,898) | (95,616) |
| Accrued expenses | (316,492) | (196,580) |
| Net cash from operating activities | 981,340 | 1,485,788 |
| **Cash flows from investing activities** | | |
| Proceeds from sales of investments | 653,081 | 791,707 |
| Purchases of investments | (640,105) | (862,568) |
| Proceeds from sale of property and equipment | 299,900 | - |
| Purchases of property and equipment | (167,135) | (415,304) |
| Net cash from investing activities | 145,741 | (486,165) |
| **Cash flows from financing activities** | | |
| Payments on long-term debt | (240,000) | (1,486,948) |
| Proceeds from restricted contributions | 12,540 | 14,927 |
| Net cash from financing activities | (227,460) | (1,472,021) |
| Net change in cash and cash equivalents | 899,621 | (472,398) |
| Cash and cash equivalents at beginning of year | 6,936,266 | 7,408,664 |
| **Cash and cash equivalents at end of year** | $ 7,835,887 | $ 6,936,266 |
| Supplemental disclosure of cash flow information | | |
| Cash paid for interest | $ 36,852 | $ 62,773 |

See accompanying notes to financial statements.

## NOTE 1 - NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Alive Hospice, Inc. (the "Organization") provides medical, psychological, and spiritual care to terminally ill patients and their families, located primarily in Middle Tennessee.

Basis of Accounting: The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Use of Estimates: The preparation of financial statements in conformity with U.S. GAAP 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. Areas where significant estimates are used in the accompanying financial statements include the allowance for uncollectible accounts and the fair values of investment securities and other financial instruments. Actual results could differ from those estimates.

Financial Statement Presentation: The financial statements report the changes in and totals of each net asset class based on the existence of donor restrictions, as applicable. Net assets are classified as unrestricted, temporarily restricted, or permanently restricted and are detailed as follows:

> Unrestricted net assets represent the part of the net assets of the Organization that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations. The unrestricted net assets are comprised of Board designated and unrestricted amounts. Board designated net assets are designated for various purposes based on the direction of the Organization's Board of Directors, and are not specified as an endowment.
>
> Temporarily restricted net assets represent the part of the net assets of the Organization resulting from contributions and other inflows of assets whose use by the Organization is limited by donor-imposed stipulations that either expire by the passage of time or by actions of the Organization. Temporarily restricted net assets at December 31, 2012 and 2011 represent pledges receivable, accumulated earnings on endowment funds, and donor-restricted funds designated for various programs offered by the Organization.
>
> Permanently restricted net assets represent the part of the net assets of the Organization resulting from contributions and other inflows of assets whose use by the Organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Organization. Permanently restricted net assets at December 31, 2012 and 2011 represent donor-restricted gifts that have been invested and are to be maintained in perpetuity, the earnings from which are temporarily restricted to support various programs offered by the Organization.

Cash and Cash Equivalents: Cash and cash equivalents consist of bank deposits in accounts that are federally insured up to $250,000. Additionally, for purposes of the statements of cash flows, the Organization considers all highly liquid investments of operating cash purchased with an original maturity of three months or less to be cash equivalents.

At December 31, 2012 and 2011, and at times during the year, deposits exceeded the federally insured limits. However, management monitors the soundness of the financial institutions and feels the Organization's risk is negligible.

**NOTE 1 - NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Accounts Receivable: The accounts receivable balance represents the unpaid amounts billed to patients and third-party payors. Contractual adjustments, discounts, and an allowance for uncollectible accounts are recorded to report receivables for patient care services at net realizable value. Past due receivables are determined based on contractual terms. The Organization does not accrue interest on any of its accounts receivable. As of December 31, 2012 and 2011, approximately 82% and 83%, respectively, of the Organization's accounts receivable are from Medicare and Medicaid.

Allowance for Uncollectible Accounts: The allowance for uncollectible accounts is determined by management based upon the Organization's historical losses, specific patient circumstances, and general economic conditions. Periodically, management reviews patient accounts receivable and records an allowance based on current circumstances, and charges off the receivable against the allowance when all attempts to collect the receivable are deemed to have failed in accordance with the internal collection policy. Management believes the allowance of $418,104 and $380,103 as of December 31, 2012 and 2011, respectively, is adequate to cover potential losses from uncollectible accounts.

