Consolidated Financial Statements

Piedmont Healthcare, Inc. and Affiliates
Years Ended June 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

Piedmont Healthcare, Inc. and Affiliates

Consolidated Financial Statements

Years Ended June 30, 2012 and 2011

Contents

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Report of Independent Auditors

The Board of Directors
Piedmont Healthcare, Inc. and Affiliates

We have audited the accompanying consolidated balance sheets of Piedmont Healthcare, Inc. and Affiliates (PHC) as of June 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of PHC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of PHC's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of PHC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Piedmont Healthcare, Inc. and Affiliates at June 30, 2012 and 2011, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, PHC changed its presentation of the provision for bad debt as a result of the adoption of amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Net Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*.

Ernst & Young LLP

October 25, 2012

Piedmont Healthcare, Inc. and Affiliates

Consolidated Balance Sheets

	June 30 2012	June 30 2011
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 204,596**	$ 198,796
Patient accounts receivable, net of allowance for doubtful accounts of $97,933 in 2012 and $73,031 in 2011	**207,317**	181,888
Other current assets	**62,711**	44,022
Total current assets	**474,624**	424,706
Investments and assets limited as to use	**453,236**	496,239
Property and equipment, net	**825,258**	580,903
Self-insurance investments	**35,638**	27,485
Beneficial interest in perpetual trust	**7,939**	8,301
Other assets	**86,848**	77,381
Total assets	**$ 1,883,543**	$ 1,615,015

	June 30	
	2012	**2011**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 9,830**	$ 8,790
Accounts payable and accrued expenses	**168,637**	121,190
Estimated third-party payor settlements	**24,880**	8,893
Current portion of self-insurance reserves	**14,743**	11,298
Other current liabilities	**2,273**	2,879
Total current liabilities	**220,363**	153,050
Long-term debt, net of current portion	**509,606**	458,133
Medical office building financing obligation	**44,528**	45,378
Note payable to a bank	**43,744**	–
Self-insurance reserves	**49,885**	33,864
Accrued pension cost	**67,638**	42,423
Other long-term liabilities	**64,919**	43,093
Net assets:		
Unrestricted	**838,683**	797,139
Temporarily restricted	**21,746**	19,187
Permanently restricted	**22,431**	22,748
Total net assets	**882,860**	839,074
Total liabilities and net assets	**$ 1,883,543**	$ 1,615,015

See accompanying notes.

Piedmont Healthcare, Inc. and Affiliates

Consolidated Statements of Operations

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Unrestricted revenue, gains, and other support:		
Patient service revenue	**$ 1,485,458**	$ 1,299,955
Provision for bad debt	**125,032**	114,447
Net patient service revenue	**1,360,426**	1,185,508
Other revenue	**54,696**	37,837
Contribution received in acquisition of Piedmont Henry	**77,087**	–
Total revenue, gains, and other support	**1,492,209**	1,223,345
Expenses:		
Salaries and benefits	**736,162**	658,124
Supplies and other expenses	**527,860**	468,307
Depreciation and amortization	**74,506**	65,602
Interest	**20,055**	14,152
Loss on assets held for sale	**6,618**	–
Total expenses	**1,365,201**	1,206,185
Operating income	**127,008**	17,160
Nonoperating income (expense):		
Investment income	**338**	78,712
Change in fair value of interest rate swaps	**(18,716)**	7,094
Gain from extinguishment of debt	**6,039**	–
	(12,339)	85,806
Excess of revenue, gains, and other support over expenses	**114,669**	102,966
Net assets released from restrictions used for purchase of property and equipment	**77**	6,127
Pension adjustments	**(72,773)**	42,233
Other	**(429)**	(1,464)
Change in unrestricted net assets	**$ 41,544**	$ 149,862

See accompanying notes.

Piedmont Healthcare, Inc. and Affiliates

Consolidated Statements of Changes in Net Assets

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Unrestricted net assets:		
Excess of revenues, gains, and other support over expenses	**$ 114,669**	$ 102,966
Net assets released from restrictions used for purchase of property and equipment	**77**	6,127
Pension adjustments	**(72,773)**	42,233
Other	**(429)**	(1,464)
Change in unrestricted net assets	**41,544**	149,862
Temporarily restricted net assets:		
Contributions	**3,648**	10,795
Net assets released from restrictions used for purchase of property and equipment	**(77)**	(6,127)
Net assets released from restrictions used for operations	**(23)**	(884)
Other	**(989)**	900
Change in temporarily restricted net assets	**2,559**	4,684
Permanently restricted net assets:		
Contributions	**25**	84
Change in beneficial interest in perpetual trust	**(362)**	1,162
Other	**20**	(100)
Change in permanently restricted net assets	**(317)**	1,146
Change in net assets	**43,786**	155,692
Net assets at beginning of year	**839,074**	683,382
Net assets at end of year	**$ 882,860**	$ 839,074

See accompanying notes.

Piedmont Healthcare, Inc. and Affiliates

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Operating activities		
Change in net assets	**$ 43,786**	$ 155,692
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**74,506**	65,602
Net change in unrealized gains/losses on investments	**26,153**	(43,683)
Change in beneficial interest in perpetual trust	**362**	(1,162)
Provision for bad debt	**125,032**	114,447
Pension adjustments	**72,773**	(42,233)
Contribution received in acquisition of Piedmont Henry	**(77,086)**	–
Loss on assets held for sale	**6,618**	–
Change in fair value of interest rate swaps	**18,716**	(7,094)
Restricted contributions	**(3,673)**	(10,879)
(Increase) decrease in:		
Patient accounts receivable	**(128,314)**	(115,055)
Other current assets	**(4,779)**	(6,508)
Other assets	**1,274**	(2,358)
(Decrease) increase in:		
Accounts payable and accrued expenses	**25,329**	7,920
Estimated third-party payor settlements	**5,555**	867
Self-insurance reserves	**7,201**	2,351
Accrued pension cost	**(47,558)**	(8,859)
Other current liabilities	**(606)**	1,385
Other long-term liabilities	**2,113**	5,398
Net cash provided by operating activities	**147,402**	115,831
Investing activities		
Decrease in investments classified as trading	**(12,137)**	(31,621)
Capital expenditures	**(145,783)**	(115,162)
Acquisitions, net of cash acquired	**(6,156)**	(2,500)
Net cash used in investing activities	**(164,076)**	(149,283)

Piedmont Healthcare, Inc. and Affiliates

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Financing activities		
Restricted contributions	**$ 3,673**	$ 10,879
Proceeds from note payable to a bank	**44,819**	–
Proceeds from debt	**41,480**	57,902
Payments on note payable to a bank	**(1,075)**	–
Payments of indebtedness	**(66,423)**	(7,490)
Net cash provided by financing activities	**22,474**	61,291
Net increase in cash and cash equivalents	**5,800**	27,839
Cash and cash equivalents at beginning of year	**198,796**	170,957
Cash and cash equivalents at end of year	**$ 204,596**	$ 198,796

See accompanying notes.

1. Organization and General

The Board of Directors of Piedmont Healthcare, Inc. and Affiliates (PHC) appoints the governing boards of:

- Piedmont Hospital, Inc. (the Hospital). The Hospital, located in Atlanta, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of the Atlanta metropolitan area. Admitting physicians are primarily practitioners in the local area.

- Piedmont West Ambulatory Surgery Center, LLC (the PWASC). The PWASC, located in Atlanta, Georgia, is a multi-specialty ambulatory surgery center 79% owned by the Hospital.

- Piedmont Healthcare Foundation, Inc. (the Foundation). The Foundation's primary purpose is to raise funds for PHC and the PHC affiliates.

- Piedmont Medical Care Corporation (PMCC). PMCC is a taxable, not-for-profit entity whose purpose is to develop a primary care network for the benefit of the PHC affiliates.

- Piedmont Clinic, Inc. (the Clinic). The Clinic is a physician-hospital organization whose purpose is to negotiate contracts with various managed care payors for the PHC affiliates.

- Piedmont Fayette Hospital, Inc. (Fayette). Fayette, located in Fayetteville, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Fayette County.

- Piedmont Mountainside Hospital, Inc. (Mountainside). Mountainside, located in Jasper, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Pickens County.

- Amster-McRae Insurance Company (AMIC). AMIC was incorporated on December 10, 2003 under the laws of the Cayman Islands. AMIC insures the hospital professional liability and commercial general liability risks of PHC and certain PHC affiliates.

