SILVER HILL HOSPITAL, INC.

Financial Statements

February 29, 2012 and February 28, 2011

(With Independent Auditors’ Report Thereon)

SILVER HILL HOSPITAL, INC.

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KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Independent Auditors' Report

The Board of Directors
Silver Hill Hospital, Inc.:

We have audited the accompanying statements of financial position of Silver Hill Hospital, Inc. (the Hospital) as of February 29, 2012 and February 28, 2011, and the related statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 the Hospital'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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1 to the financial statements, the Hospital adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2010-23, *Measuring Charity Care for Disclosure*, as of March 1, 2010 and the provisions of ASU No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, as of March 1, 2011.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Silver Hill Hospital, Inc. as of February 29, 2012 and February 28, 2011, and the results of its operations, changes in its net assets, and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

June 26, 2012

SILVER HILL HOSPITAL, INC.

Statements of Financial Position

February 29, 2012 and February 28, 2011

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents	$	2,134,460	2,553,698
Investments (note 3)		8,583,024	9,708,200
Patient accounts receivable, net of allowance for doubtful accounts of $525,515 and $733,775 (note 5)		2,133,705	2,347,022
Prepaid expenses		463,997	489,261
Pledges receivable		25,921	107,421
Other current assets		125,798	114,400
Assets limited as to use – current liabilities (note 3)		1,325,589	1,157,113
Total current assets		14,792,494	16,477,115
Assets limited as to use (note 3):			
Temporarily and permanently restricted donations		782,469	1,197,193
Line of credit – liquid reserve requirement		1,100,000	1,100,000
Total assets limited as to use		1,882,469	2,297,193
Other assets, net		124,240	90,178
Insurance claims receivable		321,219	—
Property and equipment, net (note 4)		23,338,900	19,117,005
Total assets	$	40,459,322	37,981,491
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	735,157	1,255,281
Due to patients and third parties		636,199	497,162
Accrued salaries, taxes, and other compensation		1,046,764	959,300
Other current liabilities		800,768	804,936
Total current liabilities		3,218,888	3,516,679
Line of credit (note 6)		5,127,680	6,327,680
Estimated malpractice liabilities (note 8)		570,344	117,811
Total liabilities		8,916,912	9,962,170
Net assets:			
Unrestricted		30,709,941	26,822,128
Temporarily restricted (note 11)		619,469	984,193
Permanently restricted (note 11)		213,000	213,000
Total net assets		31,542,410	28,019,321
Commitments and contingencies (notes 7 and 8)			
Total liabilities and net assets	$	40,459,322	37,981,491

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Operations

Years ended February 29, 2012 and February 28, 2011

		2012	2011
Unrestricted revenues, gains, and other support:			
Net patient service revenue (note 2)	$	32,101,190	30,301,949
Contributions		738,672	786,665
Other revenue		225,429	220,675
Net assets released from restriction for use in operations		1,005,379	234,037
Total unrestricted revenues, gains, and other support		34,070,670	31,543,326
Operating expenses (note 10):			
Salaries and related costs		15,640,484	14,827,345
Employee benefits (note 9)		3,728,765	3,591,508
Supplies and services		8,545,368	8,097,416
Depreciation and amortization		1,289,143	1,207,933
Provision for bad debts		501,058	587,384
Development expense		580,574	510,919
Interest expense		72,458	443,185
Loss on the disposal of property and equipment		92,502	37,044
Total operating expenses		30,450,352	29,302,734
Income from operations		3,620,318	2,240,592
Nonoperating gains (losses):			
Investment income		291,801	367,917
Realized gains on investments		221,535	127,194
Provision for uncollectible pledges		(23,752)	(2,500)
Other gains, net		2,861	9,141
Total nonoperating gains (losses), net		492,445	501,752
Excess of unrestricted revenues, gains, and other support and nonoperating gains (losses) over expenses		4,112,763	2,742,344
Other changes in unrestricted net assets:			
Change in net unrealized (losses) gains on other than trading securities		(295,520)	824,958
Net assets released from restriction for use in capital projects		70,570	268,965
Increase in unrestricted net assets	$	3,887,813	3,836,267

