Children's Healthcare of Atlanta, Inc. and Affiliates

Consolidated Financial Statements as of and for the Years Ended December 31, 2012 and 2011, and Independent Auditors' Report

CHILDREN'S HEALTHCARE OF ATLANTA, INC. AND AFFILIATES

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Children's Healthcare of Atlanta, Inc. and Affiliates
Atlanta, Georgia

We have audited the accompanying consolidated financial statements of Children's Healthcare of Atlanta, Inc. and affiliates (a Georgia not-for-profit corporation) ("Children's"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Children's preparation and fair presentation of the consolidated 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 Children'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Children's and its subsidiaries as of December 31, 2012 and 2011, and the results of its operations, 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.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, during 2012 Children's retrospectively changed its presentation of revenues and provision for bad debts as a result of the adoption of the amendments to the Financial Accounting Standards Board Accounting Standards Codification resulting from Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.* Our opinion is not modified as to this matter.

Deloitte & Touche LLP

May 24, 2013

CHILDREN'S HEALTHCARE OF ATLANTA, INC. AND AFFILIATES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 39,544	$ 62,017
Patient accounts receivable — less allowance for uncollectible accounts of $3,751 and $3,724 in 2012 and 2011, respectively	119,777	107,258
Assets whose use is limited (Note 4)	36,812	37,154
Contributions receivable — net	13,410	17,508
Other receivables	26,400	15,695
Supplies and prepaid expenses	17,185	16,391
Total current assets	253,128	256,023
ASSETS WHOSE USE IS LIMITED (Note 4)	2,558,985	2,137,204
PROPERTY AND EQUIPMENT — Net (Note 1)	552,811	558,302
OTHER NONCURRENT ASSETS:		
Bond issuance costs — net	3,788	4,040
Deposits and other assets	838	493
Noncurrent contributions receivable — net	9,560	17,902
Total other noncurrent assets	14,186	22,435
BENEFICIAL INTERESTS IN TRUSTS	113,530	102,062
TOTAL	$ 3,492,640	$ 3,076,026
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 9,500	$ 9,224
Long-term debt classified as current (Note 6)	36,812	37,154
Current research pledges (Note 1)	14,963	16,784
Accounts payable and other	127,355	146,297
Salaries, related taxes, and benefits	37,158	32,501
Accrued interest	2,490	1,844
Total current liabilities	228,278	243,804
LONG-TERM DEBT — Net of portion classified as current (Note 6)	423,000	431,671
NONCURRENT RESEARCH PLEDGES (Note 1)	77,705	56,011
OTHER NONCURRENT LIABILITIES	146,362	151,492
Total noncurrent liabilities	647,067	639,174
COMMITMENTS AND CONTINGENCIES (Note 8)		
NET ASSETS:		
Unrestricted	2,211,562	1,813,445
Temporarily restricted	254,218	238,433
Permanently restricted	151,515	141,170
Total net assets	2,617,295	2,193,048
TOTAL	$ 3,492,640	$ 3,076,026

See notes to consolidated financial statements.

CHILDREN'S HEALTHCARE OF ATLANTA, INC. AND AFFILIATES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
OPERATING REVENUES AND SUPPORT:		
Patient service revenue (net of contractual and other discounts)	$ 1,072,275	$ 967,089
Provision for bad debts	(17,770)	(10,273)
Net patient service revenue	1,054,505	956,816
Other operating revenue	33,731	35,433
Unrestricted contributions	9,719	8,673
Net assets released from restriction for operations	37,090	36,609
Total operating revenues and support	1,135,045	1,037,531
OPERATING EXPENSES:		
Salaries and wages	488,808	441,497
Employee benefits	99,837	92,679
Purchased services	121,459	133,671
Supplies	119,556	106,346
Other expenses	63,235	58,262
Interest expense	20,387	20,445
Depreciation and amortization	73,996	70,921
Total operating expenses	987,278	923,821
OPERATING INCOME	147,767	113,710
INVESTMENT INCOME (LOSS) AND OTHER (Note 4) — Including unrealized gains (losses) on securities of $130,027 and $(103,344) in 2012 and 2011, respectively	239,572	(28,894)
NET CHANGE IN FAIR VALUE OF INTEREST RATE SWAPS (Notes 1 and 6)	4,517	(66,286)
CONTRIBUTIONS TO HUGHES SPALDING (Note 1)	(2,337)	(3,197)
EQUITY IN INCOME OF UNCONSOLIDATED INVESTMENTS	16,252	8,457
EQUITY IN LOSS OF UNCONSOLIDATED AFFILIATES	(4,728)	(5,428)
NONCONTROLLING INTEREST IN EARNINGS OF SURGERY CENTER (Note 1)	(6,195)	(5,272)
REVENUES OVER EXPENSES	$ 394,848	$ 13,090

See notes to consolidated financial statements.