- Piedmont Newnan Hospital, Inc. (Newnan). Newnan, located in Newnan, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Coweta County.

1. Organization and General (continued)

- Piedmont Heart Institute Physicians, Inc. (PHIP). PHIP is a taxable, not-for-profit entity whose purpose is to provide an integrated cardiovascular healthcare delivery program for the benefit of the PHC affiliates.

- Piedmont Heart Institute, Inc. (PHI). PHI is a not-for-profit entity whose purpose is to provide cardiovascular research services for the benefit of the PHC affiliates.

- Piedmont Henry Hospital (Henry). Henry, located in McDonough, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Henry County. PHC acquired Henry effective January 1, 2012.

2. Significant Accounting and Reporting Policies

A summary of the significant accounting and reporting policies followed by PHC in the preparation of its consolidated financial statements is presented below.

Principles of Consolidation

The consolidated financial statements include the accounts of PHC, the Hospital, the PWASC, the Foundation, PMCC, the Clinic, Fayette, Mountainside, AMIC, Newnan, PHIP, PHI and Henry. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

2. Significant Accounting and Reporting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, deposits with banks, and investments in highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use. PHC invests cash not required for immediate operating needs principally with major financial institutions with strong credit ratings. By policy, the amount of credit exposure to any one institution is limited, and such investments are generally not collateralized.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including unrealized and realized gains and losses on investments, interest and dividends) is included in the excess of revenue, gains, and other support over expenses unless the income or loss is restricted by donor or law. PHC accounts for investment transactions on a settlement-date basis. Substantially all of PHC's investment portfolio is classified as trading, with unrealized gains and losses included in excess of revenue, gains, and other support over expenses. Fair values are based on quoted market prices if available, or estimated using quoted market prices for similar securities. PHC invests in alternative investments. These alternative investments provide PHC with a proportionate share of the fair value of the fund returns. PHC accounts for its ownership interests in the alternative investments based upon the equity method. Accordingly, PHC's share of the alternative investment's income or loss, both realized and unrealized, is recognized as investment income. Alternative investments held by the noncontributory defined benefit plan are accounted for at fair value. The cost of substantially all securities sold is based on the average cost method.

PHC classifies investments with maturities of less than one year from the balance sheet date when purchased as short-term and investments with maturities of greater than one year from the balance sheet date when purchased as long-term.

Assets Limited as to Use

These assets are limited as to use by debt instruments or designations by PHC's governing board for plant replacement, expansion of certain facilities, purchase of equipment, and payment of certain future debt service requirements.

2. Significant Accounting and Reporting Policies (continued)

Inventory

Inventories are valued at the lower of cost (first-in, first-out method) or market. Inventories consist primarily of pharmaceuticals and medical supplies and are recorded within other current assets in the accompanying consolidated balance sheets.

Property and Equipment

Property and equipment acquisitions are recorded at cost, with the exception of donated items which are recorded at fair value at the date of donation. Expenditures for renewals and improvements are charged to the property accounts. For properties sold or retired, the cost and related accumulated depreciation are removed from the property accounts. Any resulting gains or losses are included in other revenue. Replacements, maintenance, and repairs that do not improve or extend the life of the respective assets are charged to operations. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The estimated useful lives are 10–25 years for land improvements, 15–40 years for buildings and fixtures, and 3–20 years for equipment.

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

Software and Software Development Costs

Software and software development costs include costs incurred by PHC to develop software for internal use in medical records maintenance, physician order entry, and clinical documentation.

2. Significant Accounting and Reporting Policies (continued)

Costs of software developed for internal use are accounted for in accordance with the provisions of Accounting Standards Codification (ASC) 350-40, *Internal Use Software*. In accordance with ASC 350-40, internal and external costs incurred to develop internal use computer software during the application development stage are capitalized. Application development stage costs generally include software configuration, coding, installation of hardware and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized.

All other costs incurred in connection with an internal software project, including maintenance, minor upgrades, enhancements and training, are expensed as incurred. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the related software applications (3-12 years).

Long-Lived Assets

PHC periodically reviews long-lived assets, such as property and equipment, to determine whether any impairments exist. Management believes that the long-lived assets in the accompanying consolidated balance sheets are appropriately valued at June 30, 2012 and 2011.

Other Assets

Other assets include goodwill of $52,112,000 and $48,747,000 at June 30, 2012 and 2011, respectively. Prior to July 1, 2010, goodwill was being amortized over 10 to 25 years. Effective July 1, 2010, the Hospital adopted the provisions of ASC 350, *Intangibles – Goodwill and Other*. In accordance with ASC 350, the Hospital evaluates its goodwill annually for potential impairment.

Beneficial Interest in Perpetual Trust

PHC is the beneficiary of six separate endowments held in trust by a local bank, with fair values at June 30, 2012 and 2011 aggregating $7,939,000 and $8,301,000, respectively. In accordance with the requirements of accounting for these types of endowments, the beneficial interest at June 30, 2012 and 2011 has been recorded in long-term assets at fair value and the change in value has been recorded as a change in permanently restricted net assets.

Vacation Policy

PHC accrues employee vacation pay as earned by the employee.

2. Significant Accounting and Reporting Policies (continued)

Advertising Costs

Advertising costs are expensed as incurred and approximated $4,381,000 and $7,067,000 for the years ended June 30, 2012 and 2011, respectively.

Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by PHC is restricted by the donor for a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by PHC in perpetuity.

Net Patient Service Revenue, Accounts Receivable, and Allowance for Doubtful Accounts

During the year ended June 30, 2012, PHC adopted the provisions of 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* (ASU 2011-07). The adoption of ASU 2011-07 requires PHC to present the provision for bad debt related to patient services revenue separately as contra-revenue in the accompanying consolidated statements of operations. PHC's presentation of the provision for bad debt at the reporting entity level is based on an entity-wide assessment of significance. PHC has retrospectively adopted the presentation requirements of this update for the year ended June 30, 2011.

PHC has agreements with third-party payors that provide for payments to PHC at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

2. Significant Accounting and Reporting Policies (continued)

Net patient service revenue is summarized below:

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Patient service charges	**$ 4,581,160**	$ 3,942,070
Less other contractual adjustments and deductions	**3,095,702**	2,642,115
Patient service revenue	**1,485,458**	1,299,955
Less provision for bad debt	**125,032**	114,447
Net patient service revenue	**$ 1,360,426**	$ 1,185,508

Recognition of net revenue (gross charges less contractual provisions) is dependent on factors such as proper completion of medical charts following a patient visit, medical coding of charts and processing charts through PHC's billing systems and verification of patient representations at the time services are rendered as to the payor's responsible for payment of PHC's services. Net revenue is recorded based on the information known at the time of entering this information into PHC's billing system and this information is subject to change. For example, patient payor information may change following an initial attempt to bill for services due to a change in payor status. Such changes in payor status have an impact on recorded net revenue due to differing payors being subject to different contractual provision amounts. These changes in net revenue are recognized in the period that the changes in payor become known.

The provision for bad debt is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience by payor category. The results of this review are then used to make any modifications to the provision for bad debt to establish an appropriate allowance for uncollectible receivables.

2. Significant Accounting and Reporting Policies (continued)

Patient service revenue, net of contractual allowances and self-pay discounts and before the provision for bad debt, recognized from major payor sources are as follows (in thousands):

	Year Ended June 30 2012	2011
Third party payors, net of contractual allowances	**$ 1,359,262**	$ 1,210,943
Self-pay patients, net of discounts	**126,196**	89,012
Patient service revenue	**$ 1,485,458**	$ 1,299,955

PHC records a significant provision for bad debt in the period services are provided related to self-pay patients. For receivables associated with patients who have third-party coverage, PHC analyzes contractually due amounts and provides and an allowance for doubtful accounts and a provision for bad debt, if necessary. Accounts receivable are written off after collection efforts have been followed in accordance with PHC's policies. The allowance for doubtful accounts was 32% and 29% of accounts receivable after contractual allowances as of June 30, 2012 and 2011, respectively. The increase in the allowance for doubtful accounts as a percentage of accounts receivable after contractual allowances is primarily due to the slight increase in self-pay revenue as a percentage of patient service revenue.

Charity Care

PHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as revenue.

Excess of Revenue, Gains, and Other Support Over Expenses

The consolidated statements of operations include excess of revenue, gains, and other support over expenses. Changes in unrestricted net assets which are excluded from excess of revenue, gains, and other support over expenses, consistent with industry practice, include pension adjustments and contributions of long-lived assets (including assets acquired using contributions which, by donor restriction, were to be used for the purposes of acquiring such assets).

