

Financial Statements and Independent Auditors' Report

Arthritis Foundation

Chartered Entities and the National Office

Year ended December 31, 2012

(With Summarized Financial Information for the
Year ended December 31, 2011)



Independent Auditors' Report

Board of Trustees
Arthritis Foundation

We have audited the accompanying combined financial statements of the Arthritis Foundation, Chartered Entities and the National Office, (a nonprofit organization), which comprise the combined statement of financial position as of December 31, 2012, and the related combined statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audit. We did not audit the financial statements of certain Chartered Entities, whose statements reflect approximately 35 percent of total assets of \$64,445,160, as of December 31, 2012, and approximately 34 percent of total support and revenues of \$34,200,363, for the year then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for those Chartered Entities, is based solely on the report of the other auditors. We conducted our audit 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audit and the reports of other auditors, the combined the financial statements referred to above present fairly, in all material respects, the financial position of the Arthritis Foundation, Chartered Entities and the National Office, as of December 31, 2012, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the Arthritis Foundation, Chartered Entities and the National Office's 2011 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated June 4, 2012. We did not audit the financial statements of certain Chartered Entities, whose statements reflect approximately 38 percent of total assets of \$72,382,273, as of December 31, 2011, and approximately 32 percent of total support and revenues of \$33,324,784, for the year then ended. Those statements were audited by other auditors whose report was furnished to us, and our opinion, insofar as it relates to the amounts included for those Chartered Entities, is based solely on the report of the other auditors. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2011 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Metcalf Davis

Atlanta, Georgia
June 3, 2013

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE

Statement of Financial Position

December 31, 2012 with Summarized Financial Information as of December 31, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2012	2011
<u>Assets</u>					
Cash and cash equivalents	\$ 5,865,283	\$ 8,456,216	\$ 428,013	\$ 14,749,512	\$ 26,265,623
Investments	27,723,257	32,842,805	36,530,289	97,096,351	91,778,531
Accounts and notes receivable, net	2,497,331	43,766	-	2,541,097	3,399,550
Contributions receivable, net	7,986,031	5,648,430	-	13,634,461	15,753,439
Funds held in trust by others	-	8,046,888	2,907,427	10,954,315	8,878,365
Prepaid expenses and other assets	2,425,696	-	-	2,425,696	2,839,972
Inventory	499,106	-	-	499,106	430,906
Beneficial interests in perpetual trusts	-	-	30,940,150	30,940,150	29,579,936
Property and equipment, net	<u>9,364,900</u>	<u>-</u>	<u>-</u>	<u>9,364,900</u>	<u>11,553,345</u>
Total assets	<u>\$ 56,361,604</u>	<u>\$ 55,038,105</u>	<u>\$ 70,805,879</u>	<u>\$ 182,205,588</u>	<u>\$ 190,479,667</u>
<u>Liabilities and Net Assets</u>					
Accounts payable	\$ 4,362,293	\$ -	\$ -	\$ 4,362,293	\$ 4,548,892
Accrued expenses and other liabilities	7,901,539	-	-	7,901,539	7,319,674
Research awards and grants payable	8,155,946	-	-	8,155,946	6,236,082
Liabilities under split interest agreements	-	10,053,468	-	10,053,468	9,938,169
Debt obligations	<u>3,683,975</u>	<u>-</u>	<u>-</u>	<u>3,683,975</u>	<u>4,350,462</u>
Total liabilities	24,103,753	10,053,468	-	34,157,221	32,393,279
Net assets committed for future research grants	4,975,000	1,800,000	-	6,775,000	6,255,000
Other net assets	<u>27,282,851</u>	<u>43,184,637</u>	<u>70,805,879</u>	<u>141,273,367</u>	<u>151,831,388</u>
Total net assets	<u>32,257,851</u>	<u>44,984,637</u>	<u>70,805,879</u>	<u>148,048,367</u>	<u>158,086,388</u>
Total liabilities and net assets	<u>\$ 56,361,604</u>	<u>\$ 55,038,105</u>	<u>\$ 70,805,879</u>	<u>\$ 182,205,588</u>	<u>\$ 190,479,667</u>

The accompanying notes are an integral part of this statement.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE
Statement of Activities

Year Ended December 31, 2012 with Summarized Financial Information for the Year Ended December 31, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2012	2011
<u>Revenues, Gains and Public Support</u>					
Direct response marketing contributions	\$ 14,054,774	\$ -	\$ -	\$ 14,054,774	\$ 14,673,757
Corporate contributions	4,901,162	5,226,704	-	10,127,866	13,716,409
Personal contributions	1,860,578	659,505	500	2,520,583	4,114,730
Foundations	1,037,278	2,395,672	250,000	3,682,950	4,163,331
Memorials	329,269	22,721	-	351,990	343,221
Other gifts	696,557	148,199	-	844,756	1,172,487
Total contributions	22,879,618	8,452,801	250,500	31,582,919	38,183,935
Special events - gross income	26,507,428	80,000	-	26,587,428	26,313,625
Less direct donor benefit costs	(6,670,041)	-	-	(6,670,041)	(7,309,409)
Bequests/planned giving	16,005,302	4,406,286	111,728	20,523,316	24,135,529
Total direct public support	58,722,307	12,939,087	362,228	72,023,622	81,323,680
Federated campaigns	750,138	900	-	751,038	753,009
United Way	1,197,328	-	-	1,197,328	1,336,388
Total indirect public support	1,947,466	900	-	1,948,366	2,089,397
Contributed goods and services	4,080,625	-	-	4,080,625	3,135,517
Total public support	64,750,398	12,939,987	362,228	78,052,613	86,548,594
Government grants	1,471,320	-	-	1,471,320	1,648,334
Operating investment returns	3,018,020	1,920,495	-	4,938,515	4,441,010
Conferences, sales, other revenue, gains and losses	9,333,962	251,546	-	9,585,508	11,502,012
Total other revenue, gains and losses	13,823,302	2,172,041	-	15,995,343	17,591,356
Net assets released from restrictions	19,543,342	(19,543,342)	-	-	-
Total revenues, gains and public support	98,117,042	(4,431,314)	362,228	94,047,956	104,139,950
<u>Expenses</u>					
Research	13,454,241	-	-	13,454,241	14,244,054
Public health education	43,582,746	-	-	43,582,746	43,132,334
Professional education and training	2,374,123	-	-	2,374,123	3,022,350
Patient and community services	26,613,833	-	-	26,613,833	25,316,159
Fundraising	13,226,667	-	-	13,226,667	13,729,111
Management and general	11,317,962	-	-	11,317,962	11,099,736
Total expenses	110,569,572	-	-	110,569,572	110,543,744
Change in net assets from operating activities	(12,452,530)	(4,431,314)	362,228	(16,521,616)	(6,403,794)
<u>Non-operating Income</u>					
Net assets released from restrictions for					
non-operating activities	356,637	-	(356,637)	-	-
Transfer of assets to the University of Pittsburgh	(356,637)	-	-	(356,637)	-
Non-operating investment returns	2,152,130	3,811,877	11,055	5,975,062	(2,688,281)
Unrealized gains (losses) on beneficial interests in					
perpetual trusts	-	-	1,309,489	1,309,489	(779,386)
Change in valuation in split interest agreements	-	(717,682)	68,750	(648,932)	(1,009,594)
Net change in pension liabilities	204,613	-	-	204,613	(180,558)
Change in net assets from non-operating activities	2,356,743	3,094,195	1,032,657	6,483,595	(4,657,819)
Change in net assets	(10,095,787)	(1,337,119)	1,394,885	(10,038,021)	(11,061,613)
Net assets, beginning of year - reclassified and restated	42,353,638	46,321,756	69,410,994	158,086,388	169,148,001
Net assets, end of year	\$ 32,257,851	\$ 44,984,637	\$ 70,805,879	\$ 148,048,367	\$ 158,086,388