CHILDREN'S HEALTHCARE OF ATLANTA, INC. AND AFFILIATES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
NET ASSETS — December 31, 2010	$ 1,795,699	$256,268	$139,135	$ 2,191,102
Revenues over expenses	13,090	-	-	13,090
Contributions and other	162	56,776	1,026	57,964
Investment loss and other	-	(5,986)	(30)	(6,016)
Net assets released from restriction for operations	-	(36,609)	-	(36,609)
Net assets released from restriction for Emory pediatric research building (Note 1)	-	(24,500)	-	(24,500)
Net assets released from restriction for Hughes Spalding (Notes 1 and 2)	-	(3,620)	-	(3,620)
Net assets released from restriction for property additions	4,143	(4,143)	-	-
Noncontrolling interest in Surgery Center	351	-	-	351
Increase in beneficial interest in trusts	-	247	1,039	1,286
Increase (decrease) in net assets	17,746	(17,835)	2,035	1,946
NET ASSETS — December 31, 2011	1,813,445	238,433	141,170	2,193,048
Revenues over expenses	394,848	-	-	394,848
Contributions and other	4	43,941	3,611	47,556
Investment income (loss) and other	-	24,492	(481)	24,011
Net assets released from restriction for operations	-	(37,090)	-	(37,090)
Net assets released from restriction for Emory pediatric research building (Note 1)	-	(11,219)	-	(11,219)
Net assets released from restriction for Hughes Spalding (Notes 1 and 2)	-	(1,961)	-	(1,961)
Net assets released from restriction for property additions	2,378	(2,378)	-	-
Noncontrolling interest in Surgery Center	887	-	-	887
Increase in beneficial interest in trusts	-	-	7,215	7,215
Increase in net assets	398,117	15,785	10,345	424,247
NET ASSETS — December 31, 2012	$ 2,211,562	$254,218	$151,515	$ 2,617,295

See notes to consolidated financial statements.

CHILDREN'S HEALTHCARE OF ATLANTA, INC. AND AFFILIATES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	$ 424,247	$ 1,946
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	73,996	70,921
Bond premium amortization	(736)	(894)
Net change in unrealized (gains) losses on investments	(130,027)	103,344
Gains on sale of securities	(82,852)	(56,281)
Net change in fair value of interest rate swaps	(4,517)	66,286
Equity in income of unconsolidated investments	(16,252)	(8,457)
Equity in loss of unconsolidated affiliates	4,728	5,428
Provision for bad debts	17,770	10,273
Restricted contributions and investment income	(71,562)	(51,948)
Noncontrolling interest in earnings of Surgery Center	6,195	5,272
Changes in assets and liabilities:		
Patient accounts receivable and other receivables	(40,909)	(20,692)
Supplies and prepaid expenses	(793)	(1,830)
Other noncurrent assets	(11,702)	(897)
Accounts payable and accrued liabilities	(20,188)	28,719
Other noncurrent liabilities	20,855	33,567
Total adjustments	(255,994)	182,811
Net cash provided by operating activities	168,253	184,757
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(68,253)	(61,679)
Purchase of shares in Surgery Center	(585)	-
Purchase of assets whose use is limited	(2,503,452)	(2,553,351)
Proceeds from disposal of assets whose use is limited	2,311,141	2,386,678
Net cash used in investing activities	(261,149)	(228,352)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of long-term debt	1,220	3,585
Repayments of long-term debt	(9,221)	(9,364)
Distributions to noncontrolling shareholders of Surgery Center	(5,609)	(5,146)
Proceeds from sale of shares to noncontrolling shareholders of Surgery Center	225	225
Cash proceeds from restricted contributions and investment income	83,808	54,986
Net cash provided by financing activities	70,423	44,286
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(22,473)	691
CASH AND CASH EQUIVALENTS — Beginning of year	62,017	61,326
CASH AND CASH EQUIVALENTS — End of year	$ 39,544	$ 62,017

See notes to consolidated financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Organization — Children's Healthcare of Atlanta, Inc. ("Children's") was formed in 1998 when Egleston Children's Health Care System and Scottish Rite Children's Medical Center effectively merged by creating Children's as the controlling company for both hospitals. Today, Children's is a pediatric health care system based in Atlanta, Georgia, and includes the following organizations:

a. Egleston Children's Hospital at Emory University, Inc. ("Egleston"), operates as Children's Healthcare of Atlanta at Egleston and provides inpatient and outpatient pediatric health care services.

b. Scottish Rite Children's Medical Center, Inc. ("Scottish Rite"), operates as Children's Healthcare of Atlanta at Scottish Rite and provides inpatient and outpatient pediatric health care services.

c. Egleston Affiliated Services, Inc., operates as Children's Affiliated Services and provides immediate and urgent pediatric care services.

d. Egleston Pediatric Group, Inc., operates as Children's Pediatric Group and provides pediatric physician services. Children's Pediatric Group is the sole member of seven limited liability companies: Children's Anesthesia Services, LLC; Children's Sedation Services, LLC; Children's Healthcare of Atlanta Center for Pain Relief, LLC; Children's Healthcare of Atlanta Pediatric Neurology, LLC; Pediatric Neurosurgery Associates at Children's, LLC; CHOA-Hospital Based, LLC; and CHOA-Multispecialty, LLC.

e. Children's Healthcare of Atlanta Foundation, Inc., promotes Children's in the community and raises financial support for Children's services through fund-raising activities.

f. Emory-Egleston Children's Heart Center, Inc., operates as Sibley Heart Center and provides cardiac physician services.

g. The Children's Health Network is a physician hospital organization.