2. Significant Accounting and Reporting Policies (continued)

Pledges Receivable and Donor-Restricted Gifts

Unconditional promises to give cash and other assets to PHC are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements. Current pledges receivable of $1,037,000 and $6,792,000 are included in other current assets in the accompanying consolidated balance sheets at June 30, 2012 and 2011, respectively. Long-term pledges receivable of $152,000 and $669,000 are included in other assets in the accompanying consolidated balance sheets at June 30, 2012 and 2011, respectively.

Interest Expense

PHC incurred interest expense in the amount of $20,055,000 and $14,152,000 for the years ended June 30, 2012 and 2011, respectively, net of amounts capitalized of $7,468,000 and $5,357,000 for the years ended June 30, 2012 and 2011, respectively. Cash paid for interest amounted to $28,828,000 and $18,968,000 for the years ended June 30, 2012 and 2011, respectively.

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 for eligible hospitals and professionals that adopt and meaningfully use certified electronic health record ("EHR") technology. PHC has recognized approximately $1,100,000 of Medicaid incentive payments and $3,504,000 of Medicare incentive payments in other revenue in the accompanying consolidated statements of operations for the year ended June 30, 2012. PHC recognizes income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when our eligible hospitals have demonstrated meaningful use of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

2. Significant Accounting and Reporting Policies (continued)

Income Taxes

Piedmont Healthcare, Inc., the Hospital, the Foundation, Fayette, Mountainside, Newnan, Henry and PHI are organizations exempt from federal income tax pursuant to Section 501(a), as organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and state income tax. AMIC is exempt from federal and state income tax pursuant to the laws of the Government of the Cayman Islands. PMCC is a taxable, not-for-profit entity that operated in a net loss position for financial reporting and tax purposes during the years ended June 30, 2012 and 2011. The Clinic is a taxable, not-for-profit entity that operated in a nominal net income position for financial reporting and tax purposes during the year ended June 30, 2012 and a net loss position during the year ended June 30, 2011. PHIP is a taxable, not-for-profit entity that operated in a net loss position for financial reporting and tax purposes during the years ended June 30, 2012 and 2011. PWASC is a taxable, not-for-profit limited liability company that operated in a net loss position for financial reporting and tax purposes during the years ended June 30, 2012 and 2011. It has no tax provision as all taxable income or loss is reportable by its partners.

At June 30, 2012 and 2011, PMCC, the Clinic, and PHIP had net operating loss carryforwards totaling approximately $257,345,000 and $226,160,000, respectively, which expire at various dates between 2013 and 2032. PMCC, the Clinic, and PHIP had net deferred income tax assets totaling approximately $107,072,000 and $94,844,000 at June 30, 2012 and 2011, respectively. The net deferred income tax asset, which consisted primarily of net operating loss carryforwards and differences relating to allowances for doubtful accounts and accruals, were offset by a full valuation allowance.

The Company accounts for income taxes under the provisions of the *Income Taxes* Topic of the ASC (ASC 740). Under the requirements of ASC 740, tax-exempt organizations may be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. There were no material uncertain tax positions at June 30, 2012 and 2011.

Prior Year Reclassifications

Certain reclassifications have been made to the fiscal year 2011 consolidated financial statements to conform to the fiscal year 2012 presentation. These reclassifications had no impact on the results of operations or change in net assets in the accompanying consolidated financial statements.

2. Significant Accounting and Reporting Policies (continued)

Defined Benefit Pension Plan

PHC accounts for its defined benefit pension plan in accordance with ASC 715, *Compensation – Retirement Benefits*. ASC 715 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status; measure a defined benefit postretirement plan's assets and obligations that determine its funded status at the end of the employer's fiscal year; and recognize changes in the funded status of a defined benefit postretirement plan as a separate line item or items within changes in unrestricted net assets, apart from expenses, in the year in which the changes occur. PHC employees participate in PHC's trusteed noncontributory defined benefit pension plan (the Plan). The Plan's benefits are based on a combination of years of service and the employee's compensation. PHC's funding policy is to contribute annually to the Plan an amount sufficient to meet the minimum funding standards of Employee Retirement Income Security Act (ERISA) or an amount sufficient to maintain the Plan on a sound actuarial basis, as certified by an enrolled actuary. Plan assets consist primarily of common stocks, alternative investments, fixed investments, and cash equivalents. In September 2012, the PHC Board of Directors and PHC management approved a freeze of the Plan effective December 31, 2014, whereby participants would cease to accrue further benefits. PHC is in process of estimating the impact of the freeze on the consolidated financial statements for the year ended June 30, 2013.

Subsequent Events

PHC evaluated events and transactions occurring subsequent to June 30, 2012 through October 25, 2012, the date the consolidated financial statements were available to be issued. During this period there were no subsequent events that required recognition in the consolidated financial statements. Additionally, there were no nonrecognized subsequent events that required disclosure other than as disclosed above and in Note 11 relating to the freeze of the Plan.

Recent Accounting Pronouncements

On July 1, 2010, PHC adopted amendments to ASC 958-805, Not-for-Profit Entities – Business Combinations, which requires mergers to be accounted for using the carryover method and acquisitions to be accounted for using the acquisition method. These amendments require recognition of a contribution when net assets are received without transferring consideration, or if the consideration transferred is less than the fair value of the net assets received. These

2. Significant Accounting and Reporting Policies (continued)

amendments also amend ASC 350 to include not-for-profit entities within its scope, thus requiring not-for-profit entities to cease amortizing goodwill and other indefinite-lived intangible assets and perform impairment testing on at least an annual basis. These amendments also amend ASC 810 to include not-for-profit entities within the scope of its model for accounting for noncontrolling interests in consolidated financial statements. The adoption of this standard did not have a material impact on PHC's consolidated financial position or results of operations.

On July 1, 2011, PHC adopted Accounting Standard Updates (ASU) 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*, which prescribes a specific measurement basis of charity care for disclosure. The adoption of this standard did not have a material impact on PHC's consolidated financial position or results of operations.

On July 1, 2011, PHC adopted ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, which clarifies that a health care entity should not net insurance recoveries against a related claim liability. The adoption of this standard did not have a material impact on PHC's consolidated financial statements.

On January 1, 2012, PHC adopted ASU No. 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This guidance contains certain updates to the fair value measurement guidance as well as enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for "Level 3" measurements including enhanced disclosure for: (1) the valuation processes used by the reporting entity; and (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, if any.

As previously noted, PHC adopted the provisions of ASU No. 2011-07, *Healthcare Entities (Topic 954), Presentation and Disclosure of Net Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts*. ASU 2011-07 requires certain health care entities to present their bad debt provision related to patient services revenue separately as contra-revenue in the statement of operations. In addition, ASU 2011-07 requires the following disclosures: (1) An entity's policy for considering collectability in the timing and amount of revenue and bad debt recognized; (2) The amount of revenue (i.e., less contractual discounts) recognized, by major payor source; and (3) Quantitative and qualitative information about changes in the bad debt allowance, including judgments made and changes in estimates.

2. Significant Accounting and Reporting Policies (continued)

In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and Other (Topic 350), Testing Goodwill for Impairment*. The FASB decided to simplify how companies are required to test goodwill for impairment. Companies now have the option to first assess qualitative factors to determine whether it is more likely than not (likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If after considering the totality of events and circumstances an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it will not have to perform the two-step impairment test. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The ASU will be effective for PHC in the fiscal year ending June 30, 2013 and the adoption is not expected to have a material effect on the consolidated financial statements.

3. Acquisitions

Piedmont Henry Hospital

Effective January 1, 2012, PHC entered into an affiliation agreement with Piedmont Henry Hospital (f/k/a Henry Medical Center) whereby it became the sole corporate member of the entity. PHC acquired Henry to expand its presence in the southern side of Metro Atlanta. Although no consideration was transferred, PHC assumed all the assets and liabilities of Henry at the acquisition date. As part of the acquisition, PHC assumed Henry's lease with the Hospital Authority of Henry County. The lease covers certain assets and liabilities of Henry at the inception of the lease. At the termination of the lease, these assets and liabilities revert back to the Authority. In connection with the acquisition and PHC's assumption of the lease, the lease term was extended to expire in 40 years. The total cost of the Henry acquisition has been allocated to the assets acquired and liabilities assumed based upon their respective fair values in accordance with ASC 958-805, *Not-for-Profit Entities – Business Combinations* and ASC 954-805, *Health Care Entities – Business Combinations*.