The accompanying notes are an integral part of this statement.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE

Statement of Functional Expenses

Year Ended December 31, 2012 with Summarized Financial Information for the Year Ended December 31, 2011

	PROGRAM SERVICES					SUPPORTING SERVICES			Totals	
	Research	Public	Professional	Patient and	Total	Fundraising	Management	Total	2012	2011
		Health	Education and	Community	Program		and General	Supporting		
	Education	Training	Services	Services			Services			
Research grants and awards	\$ 10,204,609	\$ 24,800	\$ 100,640	\$ 68,718	\$ 10,398,767	\$ -	\$ -	\$ -	\$ 10,398,767	\$ 9,516,536
Salaries	1,164,717	15,406,101	1,169,317	10,033,089	27,773,224	5,549,184	6,306,589	11,855,773	39,628,997	38,664,921
Payroll taxes	82,946	1,195,403	93,382	784,369	2,156,100	426,234	469,658	895,892	3,051,992	2,985,737
Employee benefits	194,999	2,464,426	187,309	1,586,083	4,432,817	863,993	945,240	1,809,233	6,242,050	6,257,098
Advertising commissions	-	328,113	-	315,247	643,360	-	-	-	643,360	713,635
Professional fees and contract services	487,293	4,793,382	124,909	2,154,483	7,560,067	730,661	1,157,536	1,888,197	9,448,264	11,005,703
Professional services - contributed	266,867	200,139	222	1,124,399	1,591,627	86,937	16,219	103,156	1,694,783	2,358,859
Supplies	23,793	339,629	29,785	377,985	771,192	169,258	103,162	272,420	1,043,612	1,060,905
Supplies and materials - contributed	-	27,337	24	2,012,657	2,040,018	265,653	1,471	267,124	2,307,142	676,123
Printing, publications, and artwork	49,535	1,876,623	49,718	1,423,963	3,399,839	375,763	55,878	431,641	3,831,480	4,459,630
Membership/direct response marketing	234,532	8,998,642	117,266	187,626	9,538,066	2,242,102	117,266	2,359,368	11,897,434	11,761,779
Postage, shipping, and delivery	17,875	1,730,825	23,733	1,542,016	3,314,449	172,030	81,628	253,658	3,568,107	3,897,619
Telephone	28,840	338,645	39,068	252,754	659,307	172,073	369,825	541,898	1,201,205	1,183,065
Occupancy	110,080	1,571,615	126,632	1,079,773	2,888,100	466,622	424,426	891,048	3,779,148	3,841,263
Insurance	38,529	263,364	19,089	162,521	483,503	82,487	67,743	150,230	633,733	602,003
Staff travel	91,827	717,746	58,159	489,941	1,357,673	395,833	186,029	581,862	1,939,535	1,913,383
Meetings and conferences	201,313	1,008,353	85,085	1,338,711	2,633,462	352,871	250,696	603,567	3,237,029	3,284,785
Equipment lease and maintenance	31,887	379,941	41,751	271,472	725,051	164,962	366,150	531,112	1,256,163	1,478,782
Membership dues and subscriptions	23,803	138,060	7,131	56,339	225,333	47,342	45,484	92,826	318,159	298,457
Specific assistance to individuals	-	15,707	-	343,344	359,051	-	-	-	359,051	413,079
Advertising	6,797	735,722	41,269	379,127	1,162,915	205,969	47,432	253,401	1,416,316	1,221,475
Miscellaneous	97,139	560,264	43,367	353,199	1,053,969	356,076	212,787	568,863	1,622,832	1,709,824
Depreciation	82,377	337,660	15,273	170,814	606,124	90,679	83,721	174,400	780,524	859,873
Uncollectible receivables	14,483	130,249	994	105,203	250,929	9,938	9,022	18,960	269,889	379,210
Total operating expenses	\$ 13,454,241	\$ 43,582,746	\$ 2,374,123	\$ 26,613,833	\$ 86,024,943	\$ 13,226,667	\$ 11,317,962	\$ 24,544,629	\$ 110,569,572	\$ 110,543,744

The accompanying notes are an integral part of this statement.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE

Statement of Cash Flows

Year ended December 31, 2012 with Summarized Financial Information as of December 31, 2011

	2012	2011
Cash flows from operating activities:		
Change in net assets	\$ (10,038,021)	\$ (11,061,613)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	780,524	859,873
Loss on sale of property and equipment	26,548	161,746
Donated equipment	(14,025)	-
Donated investments	(388,698)	(160,722)
Net realized and unrealized (gains) losses in beneficial interests in perpetual trusts	(1,309,489)	779,386
Net realized and unrealized (gains) losses on investments	(6,765,647)	2,592,631
Net change in valuation in split interest agreements	648,932	1,009,594
Writedown from software impairment	1,277,473	-
Contributions restricted for long-term investment	(362,228)	(551,899)
Changes in assets and liabilities:		
Accounts and notes receivable	858,453	1,654,739
Contributions receivable	2,118,978	(2,661,387)
Funds held in trust by others	(2,075,950)	(446,213)
Prepaid expenses and other assets	414,276	(87,814)
Inventory	(68,200)	179,844
Beneficial interests in perpetual trusts	(50,725)	(87,471)
Accounts payable	(186,599)	1,294,042
Accrued expenses and other liabilities	581,865	407,630
Research awards and grants payable	1,919,864	1,615,446
Liabilities under split interest agreements	(533,633)	(1,211,785)
Net cash used in operating activities	(13,166,302)	(5,713,973)
Cash flows from investing activities:		
Purchase of property and equipment	(406,852)	(608,171)
Proceeds from sale of property and equipment	248,338	177,590
Purchase of investments	(57,770,634)	(45,758,526)
Proceeds from sale of investments	59,607,159	49,572,968
Net cash provided by investing activities	1,678,011	3,383,861
Cash flows from financing activities:		
Proceeds from contributions restricted for:		
Investment in endowment	362,228	551,899
Proceeds from note payable	109,935	8,689
Repayments of note payable	(445,000)	(576,500)
Proceeds from line of credit	1,750,000	-
Payments on line of credit	(1,000,000)	-
Payments on long-term debt / capital lease obligation	(804,983)	(356,168)
Net cash used in financing activities	(27,820)	(372,080)
Net decrease in cash and cash equivalents	(11,516,111)	(2,702,192)
Cash and cash equivalents at beginning of year	26,265,623	28,967,815
Cash and cash equivalents at end of year	\$ 14,749,512	\$ 26,265,623
Supplemental information		
Interest paid	\$ 188,988	\$ 179,208
Noncash investing and financing activities:		
Property acquired through capital leases	\$ 40,019	\$ 28,166

The accompanying notes are an integral part of this statement.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE
Notes To Financial Statements

December 31, 2012 with summarized information for the year ended December 31, 2011

NOTE 1 – DESCRIPTION OF ORGANIZATION

The Arthritis Foundation (the “Foundation”) is a voluntary health agency seeking to improve lives through leadership in the prevention, control and cure of arthritis and arthritis-related diseases. Major funding sources are from direct public contributions and bequests. The Foundation provides public health education and community service programs along with supporting arthritis-related research and influencing public policy regarding research funding, access to care and government funding of arthritis-related public health programs.