h. HSOC, Inc. (HSOC), a subsidiary of Egleston, provides management, administrative, and related services to Hughes Spalding Children's Hospital ("Hughes Spalding"), a pediatric hospital wholly owned by Grady Health System, Inc. ("Grady"). Pursuant to a management agreement, HSOC may be required to provide minimum capital investments and other financial support. HSOC may terminate the management agreement with 60 days notice to Grady.

i. Marcus Autism Center, Inc., is a provider of outpatient therapy and counseling services for children with autism and other behavioral disorders.

j. Children's Healthcare of Atlanta Surgery Center at Meridian Mark Plaza, LLC ("Surgery Center") is a 51% joint venture with physicians to operate an outpatient surgery center. Noncontrolling interests of $6,021,000 and $5,135,000 at December 31, 2012 and 2011, respectively, are included in unrestricted net assets in the accompanying consolidated balance sheets. Noncontrolling owners' share of Surgery Center's net income for the years ended December 31, 2012 and 2011, of $6,195,000 and $5,272,000, respectively, has been recorded in the accompanying consolidated statements of operations.

k. Emory-Children's Center (E-CC) is a 49% joint venture with Emory University for a pediatric physician faculty group. Pursuant to a financial support agreement, Children's may make annual financial support payments to E-CC. Children's accounts for this investment under the equity method of accounting. The accompanying consolidated statements of operations reflect equity losses related to Children's investment in this joint venture of approximately $4,728,000 and $5,428,000 for the years ended December 31, 2012 and 2011, respectively.

Egleston and Scottish Rite (collectively, the "Hospitals") were organized for the purposes of treating sick children, encouraging, and supporting scientific investigation into the medical problems of children, and providing instruction in the diseases and care of children.

Summary of Significant Accounting and Reporting Policies — A summary of the significant accounting and reporting policies followed by Children's in the preparation of its consolidated financial statements is presented below:

Principles of Consolidation — The consolidated financial statements include the accounts of Children's and all wholly owned, majority-owned, and controlled organizations. All material intercompany transactions and account balances have been eliminated in consolidation.

Cash and Cash Equivalents — Cash and cash equivalents include highly liquid instruments with original maturities of three months or less at the date of purchase and are recorded at cost, which approximates market value. Children's invests cash that is not required for immediate operating needs in major financial institutions in amounts that exceed Federal Deposit Insurance Corporation limits.

Assets Whose Use is Limited — Assets whose use is limited primarily include assets restricted by donors and assets set aside by the Board of Trustees (the "Board") over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Investments in marketable equity and other securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Generally, investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in revenues over expenses as investment income. Investments in nonmarketable securities (which primarily include investments in partnerships and limited liability companies) without readily determinable fair values are accounted for using the cost method of accounting where Children's owns less than 5% of the ownership interest or the equity method of accounting where Children's owns between 5% and 50% of the ownership interest.

Derivative Instruments — Children's occasionally uses derivative financial instruments to manage movements in interest rates. Interest rate swaps are contractual agreements between two parties for the exchange of interest payments on a notional principal amount at agreed-upon fixed or floating rates for defined periods. Children's does not enter into derivative financial instruments for trading purposes. Credit risk related to the derivative financial instruments is considered minimal and is managed by requiring high credit standards for its counterparties and periodic settlements. Any change in the fair value of these derivative instruments is included in revenues over expenses.

Property and Equipment — Property and equipment are recorded at cost. Children's policy is to capitalize major additions, including interest costs during construction, and to remove retired items from the accounts. Depreciation is provided using the straight-line method over the estimated service lives of the depreciable property and equipment. The depreciable lives applied are generally 16 to 40 years for buildings and renovations, 15 years for fixed equipment, 10 years for movable equipment, and three to five years for computer software and hardware.

A detail of property, equipment, and accumulated depreciation as of December 31, 2012 and 2011, is as follows (in thousands):

	2012	2011
Land and land improvements	$ 75,287	$ 65,394
Buildings and fixed equipment	631,297	624,404
Movable equipment and computer software	587,408	529,777
Construction in progress	8,208	19,087
Total property and equipment	1,302,200	1,238,662
Less accumulated depreciation	(749,389)	(680,360)
Property and equipment — net	$ 552,811	$ 558,302

Bond Issuance Costs — Costs incurred in issuing long-term debt are amortized over the life of the underlying debt. The gross amount of bond issuance costs as of December 31, 2012 and 2011, totaled $4,772,000, and the related accumulated amortization totaled $984,000 and $732,000, respectively.

Beneficial Interests in Trusts — Children's is the beneficiary of the proportional income from certain perpetual third-party trusts. Children's has no access to the corpus of these trusts and has only limited input into the investment mix of the funds in the trusts in some cases. The estimated fair value of these trusts has been recorded as an asset and as a component of restricted net assets in the accompanying consolidated balance sheets. Management's estimate of fair value is updated annually, the effect of which is included in the accompanying consolidated statements of changes in net assets as an increase in restricted net assets.

Net Patient Service Revenue, Patient Accounts Receivable, and Bad Debts — Children's has agreements with third-party payors that provide for payments to Children's at amounts different from its established rates. Payment arrangements may include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per-diem payments. Net patient service revenue and patient accounts receivable are 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. Retroactive adjustments are accrued on an estimated basis in the period that related services are rendered and adjusted in future periods as final settlements are determined.

