INOVA HEALTH SYSTEM

Audited Consolidated Financial Statements and Other Supplementary Information

Fiscal Year Ended
December 31, 2012

Inova Health System
Audited Consolidated Financial Statements
and Other Supplementary Information
December 31, 2012 and 2011

<u>Audited Consolidated Financial Statements</u>

<u>Other Supplementary Information</u>

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Report of Independent Auditors

The Board of Trustees
Inova Health System

We have audited the accompanying consolidated financial statements of Inova Health System (IHS), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Inova Health System at December 31, 2012 and 2011, and the consolidated results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 14, 2013

Inova Health System
Consolidated Balance Sheets
December 31, 2012 and 2011
(In thousands)

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	$ 216,672	$ 253,546
Assets whose use is limited		
By board for plant replacement and expansion	250,010	181,900
Patient accounts receivable (less allowance for doubtful accounts: 2012 - $77,160 ; 2011 - $73,865)	273,386	284,667
Third-party settlements	3,646	5,525
Other current assets	89,469	68,787
Total Current Assets	833,183	794,425
Property, Equipment and Leasehold Interests, net (Note 5)	1,305,524	1,155,052
Assets Whose Use Is Limited (Note 6, 7, 13)		
Held by bond trustee	408,546	96,473
By board for plant replacement and expansion	2,449,979	2,554,220
By board for construction projects	490,043	-
By donor	80,435	75,531
For professional liability	74,321	65,677
For health plan liability	11,994	-
	3,515,318	2,791,901
Less amounts required to meet current obligations	(250,010)	(181,900)
Total Assets Whose Use Is Limited	3,265,308	2,610,001
Other Assets		
Unrestricted long-term investments (Note 6)	116,707	97,118
Investments in and receivables from affiliates	10,368	9,630
Prepaid pension asset	22,688	-
Goodwill and other intangible assets	73,268	4,710
Other long-term assets	22,860	11,427
Total Other Assets	245,891	122,885
TOTAL ASSETS	$ 5,649,906	$ 4,682,363
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	$ 190,998	$ 171,705
Accrued salaries, wages and related items	120,291	109,197
Third-party settlements	53,711	56,117
Notes payable and other liabilities	120,711	107,118
Current portion of long-term debt	279,056	207,435
Total Current Liabilities	764,767	651,572
Non-current Liabilities		
Long-term debt, less current portion (Note 8)	1,140,331	798,178
Post employment health care benefits (Note 12)	10,661	11,094
Interest rate swap liability (Note 9)	62,390	73,303
Estimated professional liability (Note 13)	35,597	36,410
Other non-current obligations	43,300	34,114
Total Non-current Liabilities	1,292,279	953,099
Net Assets		
Unrestricted	3,501,970	2,996,415
Temporarily restricted	55,666	48,701
Permanently restricted	35,224	32,576
Total Net Assets	3,592,860	3,077,692
TOTAL LIABILITIES AND NET ASSETS	$ 5,649,906	$ 4,682,363

See notes to consolidated financial statements.

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets
For the Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Operating Revenues		
Net patient service revenue	$ 2,366,520	$ 2,309,698
Provision for bad debts	(93,059)	(82,992)
Net Patient Service Revenue less Provision for bad debts	2,273,461	2,226,706
Other operating revenue	88,056	81,577
Total Operating Revenues	2,361,517	2,308,283
Operating Expenses		
Salaries and benefits	1,141,195	1,135,075
Other operating expenses	833,724	781,450
Depreciation and amortization	141,030	140,217
Interest	32,659	35,409
Loss on extinguishment of debt and swap termination	7,216	544
Total Operating Expenses	2,155,824	2,092,695
Operating Income	**205,693**	**215,588**
Investment income and other, net (including other-than-temporary impairment losses: 2012 - $20,658 ; 2011 - $67,501)	157,209	129,229
Excess of revenues over expenses	362,902	344,817

Continued on page 4

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets (continued)
For the Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Unrestricted Net Assets		
Excess of revenues over expenses (from page 3)	$ 362,902	$ 344,817
Other Changes in Unrestricted Net Assets		
Unrealized gain (loss) on investments, net	137,292	(143,009)
Change in fair value of effective hedging interest rate swaps	(991)	(11,601)
Net assets released from restriction for purchase of equipment and land rights	681	568
Change in plan assets and benefit obligations of pension and retiree health plans	6,834	(14,370)
Other	(1,163)	(81)
Increase in Unrestricted Net Assets	505,555	176,324
Temporarily Restricted Net Assets		
Gifts and bequests	12,804	14,227
Restricted investment income	780	715
Unrealized gain on investments, net	71	121
Net assets released from restriction	(7,076)	(6,432)
Other	386	(102)
Increase in Temporarily Restricted Net Assets	6,965	8,529
Permanently Restricted Net Assets		
Gifts and bequests	66	60
Restricted investment (loss) income	(272)	340
Unrealized gain (loss) on investments, net	2,961	(2,857)
Other	(107)	74
Increase (Decrease) in Permanently Restricted Net Assets	2,648	(2,383)
Increase in Net Assets	515,168	182,470
Net Assets, Beginning of Year	3,077,692	2,895,222
NET ASSETS, END OF YEAR	$ 3,592,860	$ 3,077,692

See notes to consolidated financial statements.

Inova Health System
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Operating Activities		
Change in net assets	$ 515,168	$ 182,470
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	141,030	140,217
Change in plan assets and benefit obligations of pension and retiree health plans	(6,834)	14,370
Loss on extinguishment of debt	1,427	170
Net realized and unrealized gains on investments	(256,496)	(21,515)
Other than temporary declines in fair market value of investments	20,658	67,501
Change in fair value of interest rate swaps	(1,968)	36,489
Equity investment earnings	(3,835)	(2,965)
Gain on sale of long-lived assets	(1,950)	(5,570)
Increase (decrease) in accounts receivable and third-party settlements, net	13,158	(34,234)
Increase in accounts payable and other current liabilities	16,920	22,230
Increase in accrued salaries, wages and related items	10,503	6,869
Increase in pension asset-long term	(22,688)	-
Increase (decrease) in post employment health care benefits liability	6,401	(26,269)
Increase in estimated professional liability and other deferred liability items	8,149	8,856
Restricted contributions received	(12,870)	(14,287)
Restricted interest and dividend income	(508)	(1,055)
Other	(14,304)	(4,403)
Net Cash Provided by Operating Activities	411,961	368,874
Investing Activities		
Capital expenditures	(287,923)	(206,593)
Proceeds from sale of fixed assets	341	9,127
Investments in and advances to joint ventures and affiliates	3,099	1,561
Acquisition of Amerigroup Virginia, LLC	(82,087)	-
Purchases of marketable securities	(3,088,098)	(4,326,312)
Proceeds from sale of marketable securities	2,591,884	4,175,325
Net Cash Used in Investing Activities	(862,784)	(346,892)
Financing Activities		
Restricted contributions received	12,870	14,287
Restricted interest and dividend income	508	1,055
Principal payments on long-term debt	(25,647)	(26,498)
Proceeds from issuance of long-term debt	609,542	59,490
Refunding of long-term debt	(170,040)	(54,490)
Swap termination payments and modification	(8,945)	(3,547)
Other	(4,339)	82
Net Cash Provided by (Used in) Financing Activities	413,949	(9,621)
Net (Decrease) Increase in Cash and Cash Equivalents	(36,874)	12,361
Cash and cash equivalents at beginning of year	253,546	241,185
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 216,672	$ 253,546

See notes to consolidated financial statements.

1. Nature of Operations

Organization: Inova Health System ("IHS") is an integrated, not-for-profit health care delivery system that owns, operates and manages clinical, educational, research and hospital facilities located in Northern Virginia, serving Northern Virginia, the Washington, D.C. metropolitan area and contiguous counties in Virginia and Maryland. The principal line of business for IHS is the delivery of acute care hospital services at five hospitals located in Northern Virginia. IHS also operates an integrated network of health services including ambulatory care, home health care, senior services, assisted living and other health related services.

2. Summary of Significant Accounting Policies

Basis of Presentation: The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of Consolidation: The IHS consolidated financial statements include the accounts of the Inova Health System Foundation (the "Foundation"); Inova Health Care Services ("IHCS"); Inova Alexandria Health Services Corporation ("AHSC"); Loudoun Healthcare, Inc. ("LHI"); Inova Health System Services ("IHSS"); Inova Holdings, Inc. ("IHI"); and their majority-owned subsidiaries and controlled affiliates. All material intercompany accounts and transactions have been eliminated in consolidation.

The Foundation is a tax-exempt, non-stock corporation, which controls its affiliated corporations through its authority to appoint the governing boards of the tax-exempt, non-stock affiliates or its stock ownership. The Foundation also supports and maintains the programs, services, and facilities of IHS' health care delivery system in part through the solicitation, receipt, administration, and distribution of philanthropic gifts on behalf of its tax-exempt affiliates. Amerigroup Virginia, LLC, a wholly-owned subsidiary of the Foundation, is a Medicaid HMO licensed and authorized to do business in Virginia.

IHCS is a tax-exempt, non-stock corporation that serves the health care needs of the community by establishing, maintaining and operating hospital and health care facilities, programs, and other shared and integrated health care delivery arrangements. IHCS operates the following facilities, among others: Inova Fairfax Hospital ("Fairfax"); Inova Mount Vernon Hospital ("Mount Vernon") and Inova Fair Oaks Hospital ("Fair Oaks").