Based on the preliminary purchase price allocation at June 30, 2012, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in a contribution of approximately $77,087,000 being recorded.

3. Acquisitions (continued)

A summary of the preliminary purchase price allocation, including assumed liabilities, follows (in thousands):

Assets:	
Cash	$ 2,721
Net patient accounts receivable	22,149
Other current assets	9,585
Assets limited as to use	20,646
Property and equipment	179,263
Other assets	7,353
Total assets	241,717
Liabilities:	
Current liabilities	(49,807)
Long-term debt	(107,378)
Other liabilities	(7,445)
Total liabilities	164,630
Contribution received in acquisition of Henry	$ 77,087

The purchase price allocation remains preliminary as PHC is still in process of finalizing reserves related to amounts previously billed to governmental payors. The Henry operating results have been included in the consolidated statements of operations since the acquisition date. The net revenues, net operating loss and increase in unrestricted net assets attributable to PHC related to the acquired Henry operations for the period from January 1, 2012 through June 30, 2012 were approximately $79,657,000, $6,462,000 and $83,000, respectively. The unaudited pro forma combined summary of operations gives effect to including the acquired Henry operating results as if the acquisition had occurred as of July 1, 2010, follows (in thousands):

	Year Ended June 30	
	2012	**2011**
Net patient service revenue	**$ 1,442,765**	$ 1,329,679
Net operating income (loss)	**38,782**	(2,147)
Increase in net assets	**30,217**	125,474

3. Acquisitions (continued)

Pro forma adjustments to net operating income (loss) attributable to PHC include adjustments to record Henry's operating results on a consolidated basis and to record depreciation expense based on the estimated fair value assigned to the long-lived assets acquired. These pro forma results are not necessarily indicative of the actual results of operations that would have occurred if the acquisition had occurred on July 1, 2010.

Net patient service revenue, net operating income, and increase in unrestricted net assets attributable to PHC related to Henry for the period from January 1, 2012 through June 30, 2012 were $79,657,000, $70,627,000, and $77,475,000 respectively.

Other Acquisition

Effective July 29, 2011, in order to expand its primary care network, PHC acquired the assets and certain liabilities of The PAPP Clinic, a physician group consisting of 37 physicians located primarily in Coweta County, Georgia, for $8,953,000. The purchase price was based upon an independent fair value analysis and has been allocated to the related assets acquired and liabilities assumed based upon their respective fair values. The purchase price paid in excess of the fair value of identifiable net assets of these acquired entities aggregated approximately $3,366,000 and is recorded as goodwill in the accompanying consolidated balance sheets. The consolidated financial statements include the accounts and operations of the acquired entity subsequent to the acquisition date.

4. Net Patient Service Revenue

PHC has agreements with third-party payors that provide for payments to PHC at amounts different from its established rates. A summary of payment arrangements with major third-party payors follows.

Medicare and Medicaid

PHC renders care to patients covered by the Medicare and Medicaid programs. Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicare reimburses for outpatient services based on a prospective outpatient payment system similar to the inpatient system.

4. Net Patient Service Revenue (continued)

Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective payment reimbursement methodology. Outpatient services are reimbursed under a cost-based methodology. PHC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by PHC and audits thereof by the Medicaid fiscal intermediary.

Services rendered under these programs are recorded at established rates and reduced to the estimated amount due from the third-party payors through recording of contractual adjustments and other discounts. Because PHC cannot pursue collections for the contractual or discounted amounts, they are not reported as revenue.

Net patient service revenue from the Medicare and Medicaid programs accounted for approximately 21% and 4%, respectively, of PHC's net patient service revenue for the year ended June 30, 2012, and 24% and 2%, respectively, of PHC's net patient service revenue for the year ended June 30, 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue is reported at the estimated net realizable amounts from the Medicare and Medicaid programs for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations.

Final settlement has been reached for all Medicare cost reports prior to fiscal year 2008. In addition, final settlement has been reached for all Medicaid cost reports prior to fiscal year 2008. PHC has recorded amounts due to Medicare and Medicaid of $24,880,000 and $8,893,000 at June 30, 2012 and 2011, respectively, as an estimate of final third-party payor settlements for open cost report years. Management recorded a favorable change in estimate related to third-party settlements of $6,207,000 and $2,869,000 for the years ended June 30, 2012 and 2011, respectively. The amounts due to Medicare and Medicaid represent management's best estimate of final settlement.

Managed Care and Other Payors

PHC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations (HMOs), and preferred provider organizations. The bases for payments to PHC under these agreements include prospectively determined rates per discharge, discounts from established charges, and daily rates.

4. Net Patient Service Revenue (continued)

Georgia Provider Payment Agreement Act

Effective July 1, 2010, the State of Georgia imposed a fee on not-for-profit hospitals based on net revenue levels as defined by the State of Georgia. Included in supplies and other expenses in the accompanying consolidated statements of operations for the years ended June 30, 2012 and 2011 is approximately $14,890,000 and $11,872,000, respectively, relating to this fee.

5. Charity Care and Community Benefits

PHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as revenue or accounts receivable in the accompanying consolidated financial statements.

PHC maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services furnished under its charity care policy. The cost of providing this charity care was estimated to be approximately $22,581,000 and $23,518,000 in the years ended June 30, 2012 and 2011, respectively. PHC estimates the direct and indirect costs of providing charity care by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. PHC offers many other wellness and educational services to the community at low and, in some cases, no cost. Health fairs are held throughout the year at convenient locations, providing various health screenings, such as blood pressure and cholesterol checks. Educational programs are offered for all ages. PHC operates 24-hour emergency rooms that provide care to all patients regardless of ability to pay. The costs for these services are included in operating expenses.

6. Investments

Investments and Assets Limited as to Use

The composition of investments and assets limited as to use is set forth in the following table.

	June 30	
	2012	**2011**
	(In Thousands)	
Internally designated for capital acquisition:		
Cash and short-term investments	**$ 4,965**	$ 12,673
Corporate obligations	**14,908**	14,206
Fixed-income securities	**48,917**	114,667
Corporate stocks	**96,493**	74,012
Mutual funds	**192,982**	145,269
Alternative investments	**76,121**	74,255
	434,386	435,082
Cash held by trustee – construction funds	**–**	41,480
Cash and short-term investments	**216**	547
Corporate obligations	**647**	643
Fixed-income securities	**2,124**	5,193
Corporate stocks	**4,190**	3,352
Mutual funds	**8,379**	6,580
Alternative investments	**3,294**	3,362
	18,850	61,157
Totals	**$ 453,236**	$ 496,239

6. Investments (continued)

Alternative Investments

PHC had $33,909,000 invested in the Federal Street Associates Offshore Fund (FSAOF) at June 30, 2011 which is included in assets limited as to use in the accompanying consolidated balance sheets. At June 30, 2011, PHC recorded $2,077,000 as unrealized gains, for its proportionate share of the FSAOF unrealized gains for this investment. During fiscal year 2012, PHC liquidated this investment and recognized a loss of $863,000. These realized losses and unrealized gains are included in investment income in the accompanying consolidated statements of operations.

PHC has $24,774,000 and $25,064,000 invested in the Lighthouse Diversified Fund (LDF) at June 30, 2012 and 2011, respectively, which is included in investments and assets limited as to use in the accompanying consolidated balance sheets. At June 30, 2012 and 2011, PHC recorded $290,000 as unrealized losses and $2,276,000 as unrealized gains, respectively, for its proportionate share of the LDF unrealized losses and gains for this investment. These unrealized losses and gains are included in investment income in the accompanying consolidated statements of operations.

PHC has $17,666,000 and $18,644,000 invested in Baillie Gifford FDS Fund (BG) at June 30, 2012 and 2011, respectively, which is included in investments and assets limited as to use in the accompanying consolidated balance sheets. At June 30, 2012 and 2011, PHC recorded $978,000 as unrealized losses and $4,528,000 as unrealized gains, respectively, for its proportionate share of the unrealized losses and gains for this investment. These unrealized losses and gains are included in investment income in the accompanying consolidated statements of operations.

PHC has $12,663,000 invested in Archipelago Holdings Ltd Offshore Fund (AH) at June 30, 2012 which is included in investments and assets limited as to use in the accompanying consolidated balance sheets. At June 30, 2012, PHC recorded $338,000 as unrealized losses for its proportionate share of the AH unrealized losses for this investment. These unrealized losses are included in investment income in the accompanying consolidated statements of operations.