A summary of the payment arrangements with major third-party payors is as follows:

Medicaid and Other Governmental Programs — Payments for inpatient services rendered to Medicaid patients are based on prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for outpatient services rendered under this program are generally based on the reasonable cost of providing care or fee schedules.

Laws and regulations governing the Medicaid program are extremely complex and subject to interpretation. Net patient service revenue increased approximately $5,408,000 and $4,693,000 in 2012 and 2011, respectively, due to cash payments and the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to reviews, audits, or investigation. Children’s recognizes that net patient service revenue and patient accounts receivable from government agencies are significant to its operations.

Children’s receives funding from a variety of federal, state, and local agencies. Under provisions of the Indigent Care Trust Fund Act (ICTF), qualifying Georgia public hospitals contribute funds, supplemented by federal and state funds, to compensate Georgia hospitals that serve a disproportionate share of Medicaid and uninsured patients. For the years ended December 31, 2012 and 2011, the Hospitals recorded $1,103,000 and $5,708,000, respectively, of ICTF funds, which are included in net patient service revenue. While Children’s expects continued funding from ICTF in the near term, there can be no assurances that any such funding will continue, or continue at the levels experienced in recent years.

Managed Care and Commercial Programs — Children’s has entered into payment arrangements with certain commercial insurance companies and managed care providers. The basis for payment to Children’s under these agreements may include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Children's recognizes patient service revenue for patients that do not qualify for charity care based on standard rates for services provided. A significant portion of the patients that do not qualify for charity care will be unable or unwilling to pay for services provided. Thus, Children's records a provision for doubtful accounts related to these patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for doubtful accounts), recognized for the year ended December 31, 2012, by payor, was approximately (dollars in thousands):

Medicaid	$170,065	16%
Medicaid Managed Care	248,660	23
Managed Care	624,937	58
Commercial and other	28,613	3
Total	$1,072,275	100%

The provision for bad debts relating to patient service revenue is based on an evaluation of potentially uncollectible portions of accounts receivable. The provision considered necessary for such bad debts is based on an analysis of current and past-due accounts, collection experience in relation to amounts billed, and other relevant information. The allowance for uncollectible accounts represents the estimated uncollectible portion of patient accounts receivable. Children's allowance for uncollectible accounts was approximately 53% of self-pay accounts receivable as of December 31, 2012. Bad debt write-offs totaled approximately $34,360,000 for the year ended December 31, 2012.

A summary of activity in Children's provision for doubtful accounts is as follows (in thousands):

Balance at beginning of year	$3,724
Provision for doubtful accounts	17,770
Accounts written off, net of recoveries	(17,743)
Balance at end of year	$3,751

New Accounting Pronouncements — In July 2011, The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities*. The amendments in the ASU require Children's to change the presentation of its consolidated statements of operations and changes in net assets by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue. Additionally, the ASU requires enhanced disclosure about Children's policies for recognizing revenue and assessing bad debts, patient service revenue and qualitative and quantitative information about changes in the allowance for doubtful accounts. This ASU is effective for Children's on January 1, 2012. The consolidated statements of operations and changes in net assets were retrospectively adjusted to present the provision for bad debts as a deduction from patient service revenue and the required disclosures.

Contributions — Contributions are recorded at fair value upon receipt of cash or other assets or when unconditional promises to contribute are received and are included in contributions receivable and noncurrent contributions receivable in the accompanying consolidated balance sheets. Conditional promises to give are reported at fair value at the date the gift is received or at the time the condition is substantially met. Promises to pay are discounted to their present value using an interest rate commensurate with the collection risk involved. Gifts, bequests, and promises to pay, which are restricted by donors as to use or to be received in excess of one year, are recorded as temporarily restricted net assets until used in the manner designated or upon expiration of the time period over which the assets are to be received.

Assets released from restrictions for their intended purposes are included in operating revenues in the accompanying consolidated statements of operations or as a transfer to unrestricted net assets in the accompanying consolidated statements of changes in net assets if the use is for a capital item. Donated property and equipment are recorded as temporarily restricted net assets at fair market value on the date of receipt. When donated property and equipment are used for their intended purposes, the applicable amount is transferred to unrestricted net assets.

As of December 31, 2012 and 2011, contributions receivable are as follows (in thousands):

	2012	2011
Due in less than one year	$ 13,775	$ 17,998
Due between one and five years	10,489	19,765
Total contributions receivable	24,264	37,763
Allowance for uncollectible amounts	(1,294)	(2,353)
Contributions receivable — net	$ 22,970	$ 35,410

Children's had no material conditional promises to contribute outstanding at December 31, 2012 and 2011.

Research Pledges — To further its mission of encouraging scientific investigation into the medical problems of children, Children's periodically makes irrevocable research funding commitments to third parties. At December 31, 2012, Children's had outstanding funding commitments of approximately $114,515,000 to fund pediatric research in the Atlanta, Georgia area. These irrevocable research commitments were recorded as a component of purchased services in the year of commitment. Purchased services for the year ended December 31, 2012, included funding commitments of $23,478,000. The commitments will be paid over the next 20 years

Income Taxes — Children's is primarily comprised of organizations that have been recognized by the Internal Revenue Service as tax exempt under Internal Revenue Code Section 501(c)(3). Accordingly, no provision for income taxes has been made in the accompanying consolidated statements of operations. Sibley Heart Center and The Children's Health Network are taxable entities, and the provision for income taxes was not material for the years ended December 31, 2012 and 2011.