The Arthritis Foundation is composed of a National Office (a not-for-profit Georgia corporation) and 12 Chartered Entities located throughout the United States. The Chartered Entities (10 regions and two chapters) are affiliated with the National Office via separate charter agreements. The charter agreements impose certain obligations on the Chartered Entities including adhering to national policies and sharing revenue. The Arthritis Foundation operates under a single (Section 501(c)(3) of the Internal Revenue Code (“IRC”)) group exemption. Each chartered entity is a separate legal corporation and files its own IRS Form 990.

During the year ended December 31, 2012, two Chartered Entities became aware of information not previously considered in the preparation of their 2011 financial statements as detailed below. The net asset reclassifications relate to additional information obtained concerning the restrictive nature of certain donor gifts and the related release from restriction as funds were expended. Additionally, two beneficial interests in perpetual trusts were identified which should have been recorded in a prior year. Accounts requiring restatement as of January 1, 2011 were as follows:

Beneficial interests in perpetual trusts	\$ 702,746
Change in net assets:	
Unrestricted net assets	277,803
Temporarily restricted net assets	(139,056)
Permanently restricted net assets	<u>563,999</u>
Cumulative effect of change in net assets at January 1, 2012	<u>\$ 702,746</u>

Additionally, contributed goods and services revenue was reduced by \$1,058,838 with a corresponding decrease in public health education expenses of \$27,975 and patient and community services expenses of \$1,030,863 for the year ended December 31, 2011 due to a change in the method to account for contributed services. There was no effect on the change in net assets for 2011 as a result of this adjustment.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE
Notes To Financial Statements

December 31, 2012 with summarized information for the year ended December 31, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

Accrual Basis of Accounting - The financial statements of the Foundation have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Basis of Presentation - The accompanying combined financial statements include the accounts of the Arthritis Foundation, Inc. National Office (the “National Office”) and all Arthritis Foundation Chartered Entities (which are separately incorporated). All significant intra-Foundation accounts and transactions have been eliminated in the accompanying financial statements. The Foundation classifies its net assets and revenues, expenses, gains and losses based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation and changes therein are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Foundation and/or the passage of time.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that the Foundation maintains them permanently. Generally, the donors of these assets permit the Foundation to use all or part of the income earned on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless the use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Operating results in the statement of activities reflect all transactions increasing and decreasing net assets except those that the Foundation defines as non-operating. Non-operating includes all investment returns in excess of those classified as operating by the spending policy, unrealized gains and losses from operating accounts, unrealized gains and losses on beneficial interests in perpetual trusts, changes in valuation of split interest agreements, and net assets released from restrictions for non-operating activities, transfers of assets to the University of Pittsburgh, and net changes in pension liabilities.

In 2012, one of the Chartered Entities petitioned the court to have one of its endowment funds in the amount of \$356,637 transferred to the University of Pittsburgh (Medical and Health Sciences Foundation) in order to more effectively fund the specific research that was designated in the donor’s gift document. The petition was granted in November 2012.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE
Notes To Financial Statements

December 31, 2012 with summarized information for the year ended December 31, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Income Taxes - The Foundation is a not-for-profit corporation and has been recognized as exempt from Federal income taxes on related income under Section 501(c)(3) of the IRC. At times the Foundation may be engaged in activities for which it is responsible for payment of unrelated business income tax. Deferred tax assets and liabilities are measured based on enacted tax laws and rates expected to apply to taxable income in the year in which temporary differences are expected to be recorded or settled. Income taxes did not have a material impact on the financial position or change in net assets of the Foundation as of and for the years ended December 31, 2012 and 2011.

The Foundation's policy is to record a liability for any tax position taken that is beneficial to the Foundation, including any interest and penalties, when it is more likely than not the position taken will be overturned by a taxing authority upon examination. Management believes there are no such positions as of December 31, 2012 and 2011, and accordingly, no liability has been accrued.

Generally, the Internal Revenue Service ("IRS") may examine a tax return for three years from the date it is filed. At December 31, 2012 tax years ended December 31, 2011, 2010 and 2009 remained open for possible examination by the IRS.

Fair Value of Financial Instruments - The estimated fair value amounts for specific groups of financial instruments are presented within the notes applicable to such items. Accounts receivable, other than split-interest agreements, prepaid expenses and other assets, accounts payable and accrued expenses and other liabilities are stated at cost, which approximates fair value due to their short-term maturity. The fair value of investments, perpetual trusts, and funds held in trust by others is disclosed in other notes and is based upon quoted market values or values provided by external investment managers which were reviewed by management and the board. The carrying value of debt approximates its fair value due to its variable rates of interest.

Cash and Cash Equivalents - Cash accounts at some institutions are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000 for interest bearing accounts and to an unlimited amount for certain non-interest bearing business accounts. At December 31, 2012, the Foundation's uninsured cash balance totaled approximately \$5,200,000. The Foundation has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents. Cash equivalents are highly liquid investments with an original maturity of three months or less at the date of purchase. Because of the short maturity of these financial instruments, the carrying value approximates the fair value.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are stated at fair value. The cost assigned to investments received by gift is the fair value at the date the gift is received. Purchases and sales of securities are reflected on a trade-date basis. Gains and losses on sales of securities are based on cost (cost of securities if purchased or the fair market value at the date of gift if received by donation). Dividend and interest income is recorded on the accrual basis. In accordance with the policy of stating investments at fair value, the net change in unrealized appreciation or depreciation for the year is reflected in the statement of activities.

ARTHRITIS FOUNDATION
CHARTERED ENTITIES AND THE NATIONAL OFFICE
Notes To Financial Statements

December 31, 2012 with summarized information for the year ended December 31, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The various investments in stocks, securities, mutual funds and other investments are exposed to a variety of uncertainties, including interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is possible that changes in the values of these instruments could occur in the near term. Such changes could materially affect the amounts reported in the financial statements of the Foundation.

The Foundation utilizes the net asset value (“NAV”) reported by each of its alternative investment funds as a practical expedient for determining the fair value of the investment. These investments are redeemable at NAV under the original terms of the subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements.

Due to the nature of the investments held by these funds, changes in market conditions and the economic environment may significantly impact the NAV of the funds and, consequently, the fair value of the Foundation’s interests in the funds. Furthermore, changes to the liquidity provisions of the funds may significantly impact the fair value of the Foundation’s interest in the funds.

Accounts Receivable - Accounts receivable consist of exchange transactions primarily related to government grants and sales and service fees and are stated at unpaid balances, less an allowance for doubtful accounts when deemed necessary. Receivables are considered past due 120 days after billing.

Allowance for Doubtful Accounts - Allowance for doubtful accounts on outstanding accounts or contributions receivable balances is recorded when deemed necessary based upon historical trends, current market risk assessments and specific donor considerations.

Inventory - Educational and campaign materials are stated at lower of cost or market. Cost is determined by the weighted average method.

Split Interest Agreements - The Foundation’s split interest agreements are recorded as follows:

Charitable gift annuities and other split interest agreements where the Foundation is the trustee are valued at the date of donation using the income method and discount rates commensurate with the risks involved. Discount rates range from three to 10 percent. Charitable gift annuities are amortized over their life although changes may be made based on a change in the life expectancy of the donor. Gift annuity assets are included in investments and amounts due to the donor are included in liabilities under split interest agreements.

Split interest gifts held by others are included with other contributions receivable on the statement of financial position. These gifts which benefit not only the Foundation, but other beneficiaries as designated by the donor, are carried at fair value with the changes recorded as a component of temporarily restricted income.