Pledges Receivable: Pledges receivable represent the remaining balance of unconditional promises to give that have not yet been paid. Pledges that are expected to be collected within one year or less are recorded at net realizable value. For pledges that are expected to be collected beyond one year, management has determined the difference between net realizable value and the present value of their estimated future cash flows to be immaterial to the financial statements. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Assets Held for Sale: Assets held for sale consists of a residence that was donated to the Organization during the year ended December 31, 2011. In January 2012, this property was sold.

Investments: All investments are valued at their fair values in the statements of financial position. Unrealized gains and losses are included in the change in net assets. See Notes 4 and 12 for additional information on the Organization's investments.

Property and Equipment: Property and equipment are stated at cost or, if donated to the Organization, at their fair value on the date of the gift. Additions and improvements over $500 are capitalized; expenditures for routine maintenance are charged to operations. Depreciation and amortization is provided over the estimated useful lives of the various classes of assets on the straight-line method.

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

Impairment of Long-Lived Assets: On an ongoing basis, the Organization reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying amounts may be overstated. The Organization recognizes impairment losses if the undiscounted cash flows expected to be generated by the asset are less than the carrying value of the related asset. The impairment loss adjusts the assets to fair value. As of December 31, 2012 and 2011, management believes that no impairments existed.

**NOTE 1 - NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Goodwill: Goodwill represents the excess of the purchase price over the fair value of net assets of businesses acquired. The carrying amount of goodwill is reviewed annually to determine if facts and circumstances suggest that assets may be impaired. As of December 31, 2012 and 2011, management believes that no impairment existed.

Net Patient Service Revenue: Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Approximately 90% and 91% of the Organization's net patient service revenue was derived from the Medicare and Medicaid programs for the years ended December 31, 2012 and 2011, respectively.

Provisions for estimated third-party payor settlements have been made in the financial statements for estimated contractual adjustments, representing the difference between the standard charges for services and estimated total payments to be received from third-party payors. These estimates are adjusted in future periods as final settlements are determined.

The Organization, like other health care providers, may be subject to investigations, regulatory action, lawsuits, and claims arising out of the conduct of its business, including the interpretation of laws and regulations governing the Medicare and Medicaid programs and other third-party payor agreements. At this time, no specific alleged violations, claims, or assessments have been made. Management intends to fully cooperate with any governmental agencies in requests for information. Noncompliance with laws and regulations can make the Organization subject to regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Hospice organizations are subject to two specific payment limit caps under the Medicare program. One limit relates to inpatient care days that exceed 20% of the total days of hospice care provided for the year. The Organization did not exceed the 20% cap related to inpatient days in 2012 and 2011. The second limit relates to an aggregate Medicare reimbursement cap calculated by the Medicare fiscal intermediary. The Organization did not exceed the Medicare cap for the years ended December 31, 2012 and 2011.

Charity Care: The Organization has a policy of providing charity care to patients who are unable to pay. Such patients are identified based on financial information obtained from the patient and subsequent analysis. Since the Organization does not expect payment, estimated charges for charity care are recorded in revenue with a corresponding offsetting amount. The estimated cost of charity care was approximately $890,000 and $839,000 for the years ended December 31, 2012 and 2011, respectively. This cost estimate was based on the organization-wide cost to charge ratio.

Contributions: Contributions received and unconditional promises to give are recorded as unrestricted, temporarily restricted, or permanently restricted revenue depending on the existence of donor restrictions and the nature of such restrictions, if they exist.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restriction.

If a restriction is fulfilled in the same accounting period in which the contribution is received, the contribution is reported as unrestricted.

Donated Services: The value of time contributed by unpaid volunteers to the Organization has not been included in the financial statements. The value of donated tangible items is recorded at fair value at date of receipt.