Consolidated Statements of Cash Flows — Cash payments for interest totaled approximately $19,740,000 and $21,190,000 for the years ended December 31, 2012 and 2011, respectively.

Use of Estimates — The preparation of the consolidated 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS AND ENDOWMENTS

Temporarily restricted net assets are those net assets whose use has been limited by donors to a specific time or purpose. Temporarily restricted net assets of approximately $254,218,000 and $238,433,000 as of December 31, 2012 and 2011, respectively, are available for various purposes, including charity care for children, investment in medical technology and facilities, and the expansion of medical services.

Children's receives restricted contributions on behalf of strategic partners for specific capital purposes. Such restricted contributions are recorded as contributions to temporarily restricted net assets and are reclassified from restriction when the amounts are sent to the intended recipient. For the years ended December 31, 2012 and 2011, Children's released from temporarily restricted net assets $13,180,000 and $28,120,000, respectively.

Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Investment income on permanently restricted net assets is generally available for unrestricted purposes. Permanently restricted net assets as of December 31, 2012 and 2011, were approximately $151,515,000 and $141,170,000, respectively.

Children's follows authoritative guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations that are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). This guidance also requires enhanced disclosures for all endowment funds, including funds designated as endowments by the Board. Children's has interpreted UPMIFA as requiring the preservation of fair value of the original gift absent explicit donor stipulations to the contrary. As a result, Children's classifies as permanently restricted net assets the original value of the gifts donated to the permanent endowment, the income derived from which is expendable to support the various programs sponsored by Children's in accordance with the donor's wishes. The remaining portion of the donor-restricted endowment funds that is not classified as permanently restricted assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditures by Children's consistent with the donor's wishes. Losses on the investments of donor-restricted endowment funds are recorded as a reduction of temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining losses reduce unrestricted net assets and are excluded from revenues over expenses.

Children's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to programs supported by the endowment, while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Children's must hold in perpetuity and the unexpended appreciation on those funds. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the market average, after fees, while assuming a moderate level of investment risk. Children's expects its endowment funds, over time, to provide a real rate of return of 5% (net of fees and adjusted for inflation) as calculated based on rolling five-year periods. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, Children's relies on a total return strategy in which investment returns are achieved through capital appreciation (realized and unrealized) and current yield (interest and dividends). Children's targets a diversified asset allocation intended to achieve its long-term return objectives within prudent risk constraints.

Children's has a policy of appropriating, for distribution each year, no more than 5% of its endowment funds based on a 12-quarter rolling average market value. In establishing this policy, Children's considered the long-term expected return on its endowments.

Endowment net asset composition by type of fund as of December 31, 2012 and 2011, is as follows (in thousands):

	2012			2011		
	Unrestricted	Temporarily Restricted	Permanently Restricted	Unrestricted	Temporarily Restricted	Permanently Restricted
Donor-restricted funds	$ -	$149,320	$151,515	$ -	$126,890	$141,170
Board-designated funds	6,592	-	-	6,101	-	-
Total funds	$ 6,592	$149,320	$151,515	$ 6,101	$126,890	$141,170

Endowment net asset balances and activities for the years ended December 31, 2012 and 2011, are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance — December 31, 2010	$ 4,731	$ 130,544	$ 139,135	$ 274,410
Investment loss and other	(248)	(5,200)	(30)	(5,478)
Increase in beneficial interest in trusts	-	247	1,039	1,286
Contributions and other	1,790	6,340	1,025	9,155
Appropriations for expenditures	(172)	(5,041)	-	(5,213)
Balance — December 31, 2011	6,101	126,890	141,170	274,161
Investment income (loss) and other	757	21,493	(481)	21,769
Increase in beneficial interest in trusts	-	-	7,215	7,215
Contributions and other	-	5,926	3,611	9,537
Appropriations for expenditures	(266)	(4,989)	-	(5,255)
Balance — December 31, 2012	$ 6,592	$ 149,320	$ 151,515	$ 307,427

3. COMMUNITY BENEFIT AND CHARITY CARE

In accordance with its mission, Children's commits significant resources to promote the health and well-being of children. In support of this endeavor, Children's recognizes that some of its most fragile constituents are children whose families are financially or medically indigent. To that end, Children's provides medical treatment to children whose family or custodians are unable to pay for such treatment. Children's ensures that charity care, indigent care, education, research, and other sponsored community programs ("Community Benefit") benefit all children, regardless of economic status. Therefore, Children's maintains Community Benefit programs, within limits, that are available to the entire community, with equal consideration for those who are poor and underserved. Total Community Benefit for the year ended December 31, 2012, is estimated to be $129,000,000. Total Community Benefit for the year ended December 31, 2011, as reported in annual filings to the Internal Revenue Service, was $149,118,000 and included a one-time pediatric research gift of $15,000,000.