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Changes in Net Assets

Years ended February 29, 2012 and February 28, 2011

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets at February 28, 2010	$ 22,985,861	111,408	213,000	23,310,269
Excess of unrestricted revenues, gains, and other support and nonoperating gains (losses) over expenses	2,742,344	—	—	2,742,344
Restricted contributions	—	197,397	—	197,397
Special event revenue – gala for scholarships, net of direct donor benefit of $416,303	—	1,173,642	—	1,173,642
Investment income, net of realized gains (losses)	—	4,748	—	4,748
Change in net unrealized gains on other than trading securities	824,958	—	—	824,958
Net assets released from restriction for use in operations	—	(234,037)	—	(234,037)
Net assets released from restriction for use in capital projects	268,965	(268,965)	—	—
Change in net assets	3,836,267	872,785	—	4,709,052
Net assets at February 28, 2011	26,822,128	984,193	213,000	28,019,321
Excess of unrestricted revenues, gains, and other support and nonoperating gains (losses) over expenses	4,112,763	—	—	4,112,763
Restricted contributions	—	123,893	—	123,893
Special event revenue – gala for scholarships, net of direct donor benefit of $87,000	—	572,350 —	—	572,350 —
Investment income, net of realized gains (losses)	—	14,982	—	14,982
Change in net unrealized losses on other than trading securities	(295,520)	—	—	(295,520)
Net assets released from restriction for use in operations	—	(1,005,379)	—	(1,005,379)
Net assets released from restriction for use in capital projects	70,570	(70,570)	—	—
Changes in net assets	3,887,813	(364,724)	—	3,523,089
Net assets at February 29, 2012	$ 30,709,941	619,469	213,000	31,542,410

See accompanying notes to financial statements.

SILVER HILL HOSPITAL, INC.

Statements of Cash Flows

Years ended February 28, 2012 and 2011

		2012	2011
Cash flows from operating activities:			
Change in net assets	$	3,523,089	4,709,052
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		1,289,143	1,207,933
Provision for bad debts		501,058	587,384
Loss on disposal of assets		92,502	37,044
Provision for uncollectible pledges		23,752	2,500
Contributions restricted for capital projects		(55,899)	(186,000)
Net unrealized losses (gains) on other than trading securities		295,520	(824,958)
Realized gains on investments		(221,535)	(127,194)
Changes in assets and liabilities:			
Patient accounts receivable		(287,741)	(143,138)
Prepaid expenses		25,264	(18,962)
Pledges receivable		10,000	28,652
Insurance claims receivable		(321,219)	—
Other current assets		(11,398)	296,232
Other assets		1,415	1,415
Accounts payable and accrued expenses		45,349	(42,946)
Due to patients and third parties		139,037	(158,178)
Accrued salaries, taxes, and other compensation		87,464	79,968
Other current liabilities		(4,168)	96,468
Other liabilities		452,533	29,597
Net cash provided by operating activities		5,584,166	5,574,869
Cash flows from investing activities:			
Purchases of property and equipment		(515,580)	(246,026)
Expenditures for Hospital campus renovations		(5,641,162)	(3,410,004)
Purchases of investments		(4,839,426)	(2,001,510)
Proceeds from sale of investments		5,345,634	2,478,083
Change in assets limited as to use		791,231	(2,854,307)
Net cash used in investing activities		(4,859,303)	(6,033,764)
Cash flows from financing activities:			
Contributions restricted for capital projects		55,899	186,000
Proceeds from line of credit		1,050,000	—
Repayment of line of credit		(2,250,000)	(2,000,000)
Deferred financing costs		—	(29,523)
Net cash used in financing activities		(1,144,101)	(1,843,523)
Decrease in cash and cash equivalents		(419,238)	(2,302,418)
Cash and cash equivalents, beginning of year, as restated (note 2)		2,553,698	4,856,116
Cash and cash equivalents, end of year	$	2,134,460	2,553,698
Supplemental disclosures of cash flow information:			
Cash paid during the year for interest, including capitalized interest	$	288,204	548,562
Increase in accounts payable and accrued expense for Hospital campus renovation expenditures		—	547,252

See accompanying notes to financial statements.

(1) Nature of Activities and Significant Accounting Policies

Nature of Activities

Silver Hill Hospital, Inc. (the Hospital) is a not-for-profit private psychiatric hospital, which provides medical attention to patients with psychiatric or substance abuse diagnosis through inpatient, residential and outpatient programs. Silver Hill was incorporated in the state of Connecticut in 1934.

A summary of the Hospital's significant accounting policies is as follows:

(a) Basis of Accounting

The Hospital's financial statements have been prepared on the accrual basis of accounting.

(b) Cash and Cash Equivalents

The Hospital considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

(c) Concentration of Credit Risk

The Hospital has cash balances in financial institutions that exceed federal depository insurance limits of $250,000.