**NOTE 1 - NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Fair Value of Financial Instruments: The fair values of financial instruments other than investments, which include cash and cash equivalents, accounts receivable, accounts payable, and long-term debt, are based on a variety of factors. In some cases, fair values represent quoted market prices for identical or comparable instruments (Level 1 inputs - market approach). In other cases, fair values have been estimated based on assumptions about the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of risk (Level 2 inputs - income approach). Accordingly, the fair values may not represent actual values that could have been realized at year-end or that will be realized in the future. All other financial instruments' carrying values approximate fair value as of December 31, 2012 and 2011.

Income Taxes: The Organization is exempt from income taxes on income from related activities under Section 501(c)(3) of the U.S. Internal Revenue Code and corresponding state tax law. Accordingly, no provision has been made for federal or state income taxes.

U.S. GAAP requires that a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Due to its tax-exempt status, the Organization is not subject to U.S. federal income tax or state income tax. The Organization's Form 990 has not been subject to examination by the Internal Revenue Service or the state of Tennessee for the last three years. The Organization does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months. The Organization recognizes interest and/or penalties related to income tax matters in income tax expense. The Organization did not have any amounts accrued for interest and penalties at December 31, 2012 and 2011.

Subsequent Events: Management has performed an analysis of the activities and transactions subsequent to December 31, 2012 to determine the need for any adjustments to and/or disclosures within the audited financial statements for the year ended December 31, 2012. Management performed their analysis through May 23, 2013, the date the financial statements were issued.

**NOTE 2 - ACCOUNTS RECEIVABLE**

At December 31, 2012 and 2011, accounts receivable consists of the following by payor type:

| | 2012 | 2011 |
|---|---|---|
| Medicare | $ 2,637,538 | $ 2,854,334 |
| Medicaid | 865,123 | 963,518 |
| Commercial and other | 754,932 | 787,545 |
| | 4,257,593 | 4,605,397 |
| Allowance for doubtful accounts | (418,104) | (380,103) |
| Medicare Periodic Interim Payment Program | (1,231,564) | (1,587,417) |
| | $ 2,607,925 | $ 2,637,877 |

**NOTE 3 - PLEDGES RECEIVABLE**

The Organization recognizes unconditional promises to give at fair value in the period the promise is made. Pledges receivable are scheduled to be received over the following periods at December 31:

| | 2012 | 2011 |
|---|---|---|
| Less than one year | $ 305,146 | $ 233,982 |
| One to five years | 37,442 | 25,105 |
| Greater than five years | - | 20,000 |
| Total pledges receivable | 342,588 | 279,087 |
| Allowance for uncollectible pledges | (16,849) | (16,849) |
| | $ 325,739 | $ 262,238 |

Management has determined that any discount on pledges would be immaterial at December 31, 2012 and 2011.

Management has recorded an allowance for uncollectible pledges of $16,849 at December 31, 2012 and 2011.

**NOTE 4 - INVESTMENTS**

Investments are recorded at fair value and consisted of the following at December 31:

| | 2012 | 2011 |
|---|---|---|
| Money market funds | $ 82,302 | $ 85,610 |
| Bond funds | 588,186 | 736,798 |
| Equity mutual funds | 1,189,990 | 904,457 |
| | $ 1,860,478 | $ 1,726,865 |

The following schedule summarizes the investment return for the years ended December 31:

| | 2012 | 2011 |
|---|---|---|
| Interest and dividend income | $ 57,694 | $ 67,346 |
| Investment expenses | (10,761) | (10,558) |
| Realized gains on investments | 21,916 | 28,060 |
| Unrealized gains (losses) on investments | 124,673 | (109,450) |
| | $ 193,522 | $ (24,602) |

Investment securities are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would result in material changes in the fair value of investments and net assets of the Organization.