AHSC is a tax-exempt, non-stock corporation organized to promote the health and well being of the Alexandria, Virginia community through the coordination and operation of Inova Alexandria Hospital ("Alexandria") and other related health care entities.

LHI is a tax-exempt, non-stock corporation that serves the health care needs of Loudoun County, Virginia, and surrounding areas. LHI operates Loudoun Hospital Center, Loudoun Nursing and Rehabilitation Center, Loudoun Healthcare Foundation and other health care and related facilities.

IHSS is a tax-exempt, non-stock corporation that provides and manages the tax-exempt, clinical, non-hospital activities of IHS within its own facilities and through the facilities and programs of its subsidiaries and controlled affiliates. Those services include senior services and assisted living facilities, addiction treatment services for adults and adolescents, outpatient rehabilitation services, urgent care and other outpatient health care services.

IHI is a wholly owned subsidiary of the Foundation and is the parent holding company for various taxable entities within IHS including Technical Dynamics Inc., biomedical equipment maintenance and engineering company. IHI and its subsidiaries operate facilities providing a variety of health care and support services to patients and to affiliated health care providers.

Effective January 1, 2013, following a legal reorganization, the IHS consolidated statements will be comprised of the Foundation, IHCS and Loudoun Hospital Corporation; AHSC and IHSS will be merged into IHCS and no longer exist as

2. Summary of Significant Accounting Policies (continued)

separate legal entities. In addition, IHCS will become the owner of IHSS' interest in McLean Assisted Living and the other affiliates of IHSS will become operating divisions within IHCS. The reorganization will not have any material impact on the consolidated financial position or results of operations for IHS.

Cash and Cash Equivalents: Cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. Cash equivalents are valued at cost, which approximates fair value.

Patient Accounts Receivable: Patient accounts receivable include charges for amounts due from all patients less allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid and other insurers. IHS has a self-insured discount policy whereby uninsured patients receive a 35% discount for services rendered. Discounts to uninsured patients are classified as a deduction from revenue. The provision for bad debts is recognized when providing an allowance for uncollectible accounts.

All operating entities of IHS treat emergency patients regardless of their ability to pay. Non-emergency medically necessary care is provided virtually without restriction at all IHS tax-exempt operating entities. A patient is classified as a charity patient based upon established IHS policies that consider patient income levels and available assets. Since IHS does not pursue collection of amounts that qualify as charity care, they are deducted from gross revenue. The provision for bad debts includes unpaid accounts of patients who fail to provide required income and asset documentation to IHS. Guidelines used by IHS in determining charity care may differ from guidelines used by certain state or federal agencies.

Assets Whose Use Is Limited: Assets whose use is limited include board-designated funds for the acquisition of property and equipment, funds restricted by donors for charitable purposes, funds to cover self-insurance and medical claim liabilities, and trustee-held assets for the retirement of long-term liabilities and the funding of certain capital projects.

Fair Value Measurements: IHS evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level in which to classify them for each reporting period. See Note 7.

Property, Equipment and Leasehold Interests: Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets, and is computed using the straight-line method. The general range of useful lives is three to twenty-five years for land improvements, ten to forty years for buildings, fixed equipment, and leasehold improvements, and three to twenty years for major movable equipment. Equipment under capital lease obligations is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Repairs and maintenance are expensed as incurred.

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

Interest Rate Swap Agreements: IHS has entered into a number of fixed payer interest rate swap agreements. Certain of these swap agreements have been designated and qualify as cash flow hedges, and the effectiveness of the hedges is periodically evaluated. Accordingly, the effective portion of the change in the fair market value of the swaps is reported on the accompanying statements as a change in unrestricted net assets, and the ineffective portion is recorded in investment income and other, net. Several swap agreements which had previously been designated and qualified as cash flow hedges, no longer qualified when the underlying bonds were refinanced. The change in fair market value of the swaps that are not designated as hedges is recorded in investment income and other, net. See Note 9.

2. Summary of Significant Accounting Policies (continued)

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

Donor-restricted Gifts: Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Contributions received are reported as either temporarily or permanently restricted assets 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 accompanying consolidated statements of operations and changes in net assets as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received and contributions received where no restrictions were stipulated are reflected as unrestricted contributions reported in the accompanying consolidated financial statements as other operating revenue.

Investments in and Receivables from Affiliates: IHS makes investments in corporations and other forms of businesses. Investments where less than 20% of the ownership interest is held by IHS, and IHS does not exert significant influence over the investee, are accounted for using the cost method. Investments where 20% to 50% of the voting common stock is owned by IHS as well as certain partnership and limited liability company investments are accounted for using the equity method. The equity method is also applied to investments in which IHS owns less than 20% of the ownership interest but can exert significant influence over the investee. Significant investments in affiliates include equity investments in Innovation Health, Potomac Inova Healthcare Alliance and Genetics and IVF Institute. IHS holds 50%, 50% and 33% common stock interest in these investments, respectively.

Goodwill and Other Intangible Assets: Financial Accounting Standard Board ("FASB") guidance requires business combinations to be accounted for using the acquisition method of accounting and it also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. Goodwill represents the excess of cost of acquisition over the fair value of net assets acquired. Other intangible assets represent the values assigned to subscriber bases, provider and hospital networks, and trademarks related to an acquisition that was completed on December 1, 2012. As discussed in Note 14, the values assigned to these intangible assets are preliminary and may be subject to change as more information is gathered and the purchase price allocation is finalized.

Goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment at least annually. IHS could be required to evaluate the recoverability of goodwill and other indefinite lived intangible assets prior to the annual assessment if there is any indication of a potential impairment. Those indications may include experiencing disruptions to business, unexpected significant declines in operating results, or regulatory actions that may affect operating results. As of December 31, 2012, there were no indicators of impairment, and IHS will evaluate goodwill and indefinite lived intangible assets for impairment at least annually beginning in 2013.

Income Taxes: The Foundation, IHCS, AHSC, LHI and IHSS, are not-for-profit corporations and have been determined to be exempt from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code. IHI and its subsidiaries are taxable organizations. Deferred income taxes are provided for all significant timing differences between revenues and expenses reported for financial statement and for tax purposes. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements.

Risk Factors: IHS' ability to maintain and/or increase future revenues could be adversely affected by: (i) the growth of managed care organizations promoting alternative methods for health care delivery or payment of services, such as discounted fee for service networks and capitated fee arrangements; (ii) increased competition from other hospital facilities and integrated health care delivery systems in IHS' service areas, including health maintenance organizations (HMOs) and other entities providing health care services to the population which IHS presently serves; (iii) new statutory, legal or regulatory requirements, or structural, operational or payment changes to the health care industry, resulting from the enactment and implementation of the Patient Protection and Affordable Care Act and other similar health care reform measures, (iv) proposed and/or future changes in the laws, rules, regulations and policies relating to

2. Summary of Significant Accounting Policies (continued)

the definition, activities, and/or taxation of non-profit tax-exempt entities; (v) future legislation, regulation or other actions by federal, state and local governments and their agencies which may impose requirements or continue the trend toward more restrictive limitations on reimbursement for health care services; (vi) future legislation or adverse trends affecting the costs related to professional liability coverage; (vii) the future of Virginia's Certificate of Need (CON) program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate IHS' ability to expand new services; (viii) changes in general and local economic conditions which could influence patients' ability to pay for services or the adequacy of patients' health insurance coverage; (ix) a potential shortage of qualified nurses and other skilled health care professionals in the local employment market; and (x) changes in general and local economic conditions which could cause volatility in capital and debt markets and may impose limitations to timely access to debt markets.

Reclassification: Certain prior year balances have been reclassified to be consistent with the current year presentation.

Subsequent Events: IHS has evaluated subsequent events for recognition and disclosure through March 14, 2013, the date of issuance.

Recent Accounting Pronouncements:

In May 2011, FASB issued ASU 2011-04, *"Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs."* Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Some of the disclosures required by the amendments in this update are not required for nonpublic entities. Those disclosures include information about transfers between Level 1 and Level 2, Level 3 fair value measurement sensitivity and categorization by level for items not measured at fair value in the statement of financial position. The amendments are effective for annual periods beginning after December 15, 2011. Other than expanded disclosure in Note 7, the adoption of this guidance did not have an impact on IHS' consolidated financial statements.

In July 2011, the FASB issued ASU 2011-07, "*Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities."* ASU 2011-7 requires healthcare organizations to present their provision for doubtful accounts related to patient service revenue as a deduction from revenue, similar to contractual discounts. In addition, all healthcare organizations will be required to provide certain disclosures designed to help users understand how contractual discounts and bad debts affect recorded revenue in both interim and annual financial statements. For nonpublic entities, the amendments are effective for the first annual period ending after December 15, 2012 with early adoption permitted. Management elected to early adopt ASU 2011-07 effective January 1, 2012 and reclassify bad debts as a deduction from operating revenues beginning in 2012, and reclassified 2011 balances to conform to the new presentation.

In September 2011, the FASB issued ASU 2011-08, "*Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment*". ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350, *Intangibles-Goodwill and Other*. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The adoption of ASU 2011-08 did not materially affect IHS' financial position or results of operations.

3. Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers and others for services rendered. IHS recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not

3. Net Patient Service Revenue (continued)

qualify for charity care, IHS recognizes revenue on the basis of discounted (or negotiated) rates for services rendered as provided by policy. On the basis of historical experience, a portion of IHS's uninsured patients will be unable or unwilling to pay for the services provided. Thus, IHS records a provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts and after the provision for bad debts, is recognized from these major payer sources for the years ended December 31, 2012 and 2011 (in thousands) as follows:

	2012	2011
Gross Patient Revenue	$ 4,616,514	$ 4,430,465
Deductions:		
Medicare and Medicaid allowances	(1,093,929)	(1,045,953)
Other discounts and allowances	(895,174)	(845,649)
Charity care	(260,891)	(229,165)
Net Patient Service Revenue	2,366,520	2,309,698
Less: Provision for Bad Debts	(93,059)	(82,992)
Total	**$ 2,273,461**	**$ 2,226,706**

Significant portions of IHS' services are provided under agreements with the respective patients' health insurance carriers. The following summarizes the sources of gross revenue for acute care hospital services for the years ended December 31, 2012 and 2011:

	2012	2011
Managed care and commercial	51.3%	52.1%
Medicare	30.3	29.7
Medicaid	8.4	8.7
Uninsured	10.0	9.5
Total	**100.0%**	**100.0%**

IHS agreements with third-party payers provide for payments to IHS at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

- *Managed Care and Commercial Payers*: Under managed care and commercial insurance plans, IHS is typically reimbursed for services provided under various contractual arrangements on a discounted fee, per diem or case rate basis. Patients covered by these types of contractual arrangements are obligated to pay IHS any copayments or deductible amounts required pursuant to the provisions of their managed care plans.

- *Medicare*: Inpatient acute (operating and capital), non-acute (psych, skilled nursing, rehab, and home health) and outpatient services provided to Medicare beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Ultimately, Medicare reimbursement also takes other factors into consideration such as medical education costs, disproportionate share, transplant costs and bad debts which are reimbursed at tentative rates with final settlement determined after submission and audit of the annual cost reports. IHS' classification of patients under the Medicare program and the appropriateness of their admission may be subject to independent review by a peer review organization.

3. Net Patient Service Revenue (continued)

- *Medicaid*: The Medicaid program is administered by the Department of Medical Assistance Services (DMAS) of the Commonwealth of Virginia, pursuant to federal and state laws and regulations. DMAS receives funding for program expenditures from both the federal government and the Commonwealth of Virginia. Federal and state laws or regulations may affect limits on Medicaid payment. For inpatient Medicaid and other state programs, IHCS, AHSC and LHI are reimbursed on an all payer-diagnostic related groups based prospective payment system. Outpatient reimbursement for Medicaid patients is paid on a percentage of allowable costs.

Patient accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, IHS analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, IHS analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), IHS records a provision for bad debts in the period of service on the basis of its past experience. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts. IHS has not changed its charity care or uninsured discount policies during fiscal years 2012 or 2011.

Net patient service revenue also includes estimated retroactive adjustments resulting from future audits, reviews and investigations. Retroactive adjustments are considered in recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments are made known or as years are no longer subject to such audits, reviews and investigations. Retroactive adjustments in excess of amounts previously estimated did not have a material effect on net patient service revenue for 2012 and 2011. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates will change by a material amount in the near term.

4. Charity Care and Other Community Benefits

IHS provides healthcare services to patients who meet certain criteria under its charity care policy without charge (or at amounts less than the established rates). Since IHS does not pursue collection of amounts that qualify as charity care, such amounts are not reported as net patient service revenue. The amounts reported as charity care represent the cost of rendering such services based on the cost to charge ratio for each hospital. Various government programs provide for the indigent, including Medicaid recipients. These programs provide a percentage of reimbursement for qualifying patients; however, payment is typically below the cost of those services.

In addition to charity and uncompensated care, IHS provides benefits to the broader community. These services include health screenings and other health-related services, training health professionals, education and prevention services, family support programs, direct donations, costs of performing medical research and costs associated with providing free clinics and community services. IHS's estimated costs of providing services to the poor and broader community as of December 31, 2012 and 2011 are as follows (in thousands):

	2012	**2011**
Charity care	$ 119,696	$ 108,201
Unpaid cost of state programs to financially disadvantaged persons	64,339	66,099
Community health programs	25,394	24,400
Medical education and research	24,583	18,799
Total community benefits, at cost	**$ 234,012**	**$ 217,499**

5. Property, Equipment and Leasehold Interests

The components of property, equipment and leasehold interests, at cost, and the related accumulated depreciation were as follows at December 31, 2012 and 2011 (in thousands):

	2012	2011
Land and land improvements	$ 140,504	$ 126,612
Buildings, fixed equipment and leasehold improvements	1,505,061	1,478,478
Major movable equipment	1,022,494	899,495
	2,668,059	2,504,585
Less: Allowances for accumulated depreciation and amortization	1,599,339	1,466,249
	1,068,720	1,038,336
Construction - in - progress	236,804	116,716
Total	**$ 1,305,524**	**$ 1,155,052**

6. Investments

Details of investments held as available for sale securities, including Assets Whose Use is Limited and Unrestricted Long-Term Investments, as of December 31, 2012 and 2011 are as follows (in thousands):

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	$ 400,529	$ 400,892	$ 214,052	$ 215,820
U.S. government and agency securities	231,429	231,922	229,558	230,814
Corporate and other bonds				
- Corporate and other bonds	406,653	412,473	277,234	280,944
- Other government securities	50,758	51,931	45,110	45,974
Equity securities				
- Domestic	275,127	359,698	288,495	347,690
- International	236,497	304,841	262,854	282,431
Mutual fund				
- Equity	202,294	237,339	179,927	183,758
- Fixed income and other	552,630	573,542	436,819	439,745
Alternative investments				
- Hedge fund of funds	264,605	264,605	314,885	314,885
- Inflation hedge	128,826	128,826	70,502	60,772
- Global debt	254,495	254,495	217,912	216,386
- Private debt	116,378	116,618	50,464	50,891
- Private real estate	286,680	294,843	215,682	218,084
Other	-	-	825	825
Total	**$ 3,406,901**	**$ 3,632,025**	**$ 2,804,319**	**$ 2,889,019**

IHS records investment values on a trade-date basis. Amounts for sales and purchases of securities unsettled as of the balance sheet date are included net in the fair value amounts disclosed above in the appropriate asset class. Open sales totaled $0.5 million and $1.3 million as of December 31, 2012 and 2011, respectively. Open purchases totaled $45.2 million and $27.7 million as of December 31, 2012 and 2011, respectively.

6. Investments (continued)

Fair values of publicly traded securities and mutual funds were determined by year-end closing prices reported in the listings of the applicable major exchanges. Alternative investments, some of which are structured such that IHS holds limited partnership interests, are stated at fair value as estimated in an unquoted market. Individual investment holdings within the investments may, in turn, include investments in both nonmarketable and market-traded securities. Limited partnership interests in alternative investment funds that exceed 3% of the funds' value and whose ownership interest is considered to be more than minor are accounted for under the equity method of accounting. Valuations of these investments, and therefore, IHS' holdings may be determined by the investment manager or general partner and for "fund of funds" investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment.

Investments are carried at estimated fair value. Realized gains and losses from sales of investments are reflected in income for the period in which they occur. The average cost of the investment sold is used to determine the realized gain or loss. Interest and dividend income is reported net of investment-related expenses of $11.4 million in 2012 and $7.5 million in 2011.

Investment returns for the years ended December 31, 2012 and 2011 are summarized as follows (in thousands):

	2012	**2011**
Interest and dividend income	$ 53,408	$ 51,769
Net realized gains	116,172	167,259
Other than temporary declines in fair value of investments	(20,658)	(67,501)
Net unrealized gains (losses)	140,324	(145,745)
Total	**$ 289,246**	**$ 5,782**

	2012	**2011**
Included in investment income and other, net		
- Income from investments, net	$ 88,258	$ 122,629
- Income from equity method investments, net	60,156	27,843
Increase (decrease) in unrestricted net assets	137,292	(143,009)
Increase in temporarily restricted net assets	851	836
Increase (decrease) in permanently restricted net assets	2,689	(2,517)
Total	**$ 289,246**	**$ 5,782**

Over the past several years, the investment market has experienced significant volatility. Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. All investment holdings managed by third-party investment managers with fair value less than cost were considered other-than-temporarily impaired. IHS has the intent and ability to hold investments in mutual funds whose fair values may be less than cost, and these securities are evaluated to determine whether declines in the fair value of securities should be considered other-than-temporary. During the years ended December 31, 2012 and 2011, IHS recognized a loss for other-than-temporary declines in the fair market value of investments of approximately $20.7 million and $67.5 million, respectively.