(d) Patient Accounts Receivable

The collection of receivables from third-party payors and patients is the Hospital's primary source of cash for operations and is critical to its operating performance. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (deductibles and copayments) remain outstanding. Patient receivables, where a third-party payor is responsible for paying the amount, are carried at a net amount determined by the original charge for the service provided, less an estimate made for contractual adjustments to third-party payors. Patient receivables due directly from the patients are carried at the original charge for the service provided less amounts covered by third-party payors and less an estimated allowance for uncollectible receivables. Management estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each payor type. Recoveries of receivables previously written off are recorded as a reduction of the provision for uncollectible accounts when received. The past-due status of receivables is determined on a case-by-case basis depending on the responsible payor. Interest is generally not charged on past-due accounts.

(e) Pledges Receivable

Pledges, less an allowance for uncollectible amounts (if warranted), are recorded as pledges receivable in the year the pledge is made.

(f) Assets Limited as to Use

Assets limited as to use include assets set aside for current liabilities, including the Hospital 401(k) contribution to employees and deposits due to patients and third parties, assets restricted based on donors' intents, and liquid assets restricted by the line-of-credit agreement.

(g) Investments

The Hospital accounts for its investments in accordance with current accounting standards for not-for-profit organizations. Under these standards, investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statements of financial position. Realized and unrealized gains (losses) on investments, interest, and dividends are included in the change in unrestricted net assets in the accompanying statements of changes in net assets, unless donor or law restricted the use of the income or loss. Investments are available for current operations and therefore are classified as current in the accompanying statements of financial position.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of investment securities will occur in the near term.

(h) Property and Equipment

Property and equipment are recorded at cost and depreciated over the estimated useful life of each class of depreciable assets, using the straight-line method. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Estimated useful lives of capital assets are as follows:

	Years
Land improvements	20 years
Buildings	25 years
Vehicles	5 years
Equipment	3 – 10 years

(i) Deferred Financing Costs

Deferred financing costs are amortized to interest expense, on a straight-line basis, over the term of the related debt.

(j) Due to Patients and Third Parties

Due to patients and third parties include patient deposits for services to be performed and refunds due to third parties for overpayments. Patient deposits are recognized as income as charges are incurred. Any unearned deposits are returned to patients subsequent to discharge.

(k) Net Assets

The net assets of the Hospital and changes therein are classified and reported as follows:

Unrestricted Net Assets – unrestricted net assets are those whose use is not restricted by donors, even though their use may be limited in other respects, such as by contract, board designation, or under debt agreements.

Temporarily and Permanently Restricted Net Assets – temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

(l) Excess of Unrestricted Revenues, Gains, Other Support, and Nonoperating Gains (Losses) over Expenses

The statements of operations include the excess of unrestricted revenues, gains, other support, and nonoperating gains (losses) over expenses. Changes in unrestricted net assets that are excluded from excess of unrestricted revenues, gains, other support, and nonoperating gains (losses) over expenses, consistent with industry practice, include changes in net unrealized gains on other than trading securities and net assets released from restriction for use in capital projects.

(m) Net Patient Service Revenue

The Hospital has agreements with third-party payors, which provide for payments to the Hospital at amounts different from its 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, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(n) Charity Care

The Hospital provides care to patients who meet certain criteria established under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of accounts determined to qualify as charity care, they are not reported as revenue. The cost of providing charity care is estimated by multiplying total charges incurred by the patients that qualify for financial assistance by an overall ratio of costs to charges. The cost of providing charity care was $753,000 and $389,500, for the years ended February 29, 2012 and February 28, 2011, respectively.

In fiscal year 2012, the Hospital released $750,000 of donor-restricted funds designated as scholarship funds for patient treatment.

(o) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indication 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 statements of operations and changes in net assets as net assets released from restrictions. In the absence of donor specifications that income and gains on donated funds are restricted, such donated funds are reported as income and gains within the accompanying statements of operations.

(p) Income Taxes

The Hospital is qualified as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (the Code), and as such, no provision for income taxes has been recorded. The Internal Revenue Service informed the Hospital by a letter dated June 23, 1937 that the Hospital's operations are designed in accordance with such section of the Code. There are certain transactions that could be deemed "Unrelated Business Income" and would result in a tax liability. Management reviews transactions to estimate potential tax liabilities using a threshold of more likely than not of being sustained. It is management's estimation that there are no material tax liabilities that need to be recorded.