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NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Beneficial Interests in Perpetual Trusts - The Foundation is the beneficiary of various trusts created by donors, the assets of which are not in the possession of the Foundation. The Foundation has legally enforceable rights or claims to such assets including the right to income therefrom. Under the perpetual trust arrangement, the Foundation has recorded the asset and recognized permanently restricted contribution revenue at the fair value of its beneficial interest in the trust assets. Distributions received on the trust assets are recorded as investment income in the statement of activities unless otherwise restricted by the donor. Subsequent changes in fair value of the beneficial interest in the trust assets are recorded as net unrealized gains or losses on beneficial interest in perpetual trusts in the permanently restricted net asset class.

Funds Held in Trust by Others - Included in funds held in trust by others are split interest agreements not managed by the Foundation and funds transferred by various Chartered Entities to local community foundations to invest and manage. Most community foundation agreements state that the transfer is irrevocable and that the transferred assets will not be returned to the Arthritis Foundation. However, the community foundations will make annual distributions of the income earned on the funds. Although unlikely, the agreement also permits the community foundations to substitute another beneficiary in the place of the Arthritis Foundation if the Arthritis Foundation ceases to exist or if the governing board of the community foundations votes that support of the Arthritis Foundation either is no longer necessary or is inconsistent with the needs of the community.

Property and Equipment - Property and equipment are recorded at cost. Donated assets are capitalized at the estimated fair market value at date of receipt. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. The cost of maintenance and repairs is expensed when incurred; significant renewals and betterments are capitalized. The Foundation's policy is to capitalize property and equipment acquisitions in excess of \$5,000.

Contributed Goods and Services - Contributed goods and services are reflected as both contribution revenue and expenses if they meet the criteria defined in accordance with GAAP, "Accounting for Contributions," in the accompanying statement of activities at their estimated fair value at date of receipt. The contributions of services are recognized if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills that are provided by individuals possessing those skills and would typically need to be purchased if not provided. Generally such services include research grant application reviews, medical services, speakers, trainers, other program services, and other services that meet the criteria for recognition as contributed services.

In addition, the Foundation receives services from a large number of volunteers who give significant amounts of their time to the Foundation's programs, fundraising campaigns and management. No amounts have been reflected for these types of donated services, as they do not meet the criteria for recognition.

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December 31, 2012 with summarized information for the year ended December 31, 2011

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions - Contributions, including unconditional promises to give, are recorded at the date of gift. Bequests are recorded as revenue at the time an unassailable right to the gift has been established and the proceeds are measurable in amount. Long-term promises to give are initially recorded at fair value using the income approach using discount rates commensurate with the risk involved.

Awards and Grants - Awards and grants are recorded as expense in the year in which the award is made. The terms of research awards and grants are from one to three years with continuation of grants subject to certain performance requirements.

Functional Allocation - The cost of providing the Foundation's various programs and supporting services have been summarized on a functional basis. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Reclassifications - Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

Use of Estimates - Management of the Foundation has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare the financial statements in conformity with generally accepted accounting principles ("GAAP"). Actual results could differ from these estimates.

Comparative Data - The financial statements include certain prior year summarized financial information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such financial information should be read in conjunction with the Foundation's financial statements as of and for the year ended December 31, 2011 from which the summarized financial information was derived.

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NOTE 3 – INVESTMENTS

Investments at December 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Marketable securities		
U.S. Government securities	\$ 8,325,435	\$ 6,656,516
Corporate notes and bonds	8,457,751	8,150,565
Common stocks	19,841,555	14,318,085
Domestic equity mutual funds	18,505,392	18,344,844
Fixed income mutual funds	12,703,741	12,428,526
International equity mutual funds	5,732,614	3,593,133
Alternative investments	1,028,256	1,021,904
Other commodities	551,190	703,641
Foreign issues	551,143	446,191
Other - principally money market and other mutual funds	<u>6,450,345</u>	<u>8,728,755</u>
	82,147,422	74,392,160
Split interest agreements		
U.S. Government securities	277,810	266,225
Corporate notes and bonds	181,479	238,005
Domestic equity mutual funds	6,735,145	5,933,783
Fixed income mutual funds	4,324,914	4,387,364
International equity mutual funds	<u>1,957,400</u>	<u>1,586,555</u>
	<u>13,476,748</u>	<u>12,411,932</u>
Total marketable securities	95,624,170	86,804,092
Certificates of deposit	<u>1,472,181</u>	<u>4,974,439</u>
Total investments	<u>\$ 97,096,351</u>	<u>\$ 91,778,531</u>

The following schedule summarizes the investment returns, net of investment management fees, for the years ending December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Investment return		
Income	\$ 4,147,930	\$ 4,345,360
Net realized and unrealized gains (losses)		
(realized and unrealized)	<u>6,765,647</u>	<u>(2,592,631)</u>
Total investment return	10,913,577	1,752,729
Less investment returns designated for current operations	<u>(4,938,515)</u>	<u>(4,441,010)</u>
Non-operating investment returns	<u>\$ 5,975,062</u>	<u>\$ (2,688,281)</u>

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NOTE 4 – FAIR VALUE MEASUREMENTS

In accordance with GAAP, fair value measurement establishes a framework for measuring fair value and expands disclosures about fair value measurements.

This standard provides a consistent definition of fair value which focuses on an exit price between market participants in an orderly transaction as prescribed by GAAP. The standard also prioritizes, within the measurement of fair value, the use of market-based information over entity-specific information and establishes a three-level hierarchy for fair value measurements based on the transparency of information used in the valuation of an asset or liability as of the measurement date. The standard describes three levels of inputs that may be used to measure fair value:

Level I - Unadjusted quoted prices in active markets for identical assets or liabilities. Level I assets and liabilities include debt and equity securities that are traded in an active exchange market as well as U.S. Treasury Securities.

Level II - Inputs other than quoted prices included in Level I that are observable, either directly or indirectly. Such inputs may include quoted prices for similar assets, observable inputs other than quoted prices (interest rates, yield curves, etc.), or inputs derived principally from or corroborated by observable market data by correlation or other means. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities and alternative investments using NAV per share for which the Foundation has the ability to redeem its investment at the measurement date.

Level III - Inputs are unobservable data points for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs reflect the Foundation's assumptions based on the best information available in the circumstances. This category generally includes certain private debt and equity instruments and alternative investments where the Foundation will never have the ability to redeem its investment with the investee at NAV per share. This category also includes perpetual trusts which are valued based on the market value of the underlying securities.