6. Investments (continued)

As of December 31, 2012, IHS held 105 investment positions with unrealized losses that are considered to be temporary in nature as summarized in the following table (in thousands):

	Less than Twelve Months		Twelve Months or Longer		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government securities	$ 12,640	$ (5)	$ -	$ -	$ 12,640	$ (5)
Corporate and other bonds	129,284	(1,149)	27,980	(553)	157,264	(1,702)
Equity securities	24,061	(444)	2,167	(123)	26,228	(567)
Total	**$ 165,985**	**$ (1,598)**	**$ 30,147**	**$ (676)**	**$ 196,132**	**$ (2,274)**

As of December 31, 2011, IHS held 127 investment positions with unrealized losses that are considered to be temporary in nature as summarized in the following table (in thousands):

	Less than Twelve Months		Twelve Months or Longer		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government securities	$ 21,185	$ (55)	$ -	$ -	$ 21,185	$ (55)
Corporate and other bonds	108,228	(1,512)	35,223	(427)	143,451	(1,939)
Equity securities	48,379	(1,040)	22	(31)	48,401	(1,071)
Total	**$ 177,792**	**$ (2,607)**	**$ 35,245**	**$ (458)**	**$ 213,037**	**$ (3,065)**

7. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability, or the exit price, in an orderly transaction between market participants at the measurement date. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy distinguishes between market participant assumptions based on independent sources (observable inputs classified within Levels 1 and 2) and the reporting entity's own notions about market participant assumptions (unobservable inputs classified within Level 3). IHS adopted ASU 2010-06, "*Improving Disclosures about Fair Value Measurements*." This update requires additional disclosures about fair value measurements including transfers in and out of Levels 1 and 2 and a higher level of disaggregation for the different types of financial instruments. Transfers into and out of all levels of the fair value hierarchy are reflected at end-of-period fair value. There were no transfers of securities in or out of Levels 1 or 2 in 2011. IHS also adopted ASU 2011-04, "*Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*." This update clarifies that nonpublic entities are not required to disclose (1) transfers between Level 1 and Level 2 fair value measurements, and (2) Level 3 fair value measurement sensitivity and categorization by level for items not measured at fair value in the statement of financial position.

7. Fair Value Measurements (continued)

The fair value levels are as follows:

- Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that IHS has the ability to access at the measurement date.

- Level 2 inputs are other observable inputs for the assets or liabilities, either directly or indirectly. These may include quoted prices for similar assets and liabilities in active markets, interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals.

- Level 3 inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Fair value level assignment for assets and liabilities is based on the lowest level input that is significant to the fair value measurement in its entirety. IHS' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets and liabilities.

The following tables present IHS' assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 and 2011, respectively (in thousands). Certain assets such as open purchases and sales do not have fair values classified within a level in the valuation hierarchy. Alternative investments which are over 3% of the fund's value and whose ownership interest is considered to be more than minor are accounted for under the equity method of accounting. As a result, these are excluded from fair value tables below.

	December 31, 2012	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents	$ 445,514	$ 445,514	$ -	$ -
U.S. government and agency securities	231,922	-	231,922	-
Corporate and other bonds				
- Corporate and other bonds	412,473	-	412,473	-
- Other government securities	51,931	-	51,931	-
Equity securities				
- Domestic	359,698	356,901	2,797	-
- International	304,841	304,841	-	-
Mutual fund				
- Equity	237,339	237,339	-	-
- Fixed Income and other	573,542	573,542	-	-
Alternative investments				
- Private debt	24,239	-	-	24,239
- Private real estate	98,618	-	98,618	-
Total assets	**$ 2,740,117**	**$ 1,918,137**	**$ 797,741**	**$ 24,239**
Liabilities:				
Interest rate swap liabilities	$ (62,390)	$ -	$ (62,390)	$ -
Total liabilities	**$ (62,390)**	**$ -**	**$ (62,390)**	**$ -**

7. Fair Value Measurements (continued)

	December 31, 2011	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	$ 242,238	$ 242,238	$ -	$ -
U.S. government and agency securities	230,814	-	230,814	-
Corporate and other bonds				
- Corporate and other bonds	280,944	-	280,944	-
- Other government securities	45,974	-	45,974	-
Equity securities				
- Domestic	347,690	346,082	1,608	-
- International	282,431	282,431	-	-
Mutual fund				
- Equity	183,758	183,758	-	-
- Fixed Income and other	439,745	439,745	-	-
Alternative investments				
- Inflation hedge	60,772	-	60,772	-
- Global debt	216,386	-	216,386	-
- Private real estate	105,052	-	89,718	15,334
Total assets	**$ 2,435,804**	**$ 1,494,254**	**$ 926,216**	**$ 15,334**
Liabilities:				
Interest rate swap liabilities	$ (73,303)	$ -	$ (73,303)	$ -
Total liabilities	**$ (73,303)**	**$ -**	**$ (73,303)**	**$ -**

The fair value of IHS' securities available for sale is determined by management using third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the securities are classified within Level 2.

Assets utilizing Level 1 inputs include: cash and cash equivalents, exchange-traded equity securities, equity and fixed income mutual funds.

Assets and liabilities utilizing Level 2 inputs include: U.S. government and agency securities, derivatives, corporate, convertible, and municipal bonds, collateralized mortgage obligations, certain mortgage-backed securities, asset-backed securities, and foreign government issued securities. Certain assets fair valued using net asset value ("NAV") are also classified as Level 2 in accordance with ASU 2009-12, *"Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)."*

IHS entered into interest rate swap agreements in conjunction with the issuance of variable rate bonds. The swap contracts are valued using models based on readily observable market parameters for all substantial terms of the contract. See Note 9 for additional information.

Assets utilizing Level 3 inputs includes certain limited partnership interest in a private debt alternative investment fund where IHS' ownership percentage is currently under 3% of the fund's value. The fund invests in distressed debt and other value oriented investments. Valuation of the fund's exchange-traded holdings is based on quoted prices while that of the over-the-counter securities is based on last reported bid and ask prices. Illiquid holdings in the fund are priced by broker quotations, the market approach, discounted cash flow or recent transaction price. Management uses the fund manager's valuation report in assessing the fair value. NAV is used as a practical expedient in determining the fair value of IHS' interest in the fund. Management validates the assessment based on the fund's audited financial statement, when they become available.

7. Fair Value Measurements (continued)

The following table summarizes certain characteristics of the alternative investments which are valued using NAV as of December 31, 2012 and 2011 (in thousands):

Fund	2012 Level 2	2012 Level 3	2011 Level 2	2011 Level 3	Investment Strategy	Liquidity Restrictions
Inflation hedge	$ -	$ -	$ 60,772	$ -	Fund seeks to provide consistent returns over the long-term in rising inflation environments by investing in areas that offer strong relative performance. Holdings are primarily in equity, fixed income, commodity securities and derivatives.	Monthly with 10 business days notice
Global debt	-	-	216,386	-	Fund invests primarily in investment grade fixed income securities located worldwide (including emerging markets), but may invest up to 20% in non-investment grade securities	Daily liquidity
Private debt	-	24,239	-	-	The fund seeks capital appreciation by investing mainly in distressed debt and other value oriented investments.	Eighteen-month investment period for 50% of the commitment, and a 3-year investment period (starting from closing) for anything not withdrawn at the end of the 18 months
Private real estate	-	-	-	15,334	Fund invests in core and value added properties.	1 year redemption lockout period; 90 days written notice thereafter
Private real estate	98,618	-	89,718	-	Fund invests in income producing real property, seeking high current income and capital preservation with a low risk, low leverage core approach. The real estate portfolio consists of multi-family, industrial, retail and office properties in targeted metropolitan areas within the continental United States.	Quarterly with 45 days notice
	$ 98,618	**$ 24,239**	**$ 366,876**	**$ 15,334**		

7. Fair Value Measurements (continued)

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value that used significant unobservable inputs (Level 3) (in thousands):

	Private Real Estate	Private Debt	Total Level 3 Investments
Balance at January 1, 2011	$ -	$ -	$ -
Purchases	15,334	-	15,334
Balance at December 31, 2011	$ 15,334	$ -	$ 15,334
Unrealized gains relating to instruments still held at the reporting date	774	239	1,013
Purchases	37,323	24,000	61,323
Transfers out of Level 3	(53,431)	-	(53,431)
Balance at December 31, 2012	**$ -**	**$ 24,239**	**$ 24,239**

Unrealized gains related to instruments still held at the reporting date are reported in unrealized gain (loss) on investments, net under unrestricted, temporarily restricted and permanently restricted net assets in the Consolidated Statements of Operations and Changes in Net Assets. IHS' ownership percentage exceeded 3% in the private real estate fund in 2012. It was transferred out of Level 3 due to application of the equity method of accounting.