PHC has $24,312,000 invested in Titan Masters International Fund (TM) at June 30, 2012 which is included in investments and assets limited as to use in the accompanying consolidated balance sheets. At June 30, 2012, PHC recorded $312,000 as unrealized gains for its proportionate share of the TM unrealized gains for this investment. These unrealized gains are included in investment income in the accompanying consolidated statements of operations.

6. Investments (continued)

Investment Income

Investment income for investments and assets limited as to use is comprised of the following:

	Year Ended June 30 2012	Year Ended June 30 2011
	(In Thousands)	
Interest income	**$ 14,910**	$ 13,316
Net realized and unrealized (loss) gain on investments	**(14,225)**	65,266
Other (loss) income	**(347)**	130
Investment income	**$ 338**	$ 78,712

7. Property and Equipment

A summary of property and equipment follows:

	June 30 2012	June 30 2011
	(In Thousands)	
Land and land improvements	**$ 57,322**	$ 35,859
Buildings and fixtures	**895,381**	646,657
Equipment	**538,095**	443,167
	1,490,798	1,125,683
Less accumulated depreciation	**696,123**	653,724
	794,695	471,959
Construction-in-progress	**30,583**	108,944
Property and equipment, net	**$ 825,258**	$ 580,903

Depreciation expense for the years ended June 30, 2012 and 2011, amounted to approximately $74,506,000 and $65,602,000, respectively. Amortization of capitalized software costs of approximately $840,000 is included in depreciation and amortization expense in the accompanying consolidated statements of changes in net assets for the year ended June 30, 2012.

7. Property and Equipment (continued)

At June 30, 2012, the remaining commitment on construction contracts for remodeling PHC's facilities approximated $21,215,000.

During 2012, PHC completed construction of the new Piedmont Newnan hospital. In May, 2012 the operations of Newnan were transferred to the new hospital. At that time, the old hospital building and certain assets that were not transferred to the new building were written down to fair value less estimated cost to sell, resulting in a loss of approximately $6,618,000. The building and related assets of $3,790,000 are classified as held for sale and are included in other current assets in the accompanying consolidated balance sheets at June 30, 2012. Sale of the assets is expected to occur within one year.

In August 2006, Fayette entered into a ground lease with Piedmont Fayette Medical Office Building, LLC (PFB), whereby Fayette is leasing real property to PFB. In accordance with ASC 840, *Leases*, Fayette is considered the owner of the Medical Office Building (Fayette MOB) during the construction period and thereafter due to Fayette's continuing involvement in the Fayette MOB. Accordingly, the value of the building and the construction notes paid by the developer are included in the accompanying consolidated financial statements. At June 30, 2012, the value included in buildings and fixtures amounted to approximately $14,413,000 and the related Medical Office Building financing obligation approximated $15,858,000. At June 30, 2011, the value included in buildings and fixtures amounted to approximately $14,941,000 and the related Medical Office Building financing obligation approximated $16,917,000.

In August 2005, the Hospital entered into a ground lease with Piedmont Physicians Plaza, L.P. (PPP), whereby the Hospital is leasing real property to PPP. In accordance with ASC 840, the Hospital is considered the owner of the Medical Office Building (Piedmont MOB) during the construction period and thereafter due to the Hospital's continuing involvement in the MOB. Accordingly, the cost of the building and the related financing obligation are included in the Hospital's consolidated financial statements. At June 30, 2012, the net book value of the Piedmont MOB included in buildings and fixtures amounted to approximately $21,572,000 and the related Medical Office Building financing obligation approximated $28,670,000. At June 30, 2011, the net book value of the Piedmont MOB included in buildings and fixtures amounted to approximately $22,644,000 and the related Medical Office Building financing obligation approximated $28,460,000.

7. Property and Equipment (continued)

Capitalized software and software development costs were as follows:

	June 30 2012		June 30 2011
	(In Thousands)		
Capitalized software	**$**	**37,785**	$ 5,486
Accumulated amortization		**840**	–
Capitalized software, net	**$**	**36,945**	$ 5,486

Based on the amortizable capitalized assets that have been placed into service at June 30, 2012, the estimated amortization expense for the succeeding five fiscal years and thereafter is as follows (in thousands):

Year ended June 30,	
2013	$ 2,711
2014	2,711
2015	2,252
2016	1,763
2017	1,581
Thereafter	4,451
	$ 15,469

8. Long-Term Debt

Long-term debt consists of the following: (in thousands):

	June 30 2012	June 30 2011
Series 2010, fixed interest rates from 4.50% to 5.00%, interest payments due semi-annually, payable through 2045	**$ 100,000**	$ 100,000
Series 2009A, fixed interest rates from 4.375% to 5.25%, interest payments due semi-annually, payable through 2024	**208,140**	208,140
Series 2009B, variable interest rates (0.18% and 0.09% at June 30, 2012 and 2011, respectively), interest payments due monthly, payable through 2034	**102,300**	104,810
Series 2009C, variable interest rates (0.85% and 0.81% at June 30, 2012 and 2011, respectively), interest payments due monthly, payable through 2019	**53,465**	59,745
Series 2004, stated fixed interest rates from 4.00% to 5.00%, interest payments due semiannually, payable through 2034	**60,212**	–
Series 1997, stated fixed interest rate of 5.10%, interest payments due semi-annually, payable through 2012	**875**	–
Unamortized original issue discount, net	**(5,556)**	(5,772)
	519,436	466,923
Less current maturities	**(9,830)**	(8,790)
	$ 509,606	$ 458,133

On October 27, 2010, the Coweta County Development Authority issued $100,000,000 in Revenue Bonds Series 2010 (the Series 2010 Bonds) on behalf of PHC. The proceeds of the Series 2010 Bonds were used to construct a replacement hospital for Newnan. Cash held by trustee in the amount of $41,480,000 at June 30, 2011 is included in investments and assets limited as to use on the accompanying consolidated balance sheets. At June 30, 2012 all proceeds had been received and expended. The Series 2010 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group (Piedmont Healthcare, Inc. and all of its subsidiaries exclusive of AMIC) which provides, for among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property and limitations on additional borrowings.

8. Long-Term Debt (continued)

On November 24, 2009, the Development Authority of Fulton County and the Hospital Authority of Fayette County issued $304,345,000 and $79,540,000, respectively, ($383,885,000 collectively) in Revenue Bonds Series 2009A, 2009B and 2009C (the Series 2009 Bonds) on behalf of PHC. The proceeds of the Series 2009 Bonds were used primarily to redeem previously outstanding Series 2007, Series 2005, Series 2001, and Series 1999 Revenue Bonds and fully repay a line of credit totaling approximately $65,000,000. The Series 2009 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group (Piedmont Healthcare, Inc. and all of its subsidiaries exclusive of AMIC) which provides, for among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property and limitations on additional borrowings.

The Series 2009B Bonds may be put to PHC at the option of the bondholder. In connection with the Series 2009B Bonds, PHC entered into letter of credit agreements totaling approximately $106,188,000 to secure the Series 2009B Bonds. The letters of credit expire November 15, 2015, at which time PHC will be required to either extend the existing letters of credit or obtain an acceptable replacement letter of credit. All fees payable under the letter of credit agreements are the responsibility of PHC.

In connection with the acquisition of Henry effective January 1, 2012, PHC assumed responsibility for payment of the Authority's outstanding revenue certificates through the lease agreement described in Note 3.

In April 2004, the Hospital Authority of Henry County issued $60,000,000 Revenue Certificates, Series 2004 (the 2004 Bonds). The certificates were used primarily to finance construction, renovation and equipping of certain additions and improvements to Henry and related facilities and to finance a portion of Henry's capital equipment purchases for a period not to exceed three years. At the acquisition date, the stated value of the Series 2004 Bonds approximated $57,980,000, but were recorded at their fair value of $60,266,000. At June 30, 2012, the stated value of the Series 2004 Bonds approximated $57,980,000 and the carrying value approximated $60,212,000.

8. Long-Term Debt (continued)

In December 1999, the Hospital Authority of Henry County issued $51,955,000 Revenue Certificates, Series 1999 (the Series 1999 Bonds). The certificates were used primarily to finance construction, renovation and equipping of certain additions and improvements to Henry and related facilities and to refund a portion of the Authority's outstanding revenue certificates series 1997. At the acquisition date, the stated value of the Series 1999 Bonds approximated $44,370,000, but were recorded at their fair value of $51,164,000. The Series 1999 certificates were fully refunded in March 2012 with the proceeds from a note payable from a bank (see below). PHC incurred a gain on extinguishment of debt of approximately $6,039,000 in connection with the refunding of the Series 1999 certificates.