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NOTE 4 – FAIR VALUE MEASUREMENTS - Continued

The following table summarizes the valuation of the Foundation’s investments, split interest agreements and beneficial interests in perpetual trusts by the above hierarchy levels as of December 31, 2012:

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
U.S. Government securities	\$ 3,694,759	\$ 4,908,486	\$ -	\$ 8,603,245
Corporate notes and bonds				
Financial services industry	-	2,291,886	-	2,291,886
Industrial goods industry	-	1,483,530	-	1,483,530
Real estate industry	-	181,479	-	181,479
Utilities industry	-	103,102	-	103,102
Other	1,722,491	2,856,742	-	4,579,233
Common stocks				
Consumer goods industry	3,909,877	-	-	3,909,877
Energy industry	1,450,727	-	-	1,450,727
Financial services industry	2,889,631	-	-	2,889,631
Healthcare industry	3,058,743	-	-	3,058,743
Industrial goods industry	1,597,812	-	-	1,597,812
Materials industry	973,057	-	-	973,057
Oil and gas industry	357,367	-	-	357,367
Technology industry	2,864,374	-	-	2,864,374
Utilities industry	633,679	-	-	633,679
Other	2,106,288	-	-	2,106,288
Domestic equity mutual funds				
Energy industry	89,789	-	-	89,789
Real estate industry	94,824	-	-	94,824
Other	22,532,837	2,523,087	-	25,055,924
Fixed income mutual funds	13,325,910	3,702,745	-	17,028,655
International equity mutual funds	5,733,691	1,956,323	-	7,690,014
Other - principally money market and other mutual funds	6,374,518	75,827	-	6,450,345
Alternative investments	-	1,028,256	-	1,028,256
Other commodities	549,891	1,299	-	551,190
Foreign issues	-	551,143	-	551,143
Total marketable securities included in investments	<u>73,960,265</u>	<u>21,663,905</u>	<u>-</u>	<u>95,624,170</u>
Beneficial interests in perpetual trusts	-	-	30,940,150	30,940,150
Funds held in trust by others	-	-	10,954,315	10,954,315
Total	<u>\$ 73,960,265</u>	<u>\$ 21,663,905</u>	<u>\$ 41,894,465</u>	<u>\$ 137,518,635</u>

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NOTE 4 – FAIR VALUE MEASUREMENTS - Continued

The following table summarizes the valuation of the Foundation’s investments, split interest agreements and beneficial interests in perpetual trusts by the above hierarchy levels as of December 31, 2011:

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
U.S. Government securities	\$ 1,857,457	\$ 5,065,284	\$ -	\$ 6,922,741
Corporate notes and bonds				
Financial services industry	434,939	2,416,939	-	2,851,878
Healthcare industry	126,746	-	-	126,746
Industrial goods industry	-	981,063	-	981,063
Oil and gas industry	157,759	-	-	157,759
Real estate industry	-	789,383	-	789,383
Utilities industry	-	212,818	-	212,818
Other	936,801	2,332,122	-	3,268,923
Common stocks				
Consumer goods industry	2,998,751	-	-	2,998,751
Energy industry	1,993,920	-	-	1,993,920
Financial services industry	1,664,496	-	-	1,664,496
Healthcare industry	1,139,336	-	-	1,139,336
Industrial goods industry	2,114,850	-	-	2,114,850
Materials industry	642,039	-	-	642,039
Technology industry	1,930,420	-	-	1,930,420
Utilities industry	977,222	-	-	977,222
Other	857,051	-	-	857,051
Domestic equity mutual funds				
Consumer goods industry	101,889	-	-	101,889
Financial services industry	364,220	-	-	364,220
Healthcare industry	127,859	-	-	127,859
Real estate industry	140,525	60,204	-	200,729
Technology industry	2,366,764	-	-	2,366,764
Other	20,898,129	219,037	-	21,117,166
Fixed income mutual funds				
Financial services industry	85,943	-	-	85,943
Oil and gas industry	24,746	-	-	24,746
Other	16,660,808	44,393	-	16,705,201
International equity mutual funds				
Other	5,179,688	-	-	5,179,688
Other - principally money market and other mutual funds	8,704,935	23,820	-	8,728,755
Alternative investments	-	1,021,904	-	1,021,904
Other commodities	560,163	143,478	-	703,641
Foreign issues	-	446,191	-	446,191
Total marketable securities included in investments	<u>73,047,456</u>	<u>13,756,636</u>	<u>-</u>	<u>86,804,092</u>
Beneficial interests in perpetual trusts	-	-	29,579,936	29,579,936
Funds held in trust by others	-	-	8,878,365	8,878,365
Total	<u>\$ 73,047,456</u>	<u>\$ 13,756,636</u>	<u>\$ 38,458,301</u>	<u>\$ 125,262,393</u>

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NOTE 4 – FAIR VALUE MEASUREMENTS - Continued

The following table summarizes the Foundation’s Level III reconciliation for the beneficial interests in perpetual trusts and funds held in trust by others for the years ended December 31, 2012 and 2011:

	2012	2011
Beginning balance	\$ 38,458,301	\$ 38,704,003
Increase in beneficial interests in perpetual trusts	50,725	87,471
Increase in funds held in trust by others	2,075,950	446,213
Net unrealized gains (losses)	1,309,489	(779,386)
Ending balance	\$ 41,894,465	\$ 38,458,301

Valuation Techniques and Significant Inputs

Level II investments consist of U.S. and foreign government securities, corporate notes and bonds and REITs that are valued based on market prices for similar and actively traded investments.

Level III includes the Foundation’s beneficial interests in perpetual trusts and funds held in trust by others. The fair value is based on the value of the Foundation’s portion of the underlying investments in the trusts using valuation methods that are appropriate for those investments as determined by the trustee.

Quantitative information related to valuation inputs is not available since the value of the trusts that was provided by the trustees was used without adjustment. On an annual basis, Region management evaluates the return received from the trusts against the value of its portion of the trusts for reasonableness as compared with current market returns. Management believes that the sensitivity in the fair value measurement of the beneficial interests is related to market fluctuations, as the investments held in the trusts are primarily marketable securities.

During the current financial year there were no significant transfers between levels.

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NOTE 4 – FAIR VALUE MEASUREMENTS – Continued

The following table discloses the nature and risks of the Foundation’s alternative investments classified as Level II at December 31, 2012:

	<u>Total market value</u>	<u>Exit frequency</u>	<u>Days notice</u>
Hedge funds disclosed as Level II			
BA Hedge Fund Direct - OZ Domestic Partners II	\$ 611,911	Quarterly	45
BACAP Multi-Strategy Hedge Fund, LTD.	<u>54,606</u>	Quarterly	65
Total hedge funds disclosed as Level II	<u>666,517</u>		
Real estate funds disclosed as Level II			
BA Diversified Real Estate Fund, L.P.	<u>361,739</u>	Quarterly	90
Total alternative investments disclosed as Level II	<u>\$ 1,028,256</u>		

BA Hedge Fund Direct – OZ Domestic Partners II – This offshore hedge fund invests primarily in a portfolio of equity securities, but its portfolio includes convertible securities, debt instruments, options, futures, swaps, credit default swaps and other derivatives. The fair values of the shares of these funds have been estimated using the net asset value per share of the underlying investments as a practical expedient. At December 31, 2012, all shares of this fund could be redeemed within 45 days with prior notice.

BACAP Multi-Strategy Hedge Fund, LTD. – This offshore hedge fund invests primarily in private investment funds and discretionary managed accounts managed by fund managers who invest across a diverse range of strategies and markets. The fair values of the shares of these funds have been estimated using the net asset value per share of the underlying investments as a practical expedient. At December 31, 2012, all shares of this fund could be redeemed within 65 days with prior notice.

BA Diversified Real Estate Fund, L.P. – This partnership fund was established to conduct real estate related investment activities and any business or activities incidental to or in support of such real estate related investment activities. The fair values of the shares of these funds have been estimated using the net asset value per share of the underlying investments as a practical expedient. At December 31, 2012, all shares of this fund could be redeemed within 90 days with prior notice.

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NOTE 5 – ENDOWMENTS

The Foundation's endowment consists of a number of individual funds established for research, specific programs and operations.

The Foundation understands the law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of applicable donor gift instrument at the time the accumulation is added to the fund.