8. Long-Term Debt

	December 31, 2012	December 31, 2011
Long-Term Debt of the IHS Obligated Group:		
1988A,B,C,D Variable Rate Demand Obligation Revenue Bonds; maturing 10/1/25; monthly interest at a variable rate and maximum of 15.0%	$ 37,600	$ 37,600
1993A Hospital Revenue Refunding Bonds; maturing 8/15/23; semi-annual interest at a fixed rate of 2.75% to 5.25%	73,605	78,510
2000 Variable Rate Demand Health Care Revenue Bonds; maturing 1/1/30; monthly interest at a variable rate and maximum of 12.0%	49,300	49,300
2005A Health Care Revenue Bonds; maturing 5/15/35; monthly interest at a variable rate and maximum of 12.0%	111,420	111,420
2005C Health Care Revenue Bonds; maturing 5/15/26; monthly interest at a variable rate and maximum of 12.0%	51,550	51,550
2009A Health Care Revenue Bonds; maturing 5/15/35; semi-annual interest at a fixed rate of 3.0% to 5.5%	268,815	347,555
2009C Health Care Revenue Bonds; maturing 5/15/25; semi-annual interest at a fixed rate of 2.0% to 5.0%	61,150	64,520
2010A-1 Health Care Revenue Bonds; maturing 5/15/39; monthly interest at a variable rate	-	95,000
2010A-2 Health Care Revenue Bonds; maturing 5/15/39; monthly interest at a variable rate	95,000	95,000
2011 Health Care Revenue Bonds; maturing 8/1/2017; monthly interest at a fixed rate of 1.8%	42,381	51,463
2012A Health Care Revenue Bonds; maturing 5/15/42; semi-annual interest at a fixed rate of 3.0 % to 5.0%	290,000	-
2012B Health Care Revenue Bonds; maturing 5/15/42; semi-annual interest at a fixed rate of 3.0 % to 5.0%	60,000	-
2012C Health Care Revenue Bonds; maturing 5/15/42; monthly interest at a variable rate and maximum of 12.0%	145,000	-
2012D Health Care Revenue Bonds; maturing 5/15/29; semi-annual interest a fixed rate of 3.0% to 5.0%	70,395	-
Promissory Note Payable to Bank of America; maturing 3/29/13; monthly interest at a variable rate	313	1,517
Total long-term debt of the IHS Obligated Group	**1,356,529**	**983,435**
Less: Current portion of long-term debt	(275,934)	(204,160)
Net original issue premium/(discount)	41,083	(2,390)
Net long-term debt of the IHS Obligated Group	**$1,121,678**	**$776,885**
Long-Term Debt of the Non-Obligated IHS Affiliates:		
Promissory Note Payable to GMAC Commercial Mortgage Bank; maturing 4/1/16; monthly at a fixed interest rate of 6.26%	12,095	12,415
Promissory Note Payable to Cardinal Bank; maturing 10/1/12; monthly at a fixed interest rate of 6.0%	-	484
Promissory Note Payable to Cardinal Bank; maturing 11/24/15; monthly at a fixed interest rate of 3.89%	2,099	2,768
Promissory Note Payable to Cardinal Bank; maturing 6/16/16; monthly at a fixed interest rate of 3.79%	3,417	4,289
Promissory Note Payable to Cardinal Bank; maturing 7/28/16; monthly at a fixed interest rate of 3.2%	3,663	4,612
Promissory Note Payable to Cardinal Bank; maturing 9/21/15; monthly at a fixed interest rate of 2.75%	313	-
Promissory Note Payable to Cardinal Bank; maturing 3/12/15; monthly at a fixed interest rate of 2.25%	188	-
Total long-term debt of the Non- Obligated IHS Affiliates	**21,775**	**24,568**
Less: Current portion of long-term debt	(3,122)	(3,275)
Net long-term debt of the Non- Obligated IHS Affiliates	18,653	21,293
Total Net IHS Long-Term Debt	**$1,140,331**	**$798,178**

8. Long-Term Debt (continued)

The preponderance of IHS' debt is tax-exempt revenue bonds issued under a Master Trust Indenture, which defines the obligated subsidiaries and affiliates under the bonds. The Members of the IHS Obligated Group include substantially all of the IHS operations exclusive of IHI, Inova VNA Home Care, Franconia-Springfield Surgery Center, LLC, Inova Physical Rehabilitation Services, UMC Holdings, Inc., McLean Assisted Living, LLC, Alexandria Hospital Foundation, Loudoun Nursing & Rehabilitation Center, Loudoun Health Services, Loudoun Services Group, Loudoun Ambulatory Surgery, LLC, Loudoun Healthcare Foundation, Northern Virginia Surgery Center, LLC, Inova Woodburn Surgery Center, LLC, Inova Reston MRI Center, LLC, Inova Physician Partners, Inc., and Amerigroup Virginia, LLC.

On December 20, 2012, the Industrial Development Authority issued $70.4 million of Series 2012D bonds for the benefit of the IHS Obligated Group to advance refund one tranche of the Series 2009A Bonds which totaled $75.04 million maturing in 2029. This particular tranche was callable in May 2014. The series 2012D were sold at a premium of $10.6 million. A loss of $6.7 million was recognized related to the advance refunding.

On September 10, 2012, the mandatory tender date for the Series 2010A-2 bonds held by TD Bank, N.A. was extended from May 2, 2015 to September 1, 2021.

On August 23, 2012, the Industrial Development Authority issued $495 million of Series 2012A, B and C bonds for the benefit of the IHS Obligated Group to finance approximately $400 million of capital projects and to currently refund $95 million of Series 2010A-1 bonds. The Series 2012A, B and C bonds are comprised of three series: $290 million of fixed rate serial and term bonds (Series 2012A), $60 million of fixed rate 10-year maturity bonds (Series 2012B) and $145 million of variable rate bonds (Series 2012C). These series of bonds were sold at a premium of $33.0 million. A loss of $0.5 million was recognized related to the refinancing of the 2010A-1 bonds.

On August 23, 2012, the IHS Obligated Group converted $55.7 million of existing Series 2005A-2 variable rate bonds that were in a daily interest rate mode with a JPMorgan Chase Bank, N.A. Stand-by Bond Purchase Agreement ("SBPA") to a weekly interest rate mode with an IHS self-liquidity pledge.

On July 29, 2011, the IHS Obligated Group refunded a portion of its variable rate demand obligations ("VRDOs") under Series 1988, 2000, 2005A and 2005C with mandatory redemptions in years 2012-2017 totaling $54.5 million. These bonds were refunded to fixed rate serial bonds and directly purchased by Bank of America. A loss of $0.2 million was recognized related to early extinguishment of the debt.

Losses recognized for early extinguishment of debt relate to the write-off of unamortized costs as well the excess of amounts transferred to escrow over the principal amount of debt outstanding (representing interest).

IHS Obligated group debts are secured by an interest in all funds held by the Bond Trustee for purposes of debt service, construction and equipment acquisition. Each Member of the IHS Obligated Group covenants that it will not pledge or grant a security interest in (except as may be otherwise provided in the Master Trust Indenture) any of its property. The Master Trust Indenture for the IHS Obligated Group requires that certain minimum financial ratios be met. IHS is in compliance with the financial ratio requirements.

IHS estimates the December 31, 2012 and 2011 fair value of its long-term debt, based on year-end closing prices for similar publicly traded securities, to be approximately $1,485 million and $1,061 million, respectively, compared with the face value of approximately $1,419 million and $1,006 million, respectively. The fair value of all financial instruments other than investments and debt is estimated by management to approximate or equal their reported carrying value.

8. Long-Term Debt (continued)

The interest rate on the variable rate bonds ranged between 0.03% and 0.38% in 2012 and 0.02% and 0.41% in 2011. The variable rate bonds include an optional tender feature that allows the bond holder to tender the bonds on any daily or weekly interest payment date. The 2012C bonds, in the seven month window VRDB mode are subject to mandatory tender for purchase 210 days after tender notice. As such, both the variable and seven month window VRDB bonds are classified as current liabilities, except for those supported by certain liquidity arrangements as described below.

IHS maintains SBPAs and Letters of Credit ("LOC") to support the optional tender features on the VRDO bonds excluding the 2005A-2 bonds. The liquidity providers are summarized as follows:

Liquidity Provider	Bond Series	$000's	Expiration Date
Branch Bank & Trust Company	2000	$ 49,300	12/31/2015
TD Bank	2005A-1	55,710	4/30/2016
JP Morgan	2005C-1	25,775	10/22/2013
Northern Trust	1988 and 2005C-2	63,375	5/2/2015
Total		**$ 194,160**	

In the event of a failed remarketing, the banks are obligated to extend credit to purchase the tendered bonds. The banks may subsequently remarket the bonds and if the bonds are not remarketed, they are subject to mandatory redemption in quarterly installments by IHS.

Certain SBPAs and LOCs include a provision which specifies re-payment of advances made by the bank will begin in the 13th calendar month after the bonds are acquired by the bank. This provision ensures that tendered bonds do not become an obligation for IHS for at least one year. Accordingly, the underlying debt is not classified as current liabilities except for principal amounts due within twelve months.

The tender feature of the 2012C Bonds and certain variable rate bonds requires IHS to maintain current assets of $250.0 million and $181.9 million as of December 31, 2012 and 2011, respectively, to provide for redemption of the tendered bonds. These assets are included in the current portion of assets whose use is limited.

The promissory note payable to GMAC Commercial Mortgage Bank is secured by a mortgage on the property of McLean Assisted Living, LLC, a joint venture between IHSS (60% equity interest) and Sunrise Senior Living, Inc. (40% equity interest). The note is guaranteed by Sunrise/Inova McLean Assisted Living, LLC. The entire amount of the obligation is consolidated in the accompanying consolidated balance sheets.

Costs incurred in the issuance or conversion of long-term debt are deferred and amortized over the life of the related debt using the principal balance outstanding method.