In November 1997, the Hospital Authority of Henry County issued $26,500,000 Revenue Certificates, Series 1997 (the Series 1997 Bonds). The certificates were used primarily to finance construction, renovation and equipping of certain additions and improvements to Henry and related facilities and to refund the Authority's outstanding revenue certificates series 1992A. At the acquisition date, the stated value of the Series 1997 Bonds approximated their fair value of $875,000. The Series 2007 Bonds were paid in full in accordance with their payment schedule on July 1, 2012.

The Series 2004 certificates are payable from and secured by a first lien on and pledge of the gross revenues derived by the Authority from the operations of Henry. Additionally, payment of principal and interest when due is insured by a municipal bond insurance policy.

At the option of Henry, the Series 2004 certificates maturing on after July 1, 2015 are subject to early redemption at any time not earlier than July 1, 2014 at prices up to 101% of the principal, plus accrued interest to the redemption date.

Henry is required to maintain a sinking fund account sufficient to meet maturing principal and interest payments. Such deposits into this account are included with assets limited as to use in the accompanying consolidated financial statements.

8. Long-Term Debt (continued)

Scheduled principal payments on the Series 2010, Series 2009 Series 2004 and Series 1997 Bonds are as follows (in thousands):

Year ended June 30,	
2013	$ 9,830
2014	9,830
2015	10,425
2016	10,490
2017	11,370
Thereafter	470,815
	$ 522,760

As previously noted, the scheduled principal payments differ from the carrying value as the Series 2004 Bonds were recorded at fair value at the time of PHC's acquisition of Henry.

Note Payable to a Bank

Effective February 1, 2012, PHC entered into a note payable with a bank. The proceeds of the note totaling approximately $44,819,000 were used to repay Henry's Series 1999 Bonds. The note bears interest at a rate of 1.8% per annum payable monthly. Principal payments on the note are due as follows: $2,055,000 due July 1, 2013; $2,170,000 due July 1, 2014; $2,295,000 due July 1, 2015; $2,425,000 due July 1, 2016 and the remaining principal due July 1, 2017.

Line of Credit

During fiscal year 2010, PHC entered into a line of credit for $70,000,000 with a local bank with an interest rate based on 30-day LIBOR plus 0.75% and a maturity date of December 31, 2011. During fiscal year 2012, PHC entered into an amendment to the line of credit which reduced available borrowings to $1,000,000 and extended the maturity to December 31, 2012. There were no outstanding borrowings on the line of credit at June 30, 2012 or 2011.

8. Long-Term Debt (continued)

Interest Rate Swap Agreements

PHC has seven interest rate swap agreements that are not accounted for as cash flow hedges. These interest rate swaps are primarily utilized to economically hedge PHC's exposure to changing interest rates under its debt obligations. The change in value of the interest rate swaps is reported as a component of nonoperating income (expense) in the period it occurs. At June 30, 2012 and 2011, the total notional amount of PHC's interest rate swaps was approximately $151,907,000 and $142,629,000, respectively.

These interest rate swap agreements expose PHC to credit losses in the event of non-performance by the counterparty to the financial instruments. The counterparty is a creditworthy financial institution and PHC management believes the counterparty will be able to fully satisfy its obligations under the contracts.

PHC's interest rate swaps are reported at fair value in the accompanying consolidated balance sheets as follows:

	June 30	
	2012	**2011**
	(In Thousands)	
Other long-term liabilities	**$ 34,904**	$ 16,189

The effects of PHC's interest rate swaps on the accompanying consolidated statements of operations are as follows:

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
(Loss) gain recognized in nonoperating expense	**$ (18,716)**	$ 7,094
Loss recognized in supplies and other expenses	**(4,879)**	(4,956)
	$ (23,595)	$ 2,138

9. Medical Office Buildings

As discussed in Note 7, PHC is considered the owner of the Fayette MOB and the Piedmont MOB for financial reporting purposes. In accordance with ASC 840, *Leases,* PHC has reflected the operations of the Piedmont and Fayette MOB's in its consolidated financial statements which resulted in other income of approximately \$6,131,000, interest expense of \$5,209,000, and other operating expense of \$695,000, for the year ended June 30, 2012 and other income of approximately \$5,062,000, interest expense of \$2,476,000 and other expense of \$2,587,000 for the year ended June 30, 2011.

10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets available primarily for capital purchases, education and geriatric services were \$21,746,000 and \$19,187,000 at June 30, 2012 and 2011, respectively.

Permanently restricted net assets are as follows, with a description of how the investment income is to be used:

	June 30	
	2012	**2011**
	(In Thousands)	
Support of education	**$ 507**	$ 507
Beneficial interest in perpetual trust	**7,939**	8,301
Support of specific services	**13,985**	13,940
	$ 22,431	$ 22,748

11. Employee Benefits

Pension Plan

PHC has a trusteed noncontributory defined benefit pension plan (the Plan) covering a portion of PHC employees. The Plan's benefits are based on a combination of years of service and the employee's compensation. PHC's funding policy is to contribute annually to the Plan an amount sufficient to meet the minimum funding standards of ERISA or an amount sufficient to maintain the Plan on a sound actuarial basis, as certified by an enrolled actuary. Plan assets consist primarily of common stocks, alternative investments, guaranteed investment contracts, and cash equivalents.

11. Employee Benefits (continued)

The following amounts have not yet been recognized in the net periodic cost, and are recognized as a reduction to unrestricted net assets:

	June 30 2012	June 30 2011
	(In Thousands)	
Actuarial losses	**$ 105,661**	$ 32,744
Prior service cost	**25**	169
Total	**$ 105,686**	$ 32,913

Changes in the Plan's obligations and assets caused the following changes in unrestricted net assets:

	Year Ended June 30 2012	Year Ended June 30 2011
	(In Thousands)	
Amortization of prior service cost	**$ 144**	$ 188
Amortization of loss	**443**	4,665
Net actuarial (loss) gain during the year	**(73,360)**	37,380
Total	**$ (72,773)**	$ 42,233

11. Employee Benefits (continued)

The prior service cost and unrecognized loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ended June 30, 2013, are $13,000 and $7,701,000, respectively.

The following table presents a reconciliation of the beginning and ending balances of the Plan's projected benefit obligation, the fair value of plan assets, the funded status of the Plan, and the accumulated benefit obligation:

	June 30 2012	June 30 2011
	(In Thousands)	
Change in benefit obligations		
Projected benefit obligation, beginning of year	**$ 286,386**	$ 273,495
Service cost	**10,063**	11,213
Interest cost	**16,571**	15,301
Benefits paid	**(6,158)**	(4,696)
Actuarial loss (gain)	**54,367**	(8,927)
Projected benefit obligation, end of year	**$ 361,229**	$ 286,386
Accumulated benefit obligation	**$ 322,468**	$ 254,231
Change in Plan assets		
Fair value of Plan assets, beginning of year	**$ 243,963**	$ 179,980
Employer contributions	**55,000**	25,000
Actual return on Plan assets	**786**	43,679
Benefits paid	**(6,158)**	(4,696)
Fair value of Plan assets, end of year	**$ 293,591**	$ 243,963
Funded status of the Plan	**$ (67,638)**	$ (42,423)

The underfunded status of the Plan of $67,638,000 and $42,423,000 at June 30, 2012 and 2011, respectively, is recognized in the accompanying consolidated balance sheets as a long-term pension liability. No Plan assets are expected to be returned to PHC during the fiscal year ended 2013.

11. Employee Benefits (continued)

The following table sets forth the components of net periodic benefit cost.

	Year Ended June 30	
	2012	**2011**
	(In Thousands)	
Components of net periodic benefit cost		
Service cost	**$ 10,063**	$ 11,213
Interest cost	**16,571**	15,301
Expected return on Plan assets	**(19,779)**	(15,225)
Amortization of prior service cost	**144**	188
Amortization of net actuarial loss	**443**	4,665
Total net periodic benefit cost	**$ 7,442**	$ 16,142

The actuarial assumptions used in the accounting for the net periodic cost for the Plan were as follows:

	June 30	
	2012	**2011**
Discount rate	**5.85%**	5.65%
Rate of increase in future compensation levels	**3.00%**	3.00%
Expected long-term rate of return on Plan assets	**7.75%**	7.75%

The actuarial assumptions used to determine the year-end benefit obligations for the Plan were as follows:

	June 30	
	2012	**2011**
Discount rate	**4.82%**	5.85%
Rate of increase in future compensation levels	**3.00%**	3.00%

11. Employee Benefits (continued)

The PHC Board of Directors approved the freezing of the Plan for participation purposes, so that employees hired or re-hired on and after July 1, 2008 will not be eligible to participate in the Plan. Current participants had the option under the "Choice" program to continue to accrue benefits in the Piedmont Healthcare Retirement Plan or to participate in the new Piedmont 401(k) plan, which began on January 1, 2009. Approximately 64% of active participants elected to continue to accrue benefits in the defined benefit pension plan.