(q) Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The use of estimates and assumptions in the preparation of the accompanying financial statements is primarily related to the Hospital's determination of the net patient accounts receivable and settlements with third-party payors. Due to uncertainties inherent in the estimation and assumption process, actual results could differ from those estimates and such differences could be material. For the years ended February 29, 2012 and February 28, 2011, a change in estimate related to the allowance for doubtful accounts increased the Hospital's net income by $373,000 and $523,000, respectively.

(r) Healthcare Reform Legislation

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the Health Reform Law), which was signed into law on March 23, 2010, will change how healthcare services are covered, delivered, and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the Health Reform Law reforms certain aspects of health insurance, expands existing efforts to tie Medicare payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Because of the many variables involved with the Health Reform Law, the Hospital's management are unable to predict the net effect on the Hospital of the expected increases in insured individuals using its facilities, the reductions in Medicare spending and funding, and numerous other provisions in the law that may affect the Hospital.

(s) Recent Accounting Pronouncements

In August 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*. ASU No. 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU No. 2010-23 requires that cost be used as a measurement basis for charity care disclosure purposes and that cost be identified as the direct or indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. This new guidance is effective for fiscal years beginning after December 15, 2010. As the Hospital does not recognize revenue when charity care is provided, adoption of this guidance did not have an impact on the consolidated financial statements of the Hospital; it only requires additional disclosures, including the method used to estimate the cost of charity care (note 1(n)).

In fiscal year 2012, the Hospital adopted FASB ASU No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*. Under ASU No. 2010-24, medical malpractice claim liabilities should be determined without consideration of insurance recoveries. Healthcare entities that are indemnified for malpractice liabilities should recognize insurance receivables at the same time that they recognize the liabilities, measured on the same basis as the liabilities, subject to the need for valuation for uncollectible amounts. This guidance was effective for fiscal years beginning after December 15, 2010. The adoption of this guidance had no impact on the Hospital's consolidated operations or cash flows (note 8).

In July, 2011, the FASB issued ASU 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 No. 2011-07 states that for entities that do not assess a patient's ability to pay prior to rendering services, bad debt expense related to patient service revenue must be separately presented as a reduction of revenue. In addition, entities will be required to disclose information about the activity in the allowance for doubtful accounts such as recoveries and write-offs by using a mixture of qualitative and quantitative data. ASU No. 2011-07 is effective for interim and annual periods beginning after December 15, 2011. Retrospective application will be required for the expanded note disclosure. The Hospital is currently evaluating the impact of the adoption of this pronouncement.

(2) Net Patient Service Revenue

The Hospital has agreements with third-party payors, which provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's billings at list price and the amounts reimbursed by Medicare, Blue Cross, and certain other third-party payors, and any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. Contractual adjustments under third-party reimbursement programs are accrued on an estimated basis in the period the related services are rendered and are adjusted in future periods as final settlements are determined. A summary of the basis of reimbursement with major third-party payors is as follows:

(a) Medicare

The Hospital is paid for inpatient services rendered to Medicare program beneficiaries under the Inpatient Psychiatric Facility Prospective Payment System, which was implemented in 2005. During the initial three-year phase-in period, Medicare reimbursement to the Hospital was based on a combination of prospective payments and the cost-based TEFRA system, with a final settlement determined after submission of annual reimbursement reports by the Hospital and audits by the Medicare fiscal intermediary. For the years ended February 29, 2012 and February 28, 2011, revenue from the Medicare program accounted for approximately 5% and 4% of the Hospital’s net patient service revenue.

Laws and regulations governing the Medicare programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquires have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare programs. Third-party payor settlements for 2012 and 2011 were not significant to the financial statements.

(b) Managed Care Organizations

The Hospital has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes contractual allowances from established charges and prospectively determined per diem rates.