All bonds are subject to mandatory sinking fund redemption and to earlier redemption under certain circumstances as defined in the respective bond indenture agreements. Maturities of long-term debt for the five years succeeding December 31, 2012 are as follows (in thousands):

	2013	2014	2015	2016	2017	Thereafter	Total
Scheduled Maturities	$ 30,341	$ 30,809	$ 31,528	$ 41,351	$ 27,004	$ 968,556	$ 1,129,589
Bonds under remarketing agreement and subject to mandatory tender	248,715	-	-	-	-	-	248,715
Total	**$ 279,056**	**$ 30,809**	**$ 31,528**	**$ 41,351**	**$ 27,004**	**$ 968,556**	**$ 1,378,304**

IHS incurred interest expense of $40.0 million and $36.6 million in 2012 and 2011, respectively, which approximates amounts paid. Interest amounts capitalized was $7.4 million and $1.2 million in 2012 and 2011, respectively.

8. Long-Term Debt (continued)

Interest income from the trustee held funds relating to construction projects qualifying for interest capitalization was offset against related bond interest expense and capitalized to such projects. Amounts capitalized were approximately $0.9 million for 2012 and approximately $0.6 million for 2011.

In 2012, a portion of the 2009A Health Care Revenue Bonds which were callable in 2014 with principal outstanding in the amount of $75.04 million, were defeased. Proceeds from the 2012D bonds were transferred to an irrevocable escrow account and invested in State and Local Government Securities, the principal and interest from which is sufficient to retire the bonds on the call date. At December 31, 2012, the principal outstanding of these defeased bonds was $75.04 million.

In 2005, bond proceeds were deposited into an irrevocable escrow account and invested in U.S. Treasury Securities and cash, the principal and interest from which is sufficient to pay the principal, interest and call premiums due on the Loudoun 2002A bonds as they are retired. At December 31, 2012, there was no balance on these defeased bonds as the principal outstanding was paid in full during 2012.

In 2002, the 1993B AHSC Medical Facility Revenue Refunding Bonds, with principal outstanding in the amount of $5.6 million, were defeased. Cash was transferred to an irrevocable escrow account and invested in State and Local Government Securities, the principal and interest from which is sufficient to retire the bonds at maturity. At December 31, 2012, the principal outstanding of these defeased bonds was $1.1 million.

In December 2010, IHS issued $100 million of taxable commercial paper ("CP") under a program authorized for borrowings up to $100 million with maturity dates from one to 270 days. Proceeds from this issuance were used for a variety of working capital requirements. IHS maintains a self-liquidity program that would be used to repurchase any CP that is not remarketed. All outstanding CP is included in notes payable and other liabilities in the current liabilities section of the accompanying consolidated balance sheets.

IHCS has two unsecured bank lines of credit available in the amount of $37.5 million and $50.0 million with a variable interest rate of LIBOR plus 0.50%. No amount was outstanding at either December 31, 2012 or 2011. IHS had outstanding bank letters of credit guaranteeing payment to different beneficiaries amounting to $0.6 million at December 31, 2012 and 2011.

9. Derivative Financial Instruments

IHS maintains five interest rate swap agreements which were entered in order to hedge the variability of cash flows related to changes in market interest rates on underlying variable rate debt. The swap agreements effectively convert the variable rate debt to a fixed rate for the remaining life of the outstanding debt. The majority of the swap agreements initially qualified and were designated as cash flow hedges, and the effectiveness of the hedges is periodically evaluated. The effective portion of the change in fair value of the swap agreements is reported on the accompanying statements as a change in unrestricted net assets, and the ineffective portion is recorded in investment income and other, net. The effective hedges' maturity dates range from years 2030 to 2035.

Beginning in 2008, certain swap agreements no longer qualified as cash flow hedges because the underlying debt was refinanced with debt with fixed interest rates. Beginning as of the date the hedges were discontinued, changes in the fair value of these swap agreements are recorded in investment income and other, net, and the accumulated losses as of the date the hedges were discontinued but not previously recognized in income will be amortized and recorded as investment income and other, net, as future interest payments occur. During 2013, $0.6 million is expected to be reclassified into earnings.

In 2012, two swap agreements were recouponed to lower fixed payer rates. In 2011, several swap agreements were fully or partially terminated. A portion of the accumulated losses in fair value of the terminated swap agreements had never been recognized in income because the swap agreements had qualified as hedges. A loss of $2.7 million related to

9. Derivative Financial Instruments (continued)

accumulated losses in fair value of terminated swap agreements not previously recognized was recorded on the statement of operations in 2011.

Each of the swap agreements includes a credit support provision which requires the posting of collateral with the counter-party for liability positions in excess of specified thresholds. At December 31, 2012 and 2011, no collateral was held by the counter-parties.

The following table provides a summary of the notional volume and fair value positions of derivative instruments as well as their reporting location in the consolidated balance sheets at December 31, 2012 and 2011 (in thousands):

		2012		**2011**	
Interest rate swap agreements:	**Balance Sheet Location**	**Notional**	**Fair Value**	**Notional**	**Fair Value**
Designated as cash flow hedges	Non-current Liabilities	$ 107,085	$ (21,166)	$ 107,465	$ (24,515)
Not designated as hedges	Non-current Liabilities	125,000	(41,224)	125,000	(48,788)
Total		**$ 232,085**	**$ (62,390)**	**$ 232,465**	**$ (73,303)**

The following table presents gains and losses in the consolidated statements of operations and changes in net assets for the years ended December 31, 2012 and 2011 (in thousands):

Interest Rate Swaps Designated as Cash Flow Hedges	**Statement of Operations and Changes in Net Assets**	**2012**	**2011**
Unrealized losses - effective portion	Change in fair value of effective hedging interest rate swaps	$(1,597)	$(14,963)
Unrealized gains (losses) - ineffective portion	Investment income and other, net	4,946	(214)
Realized losses - termination	Loss on extinguishment of debt and swap termination	-	(370)
Interest Rate Swaps Not Designated as Hedges			
Unrealized gains (losses)	Investment income and other, net	$7,564	$(21,004)
Unrealized losses - amortization of discontinuance of cash flow hedges	Investment income and other, net	(606)	(612)
Realized losses - termination	Investment income and other, net	-	(2,379)

10. Fairfax County Leases

The land upon which the majority of Inova Fairfax Hospital and the entirety of Inova Mount Vernon Hospital are located and the related buildings and equipment are leased to IHCS by the Board of Supervisors of Fairfax County, Virginia ("County"), under an agreement that was partially amended in 2010 (the "County Lease"). The 2010 agreement included sale of property whereby a portion of the Inova Fairfax Hospital campus land was taken out of the County Lease and ownership of that land was conveyed to IHS. There is also land owned by IHS, off-site of the hospital campus that was conveyed to Fairfax County. Effective as of December 3, 2010, the 2010 agreement extends the County Lease for the residual land for a term of 99 years and, thus, the County Lease now expires December 2109. Under the County Lease, the property and equipment leased from the County are recorded as leasehold interests at the cost to construct or acquire. Upon termination of the County Lease, such property, including leasehold improvements and equipment will revert to the County, subject to all related long-term liabilities of IHCS incurred to finance the construction and acquisition of such property, buildings and equipment.

The County Lease also requires IHCS to set aside funds in an amount at least equal to the depreciation expense on the related leasehold interests. Such funds may be expended by IHCS for major repairs or alterations, construction of or additions to buildings, or the purchase or replacement of equipment. IHCS' Board of Trustees has also designated additional funds for the purpose of plant expansion.

The terms of the County Lease outline an indigent care policy to assure all individuals in the County have access to medically necessary care. Patients' payment obligations under the policy are determined using a sliding income scale which is based on the federal poverty guidelines. During the term of the County Lease, IHCS has agreed to notify the County of any intent to incur additional debt in excess of $1 million. IHCS has also agreed to notify the County of any intent to enter into contractual agreements for the management or operation of Inova Fairfax Hospital or Inova Mount Vernon Hospital by persons other than IHS, or any intent to change hospital rates.

11. Other Leases

IHS leases equipment, office space and certain facilities. Included in the operating expenses of IHS are lease expenses of approximately $20.0 million and $17.2 million in 2012 and 2011, respectively. Future minimum payments under noncancellable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2012 (in thousands):

	Operating Leases
2013	$ 18,219
2014	15,773
2015	12,485
2016	10,582
2017	9,266
Thereafter	18,209
Total lease payments	84,534
Less: minimum income from noncancellable subleases	(28,528)
Total	**$ 56,006**

12. Retirement Obligations

The IHS Retirement Income Plan (the "IHS Plan") is a defined benefit pension plan that covers substantially all full-time employees of IHS. The IHS Retiree Medical Plan ("Retiree Health Plan") provides benefits to certain retirees and certain active employees who met age and length of service requirements as of September 1, 1993.