In September 2012, the PHC Board of Directors and PHC management approved a freeze of the Plan effective December 31, 2014, whereby participants would cease to accrue further benefits. PHC is in process of estimating the impact of the freeze on the consolidated financial statements for the year ended June 30, 2013.

PHC uses fair value as the market-related value of assets in calculating the expected return on Plan assets component of net periodic pension expense for the years ended June 30, 2012 and 2011.

Contributions expected to be paid to the Plan during fiscal year 2013 are estimated at $0.

Benefits expected to be paid in each of the next five fiscal years are as follows: fiscal year 2013 – $7,972,000; fiscal year 2014 – $8,842,000; fiscal year 2015 – $10,038,000; fiscal year 2016 – $11,395,000; and fiscal year 2017 – $12,870,000. For fiscal years 2018 – 2022, the aggregate benefits expected to be paid are $88,427,000.

The following table sets forth the asset allocation for the Plan:

	June 30	
	2012	**2011**
Growth/equity securities	**64%**	58%
Hedge funds/private equity	**16**	18
Fixed securities	**20**	24
	100%	100%

11. Employee Benefits (continued)

The target allocation for the Plan is as follows:

	June 30	
	2012	**2011**
Growth/equity securities	**57%**	57%
Hedge funds/private equity	**20**	20
Fixed securities	**23**	23
	100%	100%

To develop the expected long-term rate of return on assets assumption, PHC considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the Plan's portfolio.

The investment strategy of the Plan is to ensure, over the long-term life of the Plan, an adequate pool of assets along with contributions by PHC to satisfy the benefit obligations to participants and beneficiaries. PHC desires to achieve market returns consistent with a prudent level of diversification. All investments are made solely in the interest of the Plan's participants and beneficiaries for the exclusive purposes of providing benefits to such participants and their beneficiaries and defraying the expenses related to administering the Plan. The target allocation of all assets is to reflect proper diversification in order to reduce the potential of a single security or single sector of securities having a disproportionate impact on the portfolio. In an effort to maintain the overall risk level of the portfolio within an acceptable range, the relative mix of asset classes will be rebalanced back toward the target allocations as opportunities permit, but in any event not less often than annually. The use of futures and options contracts will be limited to liquid instruments listed and actively traded on major exchanges (except for short-term funds) to over-the-counter options or forward contract positions executed with major dealers. No derivatives strategy may be used if it would subject the portfolios to greater variance than would be the case with the physical portfolio under a worst case scenario. Short-term funds may use only exchange-traded futures contracts and options – specifically prohibited are any off-exchange instruments and any exotic or structured securities, as well as notes whose interest rate is tied to security with a maturity of more than one year. PHC utilizes an outside investment consultant to implement its investment strategy.

11. Employee Benefits (continued)

The fair value of financial assets of the Plan measured at fair value on a recurring basis was determined using the following inputs at June 30, 2012 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets at fair value:				
Corporate obligations	**$ –**	**$ 4,528**	**$ –**	**$ 4,528**
Fixed-income securities	**356**	**–**	**–**	**356**
Corporate stocks	**9,575**	**156**	**–**	**9,731**
Mutual funds	**175,613**	**–**	**–**	**175,613**
Alternative investments	**–**	**98,604**	**4,759**	**103,363**
Total assets at fair value	**$ 185,544**	**$ 103,288**	**$ 4,759**	**$ 293,591**

The fair value of financial assets of the Plan measured at fair value on a recurring basis was determined using the following inputs at June 30, 2011 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets at fair value:				
Corporate obligations	$ –	$ 4,376	$ –	$ 4,376
Fixed-income securities	364	–	–	364
Corporate stocks	17,534	95	–	17,629
Mutual funds	116,895	–	–	116,895
Alternative investments	–	104,699	–	104,699
Total assets at fair value	$ 134,793	$ 109,170	$ –	$ 243,963

The investments at June 30, 2012 and 2011 were in domestic investments.

The Plan invests in alternative investments which provide the Plan with a proportionate share of the fair value of the fund returns. The Federal Street Associates Offshore Fund, the Lighthouse Diversified Fund and the Titan Masters International Fund are funds that invest in other alternative investments (for example, funds of funds) and these are classified as Level 2 financial assets. The Baillie Gifford FDS Fund, the LSV Emerging Markets Fund and the JPMCB Extended Duration Fund are funds whose underlying investments are in securities that are publicly traded on US and overseas exchanges and these are classified as Level 2 financial assets. The Clarion Lion Partners Fund is a fund which invests in real estate and is classified as a

11. Employee Benefits (continued)

Level 2 financial asset. The Archipelago Holdings Ltd Offshore Fund is a fund that invests in other alternative investments (for example, funds of funds) and is classified as Level 3 financial assets since there is a one year lock up period in effect at June 30, 2012.

Other than the Plan's investment in Archipelago Holdings Ltd Offshore Fund discussed above, the Plan's alternative investments do not have restrictions in excess of 90 days related to redemption.

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 financial assets for the corporate obligations were determined through evaluated bid prices provided by third-party pricing services where quoted market prices are not available. The fair value of Level 2 and Level 3 alternative investments was determined based on the use of net asset value (NAV) per share as a practical expedient in accordance with ASC 820.

The following is the reconciliation of the beginning and ending balances of Level 3 financial assets measured at fair value on a recurring basis (in thousands):

Balance at July 1, 2011	$ -
Purchases	5,000
Net unrealized losses	(241)
Balance at June 30, 2012	$ 4,759

Deferred Compensation Plan

PHC also offers a nonqualified deferred compensation plan, which is available to certain highly compensated PMCC employees. The Plan permits such employees to defer the receipt and taxation of all or a portion of their salary until future years. The deferred compensation is available for distribution to employees upon the election by the employee, provided the distribution election with respect to the deferred amounts has been made for a minimum of one year prior to the date of distribution.

11. Employee Benefits (continued)

All deferrals are held as part of PHC's general assets and are subject to the claims of PHC's general creditors. Employees' rights to the payment of benefits under the Plan are equal to those of general and unsecured creditors of the Corporation. PHC has no liability for losses under the deferred compensation plan.

The amounts recorded for the deferred compensation plan are approximately $13,365,000 and $12,004,000, at June 30, 2012 and 2011, respectively, and are recorded within other long-term liabilities in the accompanying consolidated balance sheets.

401(k) Plan

PHC offers, as the sponsor, a deferred tax annuity plan (the 401(k) Plan) pursuant to Section 401(k) of the Internal Revenue Code of 1986 covering substantially all employees of PHC. PHC contributes 100% of pretax contributions up to the first 3% of eligible pay and 50% of pretax contributions up to the next 2% into the 401(k) Plan and may make an additional discretionary contribution. PHC recognized as expense approximately $17,760,000 and $6,071,000 for the years ended June 30, 2012 and 2011, respectively, related to the 401(k) Plan.

12. Concentrations of Credit Risk

PHC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors was as follows:

	June 30	
	2012	**2011**
Medicare	**26%**	19%
Medicaid	**4**	4
Other third-party payors	**41**	43
Patients	**29**	34
	100%	100%

PHC recognizes that revenue and receivables from government agencies and third-party payors are significant to its operations but does not believe that there are significant credit risks associated with these collections.