**NOTE 5 - PROPERTY AND EQUIPMENT**

The Organization's property and equipment, and the related accumulated depreciation at December 31, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Land and improvements | $ 3,592,836 | $ 3,592,836 |
| Buildings and improvements | 10,686,722 | 10,608,229 |
| Office furniture and equipment | 2,968,782 | 2,868,269 |
| | 17,248,340 | 17,069,334 |
| Less: Accumulated depreciation | (6,546,085) | (5,633,465) |
| | $ 10,702,255 | $ 11,435,869 |

Depreciation expense for the years ended, December 31, 2012 and 2011 was $900,749 and $1,089,303, respectively.

**NOTE 6 - LONG-TERM DEBT**

A summary of long-term debt at December 31, 2012 and 2011 is as follows:

| | 2012 | 2011 |
|---|---|---|
| The Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County, Tennessee, Variable Rate Tax Exempt Revenue Bonds, Series 2001 (Alive Hospice, Inc. Project), certain principal prepayments required with final principal due August 1, 2019, with variable rate monthly interest payments (1.07% and 1.51% at December 31, 2012 and 2011, respectively), secured by a letter of credit which expires July 27, 2013. In the event the remarketing agents are unable to remarket the bonds, they become a demand note under the letter of credit and require repayment under the terms of the letter of credit. The Organization is required to meet financial and other covenants. At December 31, 2012 and 2011, the Organization was in compliance with all financial covenants. | $ 280,000 | $ 520,000 |
| Less current maturities | 280,000 | 240,000 |
| | $ - | $ 280,000 |

The Organization maintains a $2,500,000 line of credit with a financial institution, which has been subsequently renewed through March 2014. Interest only is payable monthly, and any outstanding principal amounts drawn against the line would be due at maturity. The line of credit is secured by property of the Organization and carries an interest rate at 0.75% above the financial institution's prime rate, resulting in a rate of 4% at December 31, 2012. The Organization had no borrowings outstanding on the line of credit at December 31, 2012 or 2011.

**NOTE 7 - TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are either donor-restricted for specific purposes, or for use in a specified period of time. At December 31, 2012 and 2011 the restricted purposes are as follows:

| | 2012 | 2011 |
|---|---|---|
| Endowment earnings | $ 369,197 | $ 217,156 |
| Pledges | 325,738 | 262,237 |
| Community education | 127,006 | 130,000 |
| Grief support | 50,336 | - |
| Palliative care charity care | 50,000 | 10,000 |
| Employee training | 33,167 | - |
| Other | 10,116 | 4,996 |
| | $ 965,560 | $ 624,389 |

Temporarily restricted net assets were released from restriction for the years ended December 31, 2012 and 2011 for the following purposes:

| | 2012 | 2011 |
|---|---|---|
| Pledges | $ 187,179 | $ 136,965 |
| Community education | 48,094 | - |
| Other | 5,380 | 1,071 |
| | $ 240,653 | $ 138,036 |

**NOTE 8 - LEASE COMMITMENTS**

The Organization leases office space and certain equipment under various noncancellable operating leases. The leases expire on various dates through 2017, with aggregate minimum rentals as follows:

| | |
|---|---|
| 2013 | $ 904,533 |
| 2014 | 361,353 |
| 2015 | 342,299 |
| 2016 | 350,419 |
| 2017 | 165,508 |
| | $ 2,124,112 |

Total rental expense for all operating leases was $1,232,857 and $1,316,119 for the years ended December 31, 2012 and 2011, respectively.

**NOTE 9 - RETIREMENT PLAN**

The Organization provides a defined contribution 403(b) retirement plan. Employees meeting certain eligibility requirements can participate in the plan to the extent allowed under ERISA. The plan also provides for discretionary contributions by the Organization. Participants are immediately vested in their voluntary contributions plus related earnings; whereas, participants are fully vested in the Organization contributions plus related earnings after four years of service. No contributions were made for the years ended December 31, 2012 and 2011.