(3) Assets Limited as to Use and Investments

Assets limited as to use and investments consisted of the following as of February 29, 2012 and February 28, 2011:

		2012	2011
Assets limited as to use:			
Current liabilities:			
Cash and cash equivalents	$	1,325,589	1,157,113
Donor restricted assets:			
Cash and cash equivalents		—	959,707
Certificate of deposit		238,376	237,486
Mutual funds		544,093	—
		782,469	1,197,193
Line of credit – liquid reserve requirement:			
Cash and cash equivalents		500,000	500,000
Mutual funds		600,000	600,000
		1,100,000	1,100,000
Total assets limited as to use		3,208,058	3,454,306
Less current portion		(1,325,589)	(1,157,113)
Assets limited as to use, net of current portion		1,882,469	2,297,193
Investments:			
Mutual funds		8,456,411	9,564,050
Equities		53,894	—
Market linked notes		24,700	—
Certificate of deposit		—	94,088
Corporate bonds		48,019	50,062
		8,583,024	9,708,200
Total assets limited as to use and investments	$	11,791,082	13,162,506

Current liabilities, noted above, consisted of the following as of February 29, 2012 and February 28, 2011:

		2012	2011
Hospital 401K contribution due to employees	$	689,390	659,951
Deposits due to patients and third parties		636,199	497,162
	$	1,325,589	1,157,113

Hospital 401K contributions due to employees are included in accrued salaries, taxes, and other compensation, in the accompanying statements of financial position.

The cost and market values of all investments, including those categorized as assets limited as to use, are summarized as follows as of February 29, 2012 and February 28, 2011:

		2012		
		Cost	**Unrealized gains**	**Fair value**
Investments:				
Mutual funds:				
Fixed income – domestic	$	4,965,434	123,237	5,088,671
Domestic		3,020,216	648,886	3,669,102
International		829,780	12,951	842,731
		8,815,430	785,074	9,600,504
Equities:				
Domestic		41,709	5,291	47,000
International		6,165	729	6,894
		47,874	6,020	53,894
Market linked notes		25,000	(300)	24,700
Certificates of deposit		238,376	—	238,376
Corporate bonds		49,756	(1,737)	48,019
	$	9,176,436	789,057	9,965,493

		2011		
		Cost	**Unrealized gains**	**Fair value**
Investments:				
Mutual funds:				
Fixed income – domestic	$	5,585,571	93,324	5,678,895
Domestic		2,745,481	838,349	3,583,830
International		749,690	151,635	901,325
		9,080,742	1,083,308	10,164,050
Corporate bonds		48,881	1,181	50,062
Certificates of deposit		331,486	88	331,574
	$	9,461,109	1,084,577	10,545,686

FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, establishes a formal hierarchy and framework for measuring fair value, and expanded disclosure about fair value measurements and the reliability of valuation impacts. The guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than Level 1 prices such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets; and

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities include those whose value is determined using pricing models, discounted cash flows methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

At February 29, 2012 and February 28, 2011, the Hospital estimated the fair value of most of its investments based on Level 1 inputs. The Market linked notes, purchased in 2012, are valued based on Level 2 inputs. The Hospital does not have any Level 3 assets or liabilities as of February 29, 2012 and February 28, 2011.

(4) Property and Equipment

At February 29, 2012 and February 28, 2011, property and equipment consist of:

	2012	2011
Land and land improvements	$ 2,298,295	1,942,373
Buildings	29,119,938	24,257,130
Vehicles	357,043	301,241
Equipment	5,758,589	5,165,235
Construction in progress	2,144,781	2,896,561
	39,678,646	34,562,540
Less accumulated depreciation	(16,339,746)	(15,445,535)
	$ 23,338,900	19,117,005

As of February 28, 2011, construction in progress was mainly comprised of renovation expenditures for Scavetta House and the Martin Center. These projects were completed and placed into service during the fiscal year ended February 29, 2012. As of February 29, 2012, construction in progress consists of renovation expenditures for the Pain Program and various other projects.

(5) Classification of Payor Mix

The Hospital requires advanced payments for services not covered by third-party agreements. The significant concentrations of accounts receivable for services to patients include the following as of February 29, 2012 and February 28, 2011:

	2012	2011
Medicare	9%	10%
Blue Cross	20	16
Other third-party payors	58	56
Self-pay	13	18
	100%	100%

(6) Line of Credit

In 2007, the Hospital entered into a revolving line of credit, with a term of 10 years and a maximum available borrowing of $10,000,000, which was secured by the land and buildings owned by the Hospital. Interest was charged monthly at a rate of 7.15%. In December 2010, the line-of-credit agreement was modified to include an interest rate of 5.25% and an extension of the term to 10 years. The modified line will revolve for a period of four years, with interest payments due monthly based on the balance outstanding. On December 31, 2014, the line will convert to a permanent commercial mortgage for the remaining 6 years of the term. Upon conversion, principal and interest payments will be due monthly through December 31, 2020 at which time a balloon payment for any unpaid principal and interest will be due. As of February 29, 2012 and February 28, 2011, $5,127,680 and $6,327,680, respectively, was outstanding on the line. In 2012, interest incurred on the line was $281,718, of which $209,260 was capitalized and included in property and equipment on the statements of financial position. In 2011, interest incurred on the line was $530,425, of which $87,237 was capitalized and included in property and equipment on the statements of financial position. The line-of-credit agreement requires a liquid reserve of $1,100,000 to be maintained over the term of the loan, which is included in assets limited as to use. As part of the line-of-credit agreement, the Hospital must maintain a compensating balance at the bank of $500,000.