Charity care, a component of Community Benefit, is unreimbursed costs for charity care and Medicaid services calculated using a cost-to-charge ratio times the amount of unreimbursed charges, net of funding from the state of Georgia for ICTF and neonatal care, and other funding provided to defray these costs. State and other funding which offsets unreimbursed cost totaled approximately $3,847,000 and $8,700,000 for the years ended December 31, 2012 and 2011, respectively. Children's estimates charity care to be approximately $72,800,000 and $74,800,000 for the years ended December 31, 2012 and 2011, respectively.

4. ASSETS WHOSE USE IS LIMITED

The composition of assets limited as to use as of December 31, 2012 and 2011, is set forth in the following table (in thousands):

	2012	2011
Board-designated for asset acquisition, uncompensated care, debt service, strategic, and operational activities:		
Cash and cash equivalents	$ 285,894	$ 231,594
Equity securities	1,373,762	853,480
Debt securities	179,760	140,301
Investments in nonmarketable securities accounted for under the equity method	252,770	253,966
Investments in nonmarketable securities carried at cost	200,855	399,685
Cash, cash equivalents, and debt securities held for interest rate swap agreement	33,450	36,430
Subtotal	2,326,491	1,915,456
Donor-restricted for special purposes, such as uncompensated child care:		
Cash and cash equivalents	41,899	33,920
Equity securities	201,062	187,992
Debt securities	26,345	36,990
Subtotal	269,306	258,902
Total assets whose use is limited	2,595,797	2,174,358
Less portion classified as current (Note 6)	(36,812)	(37,154)
Total assets whose use is limited — noncurrent	$2,558,985	$2,137,204

Investment Income (Loss) and Other — For the years ended December 31, 2012 and 2011, significant components of investment income (loss) on securities are as follows (in thousands):

	2012	2011
Investment income (loss):		
Interest and dividends — net of fees	$ 32,671	$ 24,241
Realized gains on sales of securities	82,852	56,281
Net change in unrealized gains (losses) on securities	130,027	(103,344)
Losses on unassociated interest rate swaps	(5,978)	(6,072)
Total	$ 239,572	$ (28,894)

Investments in Nonmarketable Securities Carried at Cost — Children's investments in nonmarketable securities carried at cost consist primarily of partnerships and limited liability companies created for the purpose of investing in privately held companies. The gross unrealized losses and fair values of Children's investments in non-marketable securities carried at cost with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012, is as follows (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Investments in nonmarketable securities carried at cost	$ 36,208	$ (5,835)	$ 28,809	$ (1,585)	$ 65,017	$ (7,420)

Losses on non-marketable securities carried at cost that are deemed to be other-than-temporarily impaired of $5,266,000 are included in investment income (loss) in the accompanying consolidated statements of operations for the year ended December 31, 2011.

Investments in Non-marketable Securities Accounted for Under the Equity Method — The accompanying consolidated statements of operations reflect equity income related to Children's investment in non-marketable securities required to be accounted for under the equity method of accounting of approximately $16,252,000 and $8,457,000 for the years ended December 31, 2012 and 2011, respectively.

Summarized unaudited financial information for the entities represented by the non-marketable securities Children's accounts for under the equity method as of and for the years ended December 31, 2012 and 2011, is as follows (in thousands):

	2012	2011
Total assets	$3,090,857	$2,847,569
Total liabilities	96,865	116,435
Equity	2,993,991	2,731,135
Revenue	55,861	37,739
Net unrealized income	170,601	47,351
Net income	295,680	101,964

At December 31, 2012, Children's had outstanding funding commitments to purchase general investment partnership interests of approximately $176,957,000. These commitments will be met over the next five years.

5. FAIR VALUE MEASUREMENTS

Children's uses fair value to measure certain financial assets and financial liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, Children's uses various valuation approaches. The hierarchy of those valuation approaches is broken down into three levels based on the reliability of inputs, as follows:

Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. The valuation under this approach does not entail a significant degree of judgment.

Level 2 — Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates and yield curves observable at commonly quoted intervals or current market), and contractual prices for the underlying financial instrument, as well as other relevant economic measures.

Level 3 — Inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The fair value table presents information about Children's assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 and 2011, as follows (in thousands):

Fair Value — December 31, 2012	Level 1	Level 2	Level 3	Total
Assets whose use is limited:				
Cash and cash equivalents	$ 361,243	$	$	$ 361,243
Equity securities:				
U.S. equities	429,517	101	-	429,618
Non U.S. equities	12,193	-	-	12,193
Real estate investments trusts	65,403	-	-	65,403
Debt securities:				
U.S. treasuries	4,273	10,692	-	14,965
Government agencies	-	2,010	-	2,010
Corporate bonds		63,639	-	63,639
Secured bank loans	-	-	125,491	125,491
Mutual funds:				
Equity funds	443,438	391,202		834,640
Hedge Funds			202,588	202,588
Fixed income funds	-	30,382	-	30,382
Beneficial interests in trusts	-	-	113,530	113,530
Total assets at fair value	$ 1,316,067	$ 498,026	$ 441,609	$ 2,255,702
Liabilities — interest rate swap agreements	$ -	$ 106,416	$ -	$ 106,416