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended December 31, 2012 and 2011 and the accumulated benefit obligation at December 31, 2012 and 2011 is as follows (in thousands):

	2012		2011	
	Pension	**Retiree Health**	**Pension**	**Retiree Health**
Projected Benefit Obligation				
Beginning of year	$ 652,586	$ 10,812	$ 621,316	$ 11,839
Service cost	24,745	57	26,516	118
Interest cost	23,822	420	29,539	550
Actuarial loss (gain)	45,593	813	33,703	(1,057)
Benefits paid	(37,073)	(565)	(58,488)	(638)
End of year	**$ 709,673**	**$ 11,537**	**$ 652,586**	**$ 10,812**
	Pension	**Retiree Health**	**Pension**	**Retiree Health**
Fair Value of plan assets				
Beginning of year	$ 651,511	$ -	$ 609,410	$ -
Actual return on plan assets	75,923	-	46,589	-
Employer contributions	42,000	565	54,000	638
Benefits paid	(37,073)	(565)	(58,488)	(638)
End of year	**$ 732,361**	**$ -**	**$ 651,511**	**$ -**
Funded status at end of year	**$ 22,688**	**$ (11,537)**	**$ (1,075)**	**$ (10,812)**

	2012		2011	
	Pension	**Retiree Health**	**Pension**	**Retiree Health**
Amounts recognized in the Consolidated Balance Sheet consist of:				
Noncurrent assets	$ 22,688	$ -	$ -	$ -
Current liabilities	-	(876)	-	(793)
Non-current liabilities	-	(10,661)	(1,075)	(10,019)
Amounts recognized in Unrestricted Net Assets consists of:				
Prior service cost (credit)	$ (1,625)	$ (4,195)	$ (415)	$ (4,744)
Actuarial loss (gain)	62,678	(1,159)	70,910	(3,218)
Accumulated benefit obligation:				
End of year	$ 690,754	$ 11,537	$ 630,797	$ 10,812
Net periodic benefit cost				
Service cost	24,745	57	26,517	118
Interest cost	23,822	420	29,539	550
Expected return on plan assets	(30,317)	-	(33,858)	-
Amortization of prior service cost	1,210	(549)	(211)	(549)
Recognized actuarial loss (gain)	6,309	(1,246)	9,098	(2,774)
Net periodic benefit cost	**$ 25,769**	**$ (1,318)**	**$ 31,085**	**$ (2,655)**

12. Retirement Obligations (continued)

For the year ended December 31, 2012, IHS recognized an increase in unrestricted net assets related to the change in plan assets and benefit obligations of the pension and retiree health plans of approximately $6.8 million. The increase resulted from higher than expected investment earnings on plan assets and a reduction in benefits paid. For the year ended December 31, 2011, IHS recognized a decrease in unrestricted net assets related to the change in plan assets and benefit obligations of the pension and retiree health plans of approximately $14.4 million. The decrease resulted from a reduction in the discount rate used to calculate the liability value offset by higher than expected investment earnings on plan assets.

The prior service credit and actuarial loss included in unrestricted net assets related to the pension plan which is expected to be recognized in net periodic pension cost during the year ending December 31, 2013 are $0.2 million and $5.6 million, respectively. The prior service credit and actuarial gain included in unrestricted net assets related to the retiree health plan and expected to be recognized in net periodic benefit cost during the year ending December 31, 2013 is $0.5 million and $0.2 million, respectively. No plan assets are expected to be returned to IHS for the year ending December 31, 2013.

Additional Information	**2012**		**2011**	
	Pension	**Retiree Health**	**Pension**	**Retiree Health**
Assumptions:				
Weighted-average assumptions used to determine benefit obligations at December 31:				
Discount rate	3.66%	3.54%	3.77%	3.96%
Rate of compensation increase	3.50%	-	3.50%	-
Weighted-average assumptions used to determine net periodic benefit costs for years ended December 31:				
Discount rate	3.77%	3.96%	4.88%	4.80%
Rate of compensation increase	3.50%	-	4.00%	-
Expected long-term return on plan assets	4.70%	-	5.50%	-

The assumed expected long-term return on plan assets is based on current and expected future asset allocations and long-term historic and expected future investment returns and is consistent with assumptions used by plans of similar size.

	2012		**2011**	
Assumed health care cost trend rates at December 31:	**Non-Medicare Eligible**	**Medicare Eligible**	**Non-Medicare Eligible**	**Medicare Eligible**
Health care cost trend rate assumed for next year:				
Medical	5.5%	5.5%	5.7%	5.7%
Prescription Drugs	5.5%	5.5%	5.7%	5.7%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	3.8%	3.8%	3.8%	3.8%
Year that the rate reaches the ultimate trend rate:				
Medical	2083	2083	2083	2083
Prescription Drugs	2083	2083	2083	2083

12. Retirement Obligations (continued)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects (in thousands):

	Retiree Health Plan	
	One Percentage Point Increase	One Percentage Point Decrease
Effect on total of service and interest cost components	$ 42	$ (38)
Effect on post-retirement benefit obligation	$ 1,094	$ (963)

The overall financial objectives for the plans' assets are (1) to provide funds for the timely payment of the plan's obligations and (2) to produce an investment rate of return that improves the overall funding status of the Plan consistent with the first objective. The investment objective of the plan seeks to strike a balance between higher returns and controlling funding status volatility. To achieve its objectives, the plan's assets were allocated 98% to cash and fixed income investments and 2% to alternative investment strategies based on market value as of December 31, 2012. The plan's allocation to fixed income investments is structured in part to match the expected stream of future benefit payments in order to minimize funding volatility risk, and to assure a return in excess of the interest crediting rate forecast for the cash balance portion of the plan.

The following tables present the IHS Plan's assets measured at fair value aggregated by the level in the fair value hierarchy within which those measurements fall as of December 31, 2012 and 2011 (in thousands):

	December 31, 2012	Level 1	Level 2	Level 3
Cash and cash equivalents*	$ (13,727)	$ (18,656)	$ 4,929	$ -
Common/collective trusts	22,112	-	22,112	-
U.S. government securities	93,271	-	93,271	-
Corporate and other bonds				
- Corporate and other bonds	137,529	-	137,529	-
- Asset-backed securities	68,748	-	68,748	-
- Other government securities	33,925	-	33,925	-
Mutual fund				
- Fixed Income	376,229	376,229	-	-
Alternative investments				
- Hedge funds of funds	10,535	-	-	10,535
- Private debt	3,739	-	-	3,739
Total	**$ 732,361**	**$ 357,573**	**$ 360,514**	**$ 14,274**

*Cash and cash equivalents included open sales of $9.7 million and open purchases of $34.0 million as of December 31, 2012, causing the Level 1 balance to be negative. Cash and cash equivalents in the retirement portfolio consist of commercial papers and short-term US Treasury bills, which are considered Level 2.

12. Retirement Obligations (continued)

	December 31, 2011	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 18,435	$ 15,969	$ 2,466	$ -
Common/collective trusts	23,586	-	23,586	-
U.S. government securities	20,450	-	20,450	-
Corporate and other bonds				
- Corporate and other bonds	116,998	-	116,998	-
- Asset-backed securities	13,153	-	13,153	-
- Other government securities	25,442	-	25,442	-
Equity securities				
- Domestic	73,337	72,506	831	-
- International	57,758	57,752	6	-
Mutual fund				
- Equity	35,390	35,390	-	-
- Fixed Income	239,512	239,512	-	-
Alternative investments				
- Hedge funds of funds	12,409	-	-	12,409
- Private debt	5,497	-	-	5,497
- Private real estate	9,544	-	-	9,544
Total	**$ 651,511**	**$ 421,129**	**$ 202,932**	**$ 27,450**

Common/collective trusts with fair value of $23.6 million were disclosed as Level 1 in 2011. This amount has been reclassified to Level 2 in the above table to present the levels appropriately. IHS does not believe that this correction was material to the previously issued 2011 financial statements.

12. Retirement Obligations (continued)

The following table summarizes certain characteristics of the alternative investments which are valued using NAV (in thousands):

Fund	2012 Level 3	2011 Level 3	Investment Strategy	Liquidity Restrictions
Private Debt	$ 3,739	$ 5,497	Mezzanine finance investments. Seek high current return and long-term capital appreciation, emphasizing fundamental credit analysis with a bias toward risk control. Focus on middle-market transactions which are sourced from the firm's relationships in the private equity community.	Winding down; at least quarterly distributions at general partner's discretion; term ends in 2015
Hedge fund of funds	10,535	12,409	Hedge fund of funds which seeks to achieve long term, non-market directional returns with low volatility relative to stocks by utilizing a variety of defensive hedge fund strategies.	Winding down; no regular liquidity [1]
Private real estate fund	-	9,544	Combination of fixed returns and participation in the cash flows and market value changes of commercial real estate investments. Direct equity investment is less important than participating mortgage financing. All property types considered, but an emphasis on apartments and industrial property.	Full redemption as of July 2012
	$ 14,274	**$ 27,450**		

[1]This fund has suspended redemption since December 2008 due to a significant decrease in liquidity in the underlying funds in which it is invested. In September 2009, this fund announced a restructuring plan under which the IHS Plan chose to liquidate its holdings. The fund will wind down over the next 2-4 years. Redemptions occur periodically as excess cash is accumulated. Since the restructuring began, the IHS Plan has received eight distributions totaling $15.0 million as of March 2013.

The fair value of IHS' Plan assets is determined by management using third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the assets are classified within Level 2. Assets utilizing Level 3 inputs include certain limited partnership interest in alternative investment funds where the valuation is based on the fund's underlying investments as reported by the funds' managers. One of the alternative investment funds met its holding period requirement and was transferred from Level 3 to Level 2 in 2011.