For the Chartered Entity organized in the state of Pennsylvania, management understands Pennsylvania State law as (1) requiring the preservation of the fair value of the original gifts as of the gift date of the donor restricted endowment funds, absent donor stipulations to the contrary and (2) allowing the spending of income and gains on permanently restricted endowments, absent explicit donor stipulations that all or a portion of such gains be maintained in perpetuity. State law also allows the Foundation to appropriate and spend such income and gains as is prudent, considering such factors as the Foundation's long and short-term needs, present and anticipated financial requirements, expected total return on investments, price level trends and general economic conditions. Accordingly, such realized and unrealized gains and losses are reported as temporarily restricted or unrestricted, based upon the presence or absence of donor stipulations as to their use.

The remaining portion of donor-restricted endowment funds in excess of the original fair value that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purpose of the Foundation or the donor-restricted endowment fund
3. General economic conditions
4. The possible effects of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Foundation
7. The investment policy of the Foundation

If the market value of any fund classified as permanently restricted at year-end is below the amount determined to be permanently restricted the deficit which cannot be funded from temporarily restricted unspent earnings of the fund are reported as a reduction in unrestricted net assets. For the years ended December 31, 2012 and 2011, as a result of unfavorable market conditions, the Foundation's endowment funds experienced deficiencies from original fair value totaling \$261 and \$56,391, respectively, which was recorded as a decrease in unrestricted net assets as required by GAAP.

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NOTE 5 – ENDOWMENTS - Continued

The primary long-term financial objective for the Foundation's endowments is to preserve the real (inflation-adjusted) purchasing power of endowment assets and income after accounting for endowment spending, inflation and costs of portfolio management. Performance of the overall endowment against this objective is measured over rolling periods of one, three and five years. The endowments shall be managed to optimize the long run total rate of return on invested assets, assuming a prudent level of risk. The goal for this rate of return is one that funds the Foundation's existing spending policy and allows sufficient reinvestment to grow the endowment principal at a rate that exceeds inflation (as measured by the Consumer Price index). Over the short term, the return for each element of the endowment portfolio should match or exceed each of the returns for the broader capital markets in which assets are invested.

Foundation policy requires that the endowment assets will be governed by a spending policy that seeks to distribute a specific payout rate of the endowment base to support the Foundation's programs. The endowment base is defined as a three-year moving average of the market value of the total endowment portfolio (calculated as of the last day of December for the prior three years). Without specific board action to either increase or decrease the payout rate, the Foundation's annual investment income payout distribution is calculated at a rate of four percent of the rolling three year average fair market value of the investments plus amounts paid for share on investment income. The policy allows for a greater predictability of spendable income for budgeting purposes and for gradual steady growth for the support of operations by the endowments. In addition, the policy minimizes the probability of invading the principal over the long-term. Spending in a given year reduces the unit value of each endowment element by the payout percentage. In no case are funds designated as True Endowment reduced below their initial unit value. In the case of short-term declines in the market value of the endowment pool of funds, the overall spending rate may be calculated below designated payout percentage in order to maintain the original unit value of certain elements of the true endowment. Growth of the unit values over time should allow for spending of principal, without drawing from the original corpus of a particular gift.

The endowment is divided into three broad asset classes: equity fund, fixed income fund and cash or near-cash fund. The purpose of dividing the endowment fund in this way is to ensure that the optimal long-term return is achieved given the Foundation's risk preference. The endowment is diversified both by asset class (equity, fixed income and cash) and within asset class (large capitalization stocks, small capitalization stocks, U.S. Treasury bonds, corporate bonds, etc.). The purpose of diversification is to provide reasonable assurance that no single security or class of securities has a disproportionate impact on the total endowment and to reduce the overall risk and volatility of the entire portfolio. The total endowment is monitored on a continual basis for consistency of investment philosophy, return relative to objectives, and asset allocation with respect to target percentages.

In considering the prudence criteria, as outlined by UPMIFA, in 2011, the board of one of the Chartered Entities determined that it was prudent to appropriate an additional \$2 million in accumulated earnings on which there were no purpose restrictions to fund research and expenses relating to regionalization.

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NOTE 5 – ENDOWMENTS - Continued

Endowment net asset composition by type of fund as of December 31, 2012:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted	\$ (261)	\$ 6,586,874	\$ 36,958,302	\$ 43,544,915
Board designated	<u>4,570,260</u>	<u>-</u>	<u>-</u>	<u>4,570,260</u>
Total funds	<u>\$ 4,569,999</u>	<u>\$ 6,586,874</u>	<u>\$ 36,958,302</u>	<u>\$ 48,115,175</u>

Endowment net asset composition by type of fund as of December 31, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted	\$ (56,391)	\$ 4,396,331	\$ 37,303,254	\$ 41,643,194
Board designated	<u>4,559,327</u>	<u>-</u>	<u>-</u>	<u>4,559,327</u>
Total funds	<u>\$ 4,502,936</u>	<u>\$ 4,396,331</u>	<u>\$ 37,303,254</u>	<u>\$ 46,202,521</u>

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NOTE 5 – ENDOWMENTS - Continued

Changes in endowment net assets:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets, January 1, 2011	\$ 5,098,136	\$ 9,940,088	\$ 36,932,097	\$ 51,970,321
Investment Return				
Income	25,376	786,742	-	812,118
Net depreciation (realized and unrealized)	<u>(7,082)</u>	<u>(1,032,343)</u>	<u>-</u>	<u>(1,039,425)</u>
Total investment return	18,294	(245,601)	-	(227,307)
Contributions	25,326	123,314	371,157	519,797
Appropriation of endowment assets for expenditure	<u>(638,820)</u>	<u>(5,421,470)</u>	<u>-</u>	<u>(6,060,290)</u>
Endowment Net Assets, December 31, 2011	4,502,936	4,396,331	37,303,254	46,202,521
Investment Return				
Income	270	661,071	-	661,341
Net appreciation (realized and unrealized)	<u>9,620</u>	<u>2,856,566</u>	<u>-</u>	<u>2,866,186</u>
Total investment return	9,890	3,517,637	-	3,527,527
Contributions	56,232	(22,618)	11,685	45,299
Appropriation of endowment assets for expenditure	941	(1,304,476)	-	(1,303,535)
Transfer of endowment to the University of Pittsburgh	<u>-</u>	<u>-</u>	<u>(356,637)</u>	<u>(356,637)</u>
Endowment Net Assets, December 31, 2012	<u>\$ 4,569,999</u>	<u>\$ 6,586,874</u>	<u>\$ 36,958,302</u>	<u>\$ 48,115,175</u>

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NOTE 6 – CONTRIBUTIONS RECEIVABLE

The Foundation had the following contributions receivable at December 31, 2012 and 2011:

	2012	2011
Amounts due		
In less than one year	\$ 11,266,288	\$ 13,867,263
In one to five years	2,825,157	2,478,367
Gross contributions receivable	14,091,445	16,345,630
Allowance for doubtful accounts	(396,499)	(552,176)
Unamortized present value discount	(60,485)	(40,015)
Net contributions receivable	\$ 13,634,461	\$ 15,753,439

Contributions receivable are net of unamortized present value discount calculated at the date of donation using rates commensurate with the risk involved (one percent to three percent).

NOTE 7 – SPLIT INTEREST AGREEMENTS AND BENEFICIAL INTERESTS IN PERPETUAL TRUSTS

The Foundation had the following interests at December 31, 2012 and 2011:

	2012	2011
Split interest agreements - Foundation is the trustee		
Charitable remainder trusts	\$ 3,077,904	\$ 2,841,438
Gift annuity fund	9,981,683	9,174,485
Pooled income fund	417,161	396,009
Split interest agreements (included in investments)	13,476,748	12,411,932
Funds held in trust by others - Foundation is not the trustee	10,954,315	8,878,365
Beneficial interests in perpetual trusts - Foundation is not the trustee	30,940,150	29,579,936
	\$ 55,371,213	\$ 50,870,233

The assets are reported on the statement of financial position and are valued at estimated fair-value. Liabilities under split interest agreements, which are \$10,053,468 and \$9,938,169 for December 31, 2012 and 2011, respectively, were valued at the date of donation using the income approach at discount rates commensurate with the risk involved (between three and ten percent). They are being amortized over the terms of the obligations. Adjustments are made to the value of the split interest agreements when there are changes in the life expectancy of the donor.