Fair Value — December 31, 2011	Level 1	Level 2	Level 3	Total
Assets whose use is limited:				
Cash and cash equivalents	$ 301,944	$ -	$ -	$ 301,944
Equity securities:				
U.S. equities	419,745	-	-	419,745
Non U.S. equities	16,435	-	-	16,435
Real estate investments trusts	81,785	-	-	81,785
Debt securities:				
U.S. treasuries	15,103	-	-	15,103
Government agencies	-	6,204	-	6,204
Corporate bonds	1,327	71,715	-	73,042
Secured bank loans	-	-	82,942	82,942
Mutual funds:				
Equity funds	421,713	101,698	-	523,411
Fixed income funds	96	-	-	96
Beneficial interests in trusts	13,247	7,072	81,743	102,062
Total assets at fair value	$ 1,271,395	$ 186,689	$ 164,685	$ 1,622,769
Liabilities — interest rate swap agreements	$ -	$ 110,933	$ -	$ 110,933

Certain investments' estimated fair value is based on unobservable inputs that are not corroborated by observable market data and are thus classified as Level 3. These investments include hedge funds, secured bank loans, and beneficial interests in trusts. Investments in hedge funds are valued using reported net asset values as of December 31. Secured bank loans are valued based on market rates for debt instruments with similar characteristics. Beneficial interests in trusts are primarily valued based on expected discounted cash flows or, in some cases, on the value of underlying assets.

As of December 31, 2012, Children's held approximately $203 million in hedge funds that pursue multiple strategies to diversify risk and reduce volatility. These funds typically allow redemptions quarterly, annually or bi-annually and require a redemption notification period of 45-90 days. No unfunded commitments existed with respect to these hedge funds as of December 31, 2012.

The following table presents changes in assets classified as Level 3 for the years ended December 31, 2012 and 2011(in thousands):

	Benefical Interest in Trust	Secured Bank Loans	Hedge Funds	Total
Balance — December 31, 2010	$ 79,109	$ -	$ -	$ 79,109
Purchases	247	83,459	-	83,706
Sales	-	-	-	
Realized and unrealized gains and Losses net of fees	2,387	(517)	-	1,870
Transfer in/(out)	-	-	-	
Balance — December 31, 2011	81,743	82,942	-	164,685
Purchases	-	33,118	184,000	217,118
Sales	(276)	-	-	(276)
Realized and unrealized gains and Losses net of fees	7,048	9,411	18,588	35,047
Transfer in/(out)	25,015	20	-	25,035
Balance — December 31, 2012	$ 113,530	$ 125,491	$ 202,588	$ 441,609

Cash and Cash Equivalents, Accounts Receivables, Accounts Payable, and Accrued Expenses — The carrying amount approximates fair value because of the short-term nature of these instruments.

Long-Term Debt — The fair value of long-term debt is estimated based on quoted market prices for the same issues. The estimated fair values of long-term debt are $506,610,000 and $502,334,000 at December 31, 2012 and 2011, respectively.

6. LONG-TERM DEBT

A summary of long-term debt as of December 31, 2012 and 2011, is as follows (in thousands):

	2012	2011
2008 Certificates & Bonds — 2008 variable rate revenue anticipation certificates and bonds due July 2042. Interest rates range from .13% to .33% for the year ended December 31, 2012. Mandatory sinking fund redemption beginning July 2009.	$ 185,770	$ 187,560
2009 Certificates & Bonds — 2009 fixed rate revenue anticipation certificates and bonds due November 2039. Interest rates range from 3.00% to 5.25%, payable semiannually — net of unamortized premium of $323 in 2012 and $413 in 2011. Mandatory sinking fund redemption beginning November 2024.	280,462	287,628
2011 Surgery Center Commercial Note — term note payable to bank due March 2021. Interest rate of 4.95% until 2016. Interest only payable the first year and principal and interest payable monthly thereafter.	3,080	2,861
Subtotal	469,312	478,049
Less current maturities of long-term debt	(9,500)	(9,224)
Less long-term debt classified as current due to terms of standby purchase agreements	(36,812)	(37,154)
Long-term debt — net of portion classified as current	$ 423,000	$ 431,671

In February 2008, the DeKalb Private Hospital Authority (the "DeKalb Authority") issued approximately $120,000,000 in tax-exempt revenue anticipation certificates, and the Development Authority of Fulton County (the "Fulton Authority") issued approximately $72,965,000 of tax-exempt revenue bonds (collectively, the "2008 Certificates & Bonds") pursuant to a trust indenture by and between the DeKalb Authority, the Fulton Authority, and certain investment banks. The proceeds were loaned to Children's pursuant to loan agreements between the DeKalb Authority and Children's and the Fulton Authority and Children's and were used to make capital additions and renovations at the Hospitals.

The 2008 Certificates & Bonds are remarketed on a weekly basis, and the bondholders have the ability to tender any or all of the certificates and bonds at each remarketing date. Children's has standby bond purchase agreements ("SBPAs") with a financial institution to serve as security for the payment of the 2008 Certificates & Bonds. In the event bondholders elect to tender any or all of the 2008 Certificates & Bonds for purchase and the revenue anticipation certificates are not able to be remarketed, the SBPAs are utilized to purchase the revenue anticipation certificates. Any amounts outstanding on the SBPAs are repayable by Children's over a five-year term in quarterly installments. As a result, Children's has included $36,812,000 and $37,154,000 in current liabilities as of December 31, 2012 and 2011, respectively. The SBPAs expire February 2018, and there were no amounts outstanding at December 31, 2012 or 2011.