## NOTE 10 - FUNCTIONAL EXPENSES

Expenses by functional classification for the years ended, December 31, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Program services | $ 26,223,235 | $ 26,149,225 |
| General and administrative | 5,056,730 | 4,816,206 |
| Fundraising | 392,758 | 376,498 |
| | $ 31,672,723 | $ 31,341,929 |

## NOTE 11 - ENDOWMENT ASSETS

Overview: The Organization's endowments consist of one fund that holds investments in securities traded on the public markets. The endowments are made up of temporarily restricted and permanently restricted assets. As required by U.S. GAAP, net assets associated with these endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law: The Organization's Board of Directors has determined the requirements of Tennessee's version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") to center around the preservation of the fair value of the original investment as of the date of the asset transfers. Investments resulting from donations directing that they be invested in perpetuity are classified as permanently restricted. The earnings generated by these investments are classified as unrestricted or temporarily restricted depending on the donors' stipulations. The temporarily restricted net assets are reclassified as unrestricted upon their appropriation for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by Tennessee's version of UPMIFA. The Organization considers the following factors in making a determination to appropriate or accumulate its endowment funds:

(1) The duration and preservation of the fund
(2) The purposes of the Organization and the donor-restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the Organization
(7) The investment policies of the Organization

Return Objectives and Risk Parameters: The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include assets of donor-restricted funds that the Organization must hold in perpetuity. Under this policy, the endowment assets are invested in a manner that is intended to produce a moderate return while assuming a moderate level of investment risk.

Strategies Employed for Achieving Objectives: To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

**NOTE 11 - ENDOWMENT ASSETS** (Continued)

Spending Policy and How the Investment Objectives Relate to Spending Policy: The Organization disburses funds as needed within the guidelines of the endowments. Disbursements to the Organization are used to assist with its programs and services according to donor restrictions.

Fund with Deficiencies: From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. Cumulative deficiencies of this nature that are in excess of related temporarily restricted amounts are reported in unrestricted net assets. There were no such deficiencies as of December 31, 2012 and 2011.

Endowment Net Asset Composition by Type of Fund: The Organization's composition of endowment assets for the years ended December 31, 2012 and 2011 is as follows:

2012:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted | $ - | $ 369,197 | $ 1,156,107 | $ 1,525,304 |

2011:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted | $ - | $ 217,156 | $ 1,143,567 | $ 1,360,723 |

Change in Endowment Net Assets: The Organization's change in endowment assets, by net asset composition, for the years ended December 31, 2012 and 2011 is as follows:

2012:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ - | $ 217,156 | $ 1,143,567 | $ 1,360,723 |
| Interest and dividends | - | 28,322 | - | 28,322 |
| Net gains | - | 123,719 | - | 123,719 |
| Additions | - | - | 12,540 | 12,540 |
| Total endowment | $ - | $ 369,197 | $ 1,156,107 | $ 1,525,304 |

2011:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ - | $ 241,051 | $ 1,128,640 | $ 1,369,691 |
| Interest and dividends | - | 34,108 | - | 34,108 |
| Net losses | - | (58,003) | - | (58,003) |
| Additions | - | - | 14,927 | 14,927 |
| Total endowment | $ - | $ 217,156 | $ 1,143,567 | $ 1,360,723 |

## NOTE 12 - FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

U.S. GAAP defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the Organization's principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

A fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date. The fair values of money market funds, bond funds, and equity mutual funds that are readily marketable are determined by obtaining quoted prices on nationally recognized securities exchanges.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. The Organization has no assets or liabilities measured at fair value using Level 2 inputs.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability. The Organization has no assets or liabilities measured at fair value using Level 3 inputs.

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| | Fair Value Measurements at December 31, 2012 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments | | | | |
| Money market funds | $ 82,302 | $ - | $ - | $ 82,302 |
| Bond funds | 588,186 | - | - | 588,186 |
| Equity mutual funds | 1,189,990 | - | - | 1,189,990 |
| Total assets | $ 1,860,478 | $ - | $ - | $ 1,860,478 |

| | Fair Value Measurements at December 31, 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments | | | | |
| Money market funds | $ 85,610 | $ - | $ - | $ 85,610 |
| Bond funds | 736,798 | - | - | 736,798 |
| Equity mutual funds | 904,457 | - | - | 904,457 |
| Total assets | $ 1,726,865 | $ - | $ - | $ 1,726,865 |