Subsequent to February 29, 2012, the Hospital repaid $5,000,000 of the outstanding line of credit, leaving an outstanding balance of $127,680. The Hospital liquidated $4,000,000 of investments in order to repay the line.

(7) Lease Obligations

The Hospital has noncancelable operating leases, which expire through April 2015. Future minimum lease payments under these noncancelable operating leases are as follows:

Year ending February 28:		
2013	$	270,351
2014		228,079
2015		22,626
2016		658
	$	521,714

Rental expense for all operating leases totaled approximately $273,000 in 2012 and 2011, respectively. Rental expenses are included in supplies and services expenses on the statements of operations.

(8) Commitments and Contingencies

Insurance

As of February 29, 2012, the Hospital maintains professional and general liability insurance coverage on a claims-made basis. The claims-made policy, which is subject to renewal on an annual basis, covers only claims made during the term of the policy but not those occurrences for which claims may be made after expiration of the policy. Coverage under the policy is $1 million per occurrence, with an aggregate limit of $3 million. The Hospital also maintains an excess umbrella policy, which provides $8 million of additional coverage.

As of February 29, 2012, the Hospital engaged an actuary to determine an undiscounted estimate of losses from unasserted claims and incidents that may have occurred but have not been reported. The actuarial evaluation is based on the Hospital’s historical experience, industry data, and other considerations. As of February 29, 2012 and February 28, 2011, the Hospital has accrued the following for losses from unasserted claims and incidents that may have occurred but have not been reported:

		2012	**2011**
Estimated malpractice liabilities	$	570,344	117,811
Insurance claims receivable		(321,219)	—
Estimated malpractice liabilities, net	$	249,125	117,811

The Hospital is party to routine litigation arising in the ordinary course of business. Although some of the matters are still in a preliminary stage and definite conclusions cannot be made as to those matters, the Hospital is of the opinion that based on information presently available, the lawsuits will not have a materially adverse effect on the financial statements of the Hospital.

Dining Services Contract

The Hospital contracts with Unidine to provide food service to its patients. The contract is cancelable by either party if the other party fails to perform all of its material obligations as outlined in the agreement. The cost is approximately $24,000 per week.

(9) Retirement Plan

The Hospital has a 401(k) defined contribution plan (401(k) Plan) that covers all full-time employees who have both attained age 21 and completed at least 1,000 hours of service during the first year of employment. The 401(k) Plan provides for an employer-based contribution allowing the Hospital to make contributions ranging from 2.5% to 7.5% of each participant’s annual compensation, depending on years of vested service. Employees may also make annual contributions up to the amount permitted by law. Expenses related to the 401(k) Plan were approximately $563,800 and $579,000, respectively, for the years ended February 29, 2012 and February 28, 2011 and are included with employee benefits within the accompanying statements of operations.

(10) Functional Expenses

The Hospital provides psychiatric and substance abuse healthcare services to residents within its geographic location. Expenses related to providing these services included in the statements of operations are as follows:

	2012	2011
Healthcare services	$ 24,418,734	23,391,890
Development	580,574	510,919
General and administrative	5,451,044	5,399,925
	$ 30,450,352	29,302,734

(11) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of February 29, 2012 and February 28, 2011:

	2012	2011
Scholarship Fund for Young Adults	$ 223,190	959,270
Scholarship Fund	330,540	—
Pain Program	—	17,060
Employee Assistance Fund	12,380	7,863
Other Funds	53,359	—
	$ 619,469	984,193

Permanently restricted net assets of $213,000 at February 29, 2012 and February 28, 2011 consist of donor-restricted funds to be maintained by the Hospital in perpetuity. The income generated from permanently restricted funds is expendable for purposes designated by donors, including adolescent and chemical dependency program services.

(12) Subsequent Events

The Hospital has evaluated and disclosed subsequent events from the statement of financial position date of February 29, 2012 through June 26, 2012, which is the date of the financial statements were available to be issued, and concluded that no additional disclosures were required.