In December 2009, the DeKalb Authority issued approximately $249,260,000 in tax-exempt revenue anticipation certificates and the Fulton Authority issued approximately $50,720,000 in tax-exempt revenue bonds (collectively, the "2009 Certificates & Bonds") pursuant to a trust indenture by and between DeKalb Authority, the Fulton Authority, and certain investment banks. The proceeds were loaned to Children's pursuant to loan agreements between the DeKalb Authority and Children's and the Fulton Authority and Children's and were used to extinguish certain tax-exempt revenue anticipation certificates and bonds.

In connection with certain bond issues, Children's entered into interest rate swap agreements with three banks effectively converting Children's interest rate exposure on a portion of this debt from a variable to a fixed rate. Children's does not follow hedge accounting for these interest rate swaps. The interest rate swaps had an aggregate notional amount of approximately $375,995,000 and $380,485,000 at December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, Children's has recorded a liability of approximately $106,416,000 and $110,933,000, respectively, related to these interest rate swaps in other noncurrent liabilities in the accompanying consolidated balance sheets. The change in fair value of these interest rate swaps of approximately $4,517,000 and ($66,286,000) is included in revenues over expenses in the accompanying consolidated statements of operations for the years ended December 31, 2012 and 2011, respectively.

The portion of the interest rate swap agreements, discussed above, that were associated with the revenue anticipation certificates and bonds refunded by the 2009 Certificates & Bonds are now held as an investment ("Unassociated Interest Rate Swaps"). The Unassociated Interest Rate Swaps had a notional amount of $190,225,000 and $192,925,000 outstanding as of December 31, 2012 and 2011. Losses on Unassociated Interest Rate Swaps of $5,978,000 and $6,072,000 are included in investment income (loss) in the accompanying consolidated statements of operations for the years ended December 31, 2012 and 2011.

In March 2011, the Surgery Center refunded the outstanding balance of the 2008 Surgery Center Commercial Note and secured additional financing for expansion and renovation of the Surgery Center. Expansion/renovation of the facilities was completed in January 2012. The loan has an initial interest rate of 4.95% for the first five years then converts to a rate not to exceed 7.25%.

Debt Maturities — Future scheduled maturities of long-term debt are as follows (in thousands):

Years Ending December 31	
2013	$ 8,904
2014	9,295
2015	9,722
2016	10,145
2017	10,591
Thereafter	420,978
Total	$ 469,635

7. RETIREMENT BENEFITS

Children's maintains defined contribution retirement plans. Contributions to the plans were $26,087,000 and $21,093,000 for the years ended December 31, 2012 and 2011, respectively.

8. COMMITMENTS AND CONTINGENCIES

Insurance Arrangements — Children's is self-insured for a substantial portion of its general and professional medical malpractice risks. Children's maintains coverage in excess of its self-insurance plan limits (currently $1,000,000 per occurrence for general liability/$3,000,000 per medical incident for professional liability with a $12,000,000 combined annual aggregate). General liability coverage is subject to an occurrence-based policy, and professional liability coverage is limited to claims made rather than claims incurred during its term. In addition, claims incurred but not reported prior to January 1, 2001, are covered under a commercial insurance policy subject to a $250,000 per occurrence and $750,000 aggregate retention.

The accrual for self-insured general and professional medical malpractice losses, including loss adjustment expense, is based on actuarial estimates using historical claims experience adjusted for current industry trends. The actual claim settlements and expenses may differ from amounts provided, but in the opinion of management, an adequate accrual has been made for such claims at December 31, 2012 and 2011.

Children's self-insures its health insurance and workers' compensation programs, supplemented with certain stop-loss coverages. Estimates are made for known claims outstanding and claims incurred but not reported under the programs and are recorded as accrued liabilities in the accompanying consolidated balance sheets.

Leases — Children's leases office space and equipment under various operating leases. Total rent expense for all operating leases amounted to approximately $12,382,000 and $11,646,000 for the years ended December 31, 2012 and 2011, respectively.

Future aggregate minimum rental commitments under all noncancelable operating leases are as follows (in thousands):

Years Ending December 31	
2013	$ 8,361
2014	7,734
2015	6,884
2016	5,621
2017	4,097
Thereafter	10,875
Total	$ 43,572

Litigation — Certain lawsuits have been filed against Children's claiming alleged personal and punitive damages. While the outcome of these lawsuits is not presently determinable, it is the opinion of management that the claims will not have a material adverse effect on Children's consolidated financial position, results of operations, or cash flows.

9. FUNCTIONAL EXPENSES

Children's primarily provides inpatient and outpatient medical care for pediatric residents in the Atlanta metropolitan area. For the years ended December 31, 2012 and 2011, expenses relating to providing these services are as follows (in thousands):

	2012	2011
Healthcare services	$ 811,278	$ 760,158
General and administrative	176,000	163,663
Total	$ 987,278	$ 923,821

10. SUBSEQUENT EVENTS

Children's has evaluated events and transactions for potential recognition or disclosure through May 24, 2013, the date the consolidated financial statements were issued, and noted no significant subsequent events or transactions requiring recognition or disclosure.

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