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NOTE 8 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2012 and 2011:

	Estimated useful life	<u>2012</u>	<u>2011</u>
Land		\$ 3,047,651	\$ 3,141,051
Building and improvements	(10-30 years)	11,527,524	11,728,265
Leasehold improvements	(3-10 years)	659,491	1,138,294
Furniture and other equipment	(3-5 years)	<u>3,676,931</u>	<u>5,206,225</u>
		18,911,597	21,213,835
Accumulated depreciation		<u>(9,546,697)</u>	<u>(9,660,490)</u>
Net property and equipment		<u>\$ 9,364,900</u>	<u>\$ 11,553,345</u>

Depreciation expense was \$780,524 and \$859,873 for the years ended December 31, 2012 and 2011 respectively.

NOTE 9 – ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consisted of the following at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Wages, payroll taxes and other related liabilities	\$ 2,621,688	\$ 2,269,980
Defined benefit obligation - unfunded	1,288,552	1,437,743
Other	<u>3,991,299</u>	<u>3,611,951</u>
Total accrued expenses and other liabilities	<u>\$ 7,901,539</u>	<u>\$ 7,319,674</u>

NOTE 10 – DEBT OBLIGATIONS

The Foundation has leased various assets, primarily office equipment, with lease terms approximating the useful lives of the assets. During the year ended December 31, 2012, management of the National Office suspended development on a computer software system. This suspension reduced the total lease obligation by \$276,439. The present value of the remaining future minimum lease payments which are recorded as capitalized lease assets and related notes payable were both reduced. Assets under capital leases (net of accumulated depreciation) at December 31, 2012 and 2011 were \$216,470 and \$1,728,134, respectively, and are included in property and equipment on the statement of financial position.

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NOTE 10 – DEBT OBLIGATIONS - Continued

Revenue Bonds - On November 1, 2009, the National Office amended its loan agreement (original date: December 1, 1996) with the Development Authority of Fulton County. Under this amendment, the National Office converted its existing bonds in the amount of \$3,600,000 to “bank qualified” bonds to be held until maturity by SunTrust Bank. The principal amount of the reissued bonds was \$3,600,000. The credit agreement between the National Office and SunTrust Bank and the amended and restated Indenture of Trust stipulate that the interest rate paid on the bonds shall be a rate equal to 67 percent of the sum of LIBOR plus 2.5 percent. The substantive effect of the reissuance of the bonds was to eliminate the need to remarket the bonds which lowers the National Office’s overall cost of borrowing by the amount of the remarketing and letter of credit fees. The National Office had related notes payable balances in the amount of \$2,000,000 and \$2,400,000 at December 31, 2012 and 2011 with related interest rates of 1.82 percent and 1.86 percent, respectively. This loan includes certain affirmative and negative covenants of which the National Office either complies or has received a waiver for compliance from the lender.

One of the Chartered Entities has a note payable in the amount of \$14,374 at December 31, 2012, which is secured by a vehicle with a net book value of \$21,428. The non-interest bearing note is payable in 60 monthly installments of \$599 through December of 2014.

Line of Credit - At December 31, 2012, the Foundation had available lines of credit in the amount of \$2,500,000. At December 31, 2012 and 2011, the Foundation had drawn amounts on the lines of credit totaling \$750,000 and \$473,955, respectively. Such debt obligations are secured by land, building and other assets. Interest rates ranged from 3 percent to 3.25 percent at December 31, 2012.

Future minimum lease payments under capital leases were as follows at December 31, 2012 and 2011:

	2012	2011
2012	\$ -	\$ 452,143
2013	446,332	417,854
2014	418,689	389,772
2015	97,241	342,663
2016	33,760	9,903
2017	13,765	-
Total future minimum lease payments	1,009,787	1,612,335
Less amounts representing interest	(90,186)	(135,828)
Present value of net minimum lease payments	919,601	1,476,507
Notes payable	2,014,374	2,400,000
Lines of credit	750,000	473,955
Total debt obligations	\$ 3,683,975	\$ 4,350,462

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NOTE 10 – DEBT OBLIGATIONS - Continued

Maturities of notes payable and lines of credit are as follows for the years ending subsequent to December 31, 2012:

	<u>Notes Payable</u>	<u>Lines of credit</u>
2013	\$ 402,875	\$ 750,000
2014	502,875	-
2015	502,875	-
2016	602,875	-
2017	<u>2,874</u>	<u>-</u>
Total	<u>\$ 2,014,374</u>	<u>\$ 750,000</u>

NOTE 11 – JOINT COSTS

In 2012 and 2011, the Foundation incurred joint costs of \$11,897,434 and \$11,761,779, respectively, for informational materials and activities that included fundraising appeals, such as the Foundation’s direct mail. Joint costs for the years ended December 31, 2012 and 2011 were allocated as follows:

	<u>2012</u>	<u>2011</u>
Public health education	\$ 8,998,642	\$ 8,424,211
Fundraising	2,242,102	2,654,668
Management and general	117,266	121,947
Other programs	<u>539,424</u>	<u>560,953</u>
	<u>\$ 11,897,434</u>	<u>\$ 11,761,779</u>

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NOTE 12 – NET ASSETS

Temporarily restricted net assets at December 31, 2012 and 2011 were available for the following purposes:

	<u>2012</u>	<u>2011</u>
Programs, scholarships, training and projects	\$ 15,906,645	\$ 16,029,600
Research	11,738,711	16,346,217
Building improvements	273,702	270,000
Use in future periods	<u>17,065,579</u>	<u>13,675,939</u>
Total temporarily restricted net assets	<u>\$ 44,984,637</u>	<u>\$ 46,321,756</u>

Permanently restricted net assets consisted of the following at December 31, 2012 and 2011 and represent endowed gifts to be held in perpetuity with the investment income to be used for the following purposes:

	<u>2012</u>	<u>2011</u>
Research and specific projects	\$ 38,169,675	\$ 40,225,512
Operations	<u>32,636,204</u>	<u>29,185,482</u>
Total permanently restricted net assets	<u>\$ 70,805,879</u>	<u>\$ 69,410,994</u>

Temporarily restricted net assets released from restrictions consisted of the following in the years ended December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Programs	\$ 9,300,389	\$ 9,172,371
Research	7,828,491	8,553,063
Time release	<u>2,414,462</u>	<u>4,548,000</u>
Total net assets released from restriction	<u>\$ 19,543,342</u>	<u>\$ 22,273,434</u>

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NOTE 13 – OPERATING LEASES

Rental expense for Foundation office space was \$4,055,431 and \$4,009,074 for the years ended December 31, 2012 and 2011, respectively. Lease agreements having an original term of more than one year expire on various dates through 2020. Total future minimum lease payments were as follows at December 31, 2012:

2013	\$ 3,467,442
2014	3,117,838
2015	2,557,846
2016	2,096,955
2017	1,470,466
Thereafter	<u>1,066,736</u>
Total future minimum lease payments	<u>\$ 13,777,283</u>

The National Office rents office space to tenants under leases having an original term of more than one year expiring on various dates through the year 2018. Minimum rental income under leases expiring subsequent to December 31, 2012 is as follows:

2013	\$ 263,202
2014	137,123
2015	76,241
2016	38,675
2017	28,097
Thereafter	<u>41,140</u>
Total	<u>\$ 584,478</u>

NOTE 14 – EMPLOYEE BENEFIT PLAN

Employee Contribution Plans

Defined Contribution Plan - The Foundation sponsors various defined contribution retirements plans (the “defined contribution plans”) covering substantially all of the employees of the Foundation. Participants may contribute a percentage of their compensation on a pretax basis. The Foundation matches a portion of the participants’ compensation. Vesting policies are based on the specific defined contribution plan operated either at the National Office or the chartered entity. Total contributions to the defined contribution plans for the years ended December 31, 2012 and 2011 were \$1,720,387 and \$1,723,443, respectively.