13. Commitments and Contingencies

General and Professional Liability Insurance

PHC has a trusteed self-insurance program for general and professional liability coverage, through AMIC. AMIC insures PHC with professional liability and commercial general liability risks of PHC affiliates, namely the Hospital, Mountainside, Fayette, Newnan, Henry, PHIP and PMCC, on a claims-made basis for the hospital professional liability and on an occurrence basis for the commercial general liability. The insurance policies between PHC and AMIC are $5,000,000 per occurrence and $20,000,000 aggregate annual limit for coverage effective May 1, 2003, subject to a retroactive date of May 1, 2001, and $5,000,000 per occurrence and $19,000,000 aggregate annual limit for coverage effective May 1, 2005, through April 30, 2012. AMIC is consolidated by PHC. PHC records the reported and estimated incurred but not reported liability based on an actuarial study at June 30, 2012 and 2011, which amounted to approximately $34,542,000 and $31,142,000, respectively, and is recorded as self-insurance reserves in the accompanying consolidated balance sheets. Commercial insurance has been obtained on a claims-incurred basis to provide for excess coverage.

The general and professional self-insurance reserves included in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2012 and 2011, applicable to the general and professional liability self-insurance plans for PHC. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice losses have been discounted at 4% at June 30, 2012 and 2011.

Other Self-Insurance Programs

PHC self-insures a portion of its workers' compensation liability exposure up to $350,000 per claim at June 30, 2012 and 2011. Reserves for the self-insurance program are established to provide for estimated claims losses and applicable legal expenses for any claims incurred, both reported and unreported, through June 30, 2012, and are recorded in the accompanying consolidated financial statements. PHC recorded the reported and estimated incurred but not reported liability for its claims at June 30, 2012 and 2011, which amounted to approximately $6,235,000 and $5,646,000, respectively. Commercial insurance has been obtained on a claims-incurred basis to provide for excess coverage.

13. Commitments and Contingencies (continued)

The workers' compensation self-insurance reserves included in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2012. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued workers' compensation losses have been discounted at 4% at June 30, 2012 and 2011.

PHC is self-insured for employee health benefits for its subsidiaries with reinsurance for high dollar claims. At June 30, 2012 and 2011, PHC recorded $5,039,000 and $3,408,000, respectively, as a liability for health benefit claims within the current portion of self-insurance reserves line item in the accompanying consolidated balance sheets.

The employee health benefits self-insurance reserves in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2012, applicable to the employee health benefits self-insurance plans. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued employee health benefits losses have not been discounted due to the short-term nature of the payout of these liabilities.

In the opinion of management, adequate provision has been made for losses that may occur from the asserted and unasserted claims for all self-insurance programs.

Operating Leases

PHC leases various equipment and facilities under operating leases expiring at various dates through fiscal year 2024. Total rent expense in fiscal years 2012 and 2011 for all operating leases was $38,562,000 and $33,871,000, respectively.

13. Commitments and Contingencies (continued)

The following is a schedule by year of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year (in thousands):

Year ended June 30,	
2013	$ 24,469
2014	22,272
2015	22,592
2016	21,387
2017	19,264
Thereafter	100,405
	$ 210,389

Litigation

PHC is involved in litigation arising in the ordinary course of business. After consultation with legal counsel, management estimates that these matters will be resolved without a material adverse effect on PHC's future financial position or results of operations.

14. Functional Expenses

PHC does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Further, since PHC receives substantially all of its resources from providing health care services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

15. Fair Value of Financial Instruments

PHC follows ASC 820 which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measure date. ASC 820 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

15. Fair Value of Financial Instruments (continued)

Certain of the PHC's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market, fixed income and equity instruments, and interest rate swap agreements. The three levels of the fair value hierarchy defined by ASC 820 and a description of the valuation methodologies used for instruments measured at fair value are 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 PHC has the ability to access.

Level 2 – Financial assets and liabilities whose values are based on pricing inputs which are either directly observable or that can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets or liabilities in nonactive markets or pricing models whose inputs are observable for substantially the full term of the asset or liability.

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both significant to the fair value of the financial asset or financial liability and are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

15. Fair Value of Financial Instruments (continued)

The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at June 30, 2012 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 204,596	$ –	$ –	$ 204,596
Investments and assets limited as to use:				
Cash and cash equivalents	5,181	–	–	5,181
Corporate obligations	1,184	14,371	–	15,555
Fixed income securities	51,041	–	–	51,041
Corporate stocks	100,683	–	–	100,683
Mutual funds	201,361	–	–	201,361
Total investments and assets limited as to use	359,450	14,371	–	373,821
Self-insurance investments:				
Corporate obligations	1,119	7,632	–	8,751
Treasury inflation protection securities	–	5,032	–	5,032
Fixed-income securities	7,192	–	–	7,192
Mortgage-backed securities	–	3,444	–	3,444
Mutual funds	11,219	–	–	11,219
	19,530	16,108	–	35,638
Beneficial interest in perpetual trust	–	–	7,939	7,939
Total assets at fair value	$ 583,576	$ 30,479	$ 7,939	$ 621,994
Liabilities				
Interest rate swaps	$ –	$ 34,904	$ –	$ 34,904
Total liabilities at fair value	$ –	$ 34,904	$ –	$ 34,904

15. Fair Value of Financial Instruments (continued)

The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at June 30, 2011 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 198,796	$ –	$ –	$ 198,796
Investments and assets limited as to use:				
Cash and cash equivalents	13,219	–	–	13,219
Cash held by trustee	41,480	–	–	41,480
Corporate obligations	1,087	13,763	–	14,850
Fixed income securities	119,860	–	–	119,860
Corporate stocks	77,364	–	–	77,364
Mutual funds	151,849	–	–	151,849
Total investments and assets limited as to use	404,859	13,763	–	418,622
Self-insurance investments:				
Corporate obligations	765	7,463	–	8,228
Treasury inflation protection securities	–	3,555	–	3,555
Fixed-income securities	5,179	–	–	5,179
Mortgage-backed securities	–	2,237	–	2,237
Mutual funds	8,286	–	–	8,286
	14,230	13,255	–	27,485
Beneficial interest in perpetual trust	–	–	8,301	8,301
Total assets at fair value	$ 617,885	$ 27,018	$ 8,301	$ 653,204
Liabilities				
Interest rate swaps	$ –	$ 16,189	$ –	$ 16,189
Total liabilities at fair value	$ –	$ 16,189	$ –	$ 16,189

15. Fair Value of Financial Instruments (continued)

The investments at June 30, 2012 and 2011 were in domestic investments.

Financial assets and financial liabilities are reflected in the accompanying consolidated balance sheets as follows:

	June 30	
	2012	**2011**
	(In Thousands)	
Investments and assets limited as to use measured at fair value	**$ 373,821**	$ 418,622
Alternative investments accounted for under the equity method	**79,415**	77,617
Total investments and assets limited as to use	**$ 453,236**	$ 496,239

See Note 8 for location of interest rate swap liabilities in the accompanying consolidated balance sheets.

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair value of Level 2 and Level 3 financial assets and liabilities were determined as follows:

Corporate obligations, treasury inflated protection securities, and mortgage-backed securities – These Level 2 investments were determined through evaluated bid prices provided by third-party pricing services where quoted market values are not available. There is not significant subjectivity in the fair value estimate due to changes in the unobservable inputs.

Beneficial interest in perpetual trust – The fair values of these financial assets were determined from the fair value of the underlying assets contributed to the trusts. Based on the nature of the underlying assets, there is not significant subjectivity in the fair value estimate due to changes in the unobservable inputs.

15. Fair Value of Financial Instruments (continued)

Interest rate swaps – The fair values of these financial liabilities interest rate swaps were determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The analysis reflects contractual terms of the interest rate swaps and uses observable market-based inputs, such as interest rate curves. In addition credit valuation adjustments are included to reflect nonperformance risk. PHC pays fixed rates ranging from 3.17% to 4.84% and receives cash flows based on 67% of 1 month LIBOR.

The following is the reconciliation of the beginning and ending balances of Level 3 financial assets measured at fair value on a recurring basis (in thousands):

Balance at July 1, 2011	$ 8,301
Net realized and unrealized losses	(362)
Balance at June 30, 2012	$ 7,939

The net realized and unrealized losses on the Level 3 assets are included in changes to beneficial interest in perpetual trust within permanently restricted net assets in the accompanying consolidated statements of changes in net assets.

The carrying values of patient accounts receivable, pledges receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments. The fair value of the PHC's fixed-rate bonds is derived using Level 2 market-observable inputs, such as risk-free rates, yield curves and credit spreads for debt that is actively traded and has similar maturities and credit ratings. The fair value of PHC's bonds and note payable approximated $455,542,000 compared to a carrying value of approximately $410,499,000 at June 30, 2012 and approximated $314,000,000 compared to a carrying value of approximately $308,140,000 at June 30, 2011. The carrying value approximates fair value for all other long-term debt at June 30, 2012 and 2011.

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