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NOTE 14 – EMPLOYEE BENEFIT PLAN - Continued

Deferred Compensation Plan - The National Office maintains a 457(b) nonqualified deferred compensation plan (the “deferred compensation plan”) that permits a select group of executive level employees to set aside a portion of salary on a before-tax basis. In addition to voluntary elective deferrals, the National Office makes non-elective contributions to the plan. At the discretion of the National Office, participants are allowed to allocate deferred compensation plan contributions and designate beneficiaries.

The National Office’s contributions totaled \$81,730 and \$82,500 for the years ended December 31, 2012 and 2011, respectively. All assets under the deferred compensation plan remain part of the National Office’s general assets and are subject to the claims of its creditors. All rights to amounts held under the plan are owned by the National Office. Therefore, the National Office reports the assets and related liabilities of the deferred compensation plan in its statement of financial position. At December 31, 2012 and 2011, the assets and liabilities totaled \$487,895 and \$393,994, respectively.

Defined Benefit Plan

The Foundation has various defined benefit pension plans (the “Plan”) covering certain employees. Benefits are based on years of service and compensation. Contributions are determined in accordance with each Plan’s provisions.

The following table illustrates the percentage of fair value of total plan assets for each major category of plan assets for the year ended December 31, 2012 and 2011.

	2012	2011
Equity	0-65%	0-69%
Debt Securities	0-99%	0-18%
Other	<u>0-18%</u>	<u>0-100%</u>
	<u>100%</u>	<u>100%</u>

The following table sets forth the Plan’s funded status and amounts recognized in the Foundation’s statement of financial position as part of accrued expenses and other liabilities.

	2012	2011
Fair value of plan assets at year end	\$ 4,229,529	\$ 4,033,550
Benefit obligation at year end	<u>5,518,081</u>	<u>5,471,293</u>
Funded Status	<u>\$ (1,288,552)</u>	<u>\$ (1,437,743)</u>

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NOTE 14 – EMPLOYEE BENEFIT PLAN - Continued

Amounts recognized on the statement of financial position consist of:

	<u>2012</u>	<u>2011</u>
Accrued benefit cost	\$ (1,288,552)	\$ (1,437,743)
Net amount recognized	<u>\$ (1,288,552)</u>	<u>\$ (1,437,743)</u>

Weighted average assumptions as of the year end December 31, 2012 and 2011:

	December 31,	
	<u>2012</u>	<u>2011</u>
Discount rate	3.7-4.2%	4.5-5.0%
Expected return on plan assets	3.7-8.0%	3.5-7.0%
Rate of compensation increase	5.0-6.0%	4.5-6.0%
Benefit cost	<u>\$ 78,601</u>	<u>\$ 12,227</u>
Employer contribution	<u>\$ 390,260</u>	<u>\$ 440,151</u>
Benefits paid	<u>\$ 204,583</u>	<u>\$ 990,304</u>

The components of net periodic benefit are:

	December 31,	
	<u>2012</u>	<u>2011</u>
Service cost	\$ 103,116	\$ 145,657
Interest cost	157,696	225,594
Actual return on plan assets	(139,331)	(87,259)
Amortization of initial unrecognized net obligation of (net assets)	(2,002)	(15,742)
Amortization of prior service cost	7,208	10,723
Amortization of loss deferred	<u>84,225</u>	<u>2,537</u>
Net periodic pension cost	<u>\$ 210,912</u>	<u>\$ 281,510</u>

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NOTE 14 – EMPLOYEE BENEFIT PLAN - Continued

The following represents the Foundation’s estimate of benefit payments for the Plan to be made in the next five years and in the aggregate for the five years thereafter:

<u>Year ended December:</u>	
2013	\$ 1,374,431
2014	155,501
2015	39,333
2016	37,926
2017	167,133
Five years thereafter	<u>1,743,390</u>
Total estimated benefit payments for the next ten years	<u>\$ 3,517,714</u>

For each chartered entity with a defined benefit plan, the expected long-term rate of return on plan assets assumption, ranging from 4.75 percent to 7.00 percent, was selected using the “building block” approach described by the Actuarial Standards Board in Actuarial Standards of Practice No. 27 – Selection of Economic Assumptions for Measuring Pension Obligations. Based on the various Chartered Entities’ investment allocation for the pension plan in effect as of the beginning of fiscal year, a best estimate range was determined for both the real rate of return (net of inflation) and for inflation based on historical 30 year period rolling averages. An average inflation rate within the range was selected and added to the real rate of return range to arrive at a best estimate range. A rate which is within the best estimate range was selected.

Management of the Foundation expects to make contributions to the Plan of approximately \$282,603 during 2013.

The following is a reconciliation of items not yet reflected in the net periodic benefit cost:

	January 1, 2012	Reclassified as Net Periodic Benefit Cost	Amounts Arising During Period	December 31, 2012
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Unrecognized transition obligation (asset)	\$ 84,151	\$ 5,628	\$ 18,112	\$ 107,891
Net loss or (gain)	<u>\$ 618,700</u>	<u>\$ (39,517)</u>	<u>\$ 23,300</u>	<u>\$ 602,483</u>

The estimated amounts to be reclassified during 2012 as net period benefit amounts include an unrecognized transition obligation of \$5,628. Additionally, no plan assets are expected to be returned to the Foundation during the 2013 fiscal year.

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NOTE 15 – SOFTWARE IMPAIRMENT

In 2010, the National Office began implementation of an enhancement to its constituent relationship management software system (“CRM”). The costs for that implementation were recorded as a work-in-progress asset. This asset would have been depreciated over five years once the implementation was completed. However, during 2012, the National Office indefinitely suspended the CRM enhancement project. The suspension of the software project created an impairment of the asset which resulted in a reduction of the accumulated costs to zero. The loss recognized on this impairment was \$1,277,473, which is included under other income and losses on the statement of activities.

NOTE 16 – COMMITMENTS AND CONTINGENCIES

The Foundation has commitments for research awards and grants for future years. The terms of research awards and grants are from one to three years with continuation of grants subject to certain performance requirements. At December 31, 2012, these commitments were as follows:

2013	\$ 5,775,000
2014	500,000
2015	<u>500,000</u>
Total commitments	<u>\$ 6,775,000</u>

Total research awards and grant commitments are reflected on the statement of financial position as net assets designated for future research grants.

The Foundation is involved in litigation arising from the normal course of business. Although the ultimate outcome of such matters cannot be predicted with certainty, management believes that the current expected outcome of any such matter will not have a material adverse effect on the Foundation’s financial condition.

NOTE 17 – SUBSEQUENT EVENTS

The Foundation has evaluated subsequent events for potential recognition and/or disclosure in the December 31, 2012 financial statements through June 3, 2013, the date that the financial statements were available to be issued.