12. Retirement Obligations (continued)

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value that used significant unobservable inputs (Level 3) (in thousands):

	Hedge Fund of Funds	Private Debt	Private Real Estate	Total Level 3 Investments
Balance at January 1, 2011	$ 31,714	$ 9,212	$ 8,639	$ 49,565
Actual return on plan assets				
Related to assets still held	2,058	1,134	892	4,084
Related to assets sold during the period	-	-	4	4
Purchases	-	-	9	9
Settlements	(5,496)	(4,849)	-	(10,345)
Transfers out of Level 3	(15,867)	-	-	(15,867)
Balance at December 31, 2011	**$ 12,409**	**$ 5,497**	**$ 9,544**	**$ 27,450**
Actual return on plan assets				
Related to assets still held	645	1,112	-	1,757
Related to assets sold during the period	-	-	426	426
Sales	-	-	(9,970)	(9,970)
Settlements	(2,519)	(2,870)	-	(5,389)
Balance at December 31, 2012	**$ 10,535**	**$ 3,739**	**$ -**	**$ 14,274**

IHS plans to contribute $24 million to the IHS Plan in 2013.

IHS' expected future benefit payments, which reflect expected future service as appropriate, are as follows (in thousands):

Fiscal Year	Pension	Retiree Health
2013	$ 44,002	$876
2014	38,271	844
2015	40,250	834
2016	41,362	822
2017	42,383	814
2018 to 2022	227,249	3,872

IHS also sponsors the Inova Health System Retirement Savings Plan (401K Plan) that covers the same groups covered under the IHS Plan. Employees may contribute to the 401K Plan and IHS may contribute to this plan in varying amounts. Defined contribution benefit expense was $21.2 million and $21.3 million in 2012 and 2011, respectively.

13. Malpractice Insurance

IHS maintains coverage for professional and general liability through claims-made policies issued by InovaCap, LLC ("InovaCap"). InovaCap is a wholly owned captive insurance company domiciled in Vermont. Because InovaCap is a wholly owned subsidiary of IHS, its assets, liabilities, revenues and expenses are fully consolidated in the accompanying financial statements.

InovaCap retains risk of $2.05 million per claim and $19 million in annual aggregate for professional liability. Additional risk is reinsured in umbrella forms through Lloyds of London, other European companies, Zurich North American, and CNA, together providing limits of $50 million per claim, and $50 million in the aggregate, in excess of the InovaCap retention. The consolidated balance sheets at December 31, 2012 and 2011 include an accrued liability of $35.6 million and $36.4 million, respectively, based on actuarial estimates of payments to be made under its professional

13. Malpractice Insurance (continued)

liability insurance programs for known claims, as well as for estimated losses on unfiled claims, which relate to events occurring in 2012 and prior years. The liabilities are discounted at 1.6% and 2.0% at December 31, 2012 and 2011, respectively.

Assets held by InovaCap of $74.3 million and $65.7 million at December 31, 2012 and 2011, respectively, are restricted by statute from being transferred to another subsidiary or obligated for any other purpose and accordingly are included as assets whose use is limited in the consolidated balance sheets.

14. Acquisition of Amerigroup Virginia, LLC

On December 1, 2012, IHS completed the acquisition of Amerigroup Virginia, Inc. ("Amerigroup VA"), a Medicaid HMO licensed and authorized to do business in Virginia. Amerigroup VA serves approximately 55,000 members who receive Temporary Assistance for Needy Families, Children's Health Insurance and Supplemental Security Income/Aged, Blind and Disabled benefits through its Medallion II and Family Access to Medical Insurance Security programs. The acquisition of Amerigroup VA is expected to enable IHS to improve care through appropriate utilization and care management measures and by enhancing access of Medicaid patients to IHS' unique wellness and health management programs. Through this transaction, IHS acquired all outstanding common shares of Amerigroup VA for a total purchase price of approximately $88.5 million in cash.

The fair value of assets acquired and liabilities assumed was based on a preliminary valuation and our estimates are subject to change within the measurement period. The primary areas of the purchase price that are not yet finalized are related to certain intangible assets. Of the $88.5 million total purchase price, the fair value of the assets acquired and liabilities assumed are as follows (in millions):

Cash and cash equivalents	$ 6.4
Current assets	14.6
Property and equipment	1.3
Assets whose use is limited	11.9
Goodwill and identifiable intangible assets	68.6
Notes payable and other liabilities	(14.3)
Net assets acquired	**$ 88.5**

The operating results of Amerigroup VA have been included in the consolidated income statements of IHS since December 1, 2012, the acquisition date. The revenue and net income attributable to Amerigroup VA since December 1, 2012 was $13.9 million and $0.5 million, respectively (prior to intercompany eliminations). The following unaudited pro forma condensed consolidated results of operations assume the Amerigroup VA acquisition occurred on January 1, 2012, and the comparable prior reporting period (in millions):

	Years Ended December 31, (unaudited)	
	2012	**2011**
Pro forma operating revenues	$ 2,509	$2,414
Pro forma operating income	213	221

The 2012 profoma operating income amounts in the above table have been adjusted to exclude approximately $1.6 million of acquisition related expenses. However, there were no 2012 or 2011 pro forma adjustments made to reflect potential operating efficiencies or synergies. Accordingly, the combined pro forma financial information is for comparative purposes only and is not necessarily indicative of the results that IHS would have experienced if the Amerigroup VA acquisition had actually occurred on January 1, 2011 and do not reflect any intercompany eliminations. IHS recorded approximately $1.6 million of acquisition related costs that were included in other operating expenses in the Consolidated Statements of Operations and Changes in Net Assets during the year ended December 31, 2012.

15. Other Commitments and Contingencies

IHCS, AHSC, and LHI have entered into several contracts for the acquisition of equipment, IT applications, and for the construction of facilities. Future commitments under these contracts at December 31, 2012 were approximately $248.6 million. IHS currently anticipates that these projects will be financed with a combination of bond proceeds, funds generated from earnings and donations. These projects include expansion of Alexandria, Loudoun, Fair Oaks Mt. Vernon, and Fairfax Hospital facilities, as well as implementation of the Epic Systems Corporation's clinical and revenue cycle applications.

In June 2012, IHS entered into an agreement with Aetna ACO Holdings, Inc ("Aetna") to establish Innovation Health, a jointly owned health plan in which the Foundation and Aetna each has a 50% interest, to offer individual, commercial and Medicare Advantage HMO and PPO products in Northern Virginia. These new products are expected to give employers and consumers access to more affordable, coordinated and integrated health care in the region. This new health plan is expected to become licensed and to begin offering services in 2013. IHS' planned capital contribution to this joint venture is approximately $28.5 million. IHS made an initial contribution of $1.5 million in June 2012.

IHS is subject to various legal claims and contingencies arising in the ordinary course of its business. While the outcomes of such matters are uncertain, management believes that their ultimate resolution will not have a material adverse effect on IHS' financial position or on the changes in its net assets or cash flows.

16. Functional Expenses

IHS provides various health care services to patients within its geographic region. Operating expenses related to providing these services for the years ended December 31, 2012 and 2011 are as follows (in thousands):

	2012	**2011**
Health care services	$ 1,817,822	$ 1,924,581
General and administrative	338,002	168,114
Total	**$ 2,155,824**	**$ 2,092,695**

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Report of Independent Auditors on Other Supplementary Information

The Board of Trustees
Inova Health System

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The following supplementary information, as described on the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

March 14, 2013

Inova Health System
Consolidating Balance Sheets
December 31, 2012 and 2011
(In thousands)

	Inova Health Care Services		Alexandria Health Services Corporation		Inova Holdings, Inc.		Inova Health System Services		Loudoun Healthcare, Inc.		Foundation		System Offices		Eliminations and Consolidating Entries		Totals	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
ASSETS																		
Current Assets																	-	
Cash and cash equivalents	$ 181,700	$ 231,553	$ 5,952	$ 3,903	$ 5	$ 4	$ 8,563	$ 7,447	$ 8,924	$ 8,493	$ 1	$ 1	$ 11,527	$ 2,145	$ -	$ -	$ 216,672	$ 253,546
Assets whose use is limited																		
By board for plant replacement and expansion	250,010	181,900	-	-	-	-	-	-	-	-	-	-	-	-	-	-	250,010	181,900
Patient accounts receivable (less allowances for doubtful accounts: 2012 - $77,160 ; 2011 - $73,865)	201,881	208,036	35,980	39,627	1,563	1,583	6,170	6,723	28,449	28,698	-	-	-	-	(657)	-	273,386	284,667
Third-party settlements	2,696	4,080	543	1,152	-	-	-	-	407	293	-	-	-	-	-	-	3,646	5,525
Other current assets	61,732	56,561	4,617	4,897	2,581	2,556	2,309	1,899	4,927	4,780	3,866	4,350	15,422	721	(5,985)	(6,977)	89,469	68,787
Total Current Assets	698,019	682,130	47,092	49,579	4,149	4,143	17,042	16,069	42,707	42,264	3,867	4,351	26,949	2,866	(6,642)	(6,977)	833,183	794,425
Property, Equipment and Leasehold Interests																		
Land and land improvements	43,690	28,274	3,120	2,323	-	1	12,306	12,280	49,507	49,490	2,275	2,276	29,606	31,968	-	-	140,504	126,612
Buildings, fixed equipment and leasehold improvements	954,082	933,076	211,093	207,380	3,659	3,161	87,657	87,641	152,764	152,200	-	-	95,806	95,020	-	-	1,505,061	1,478,478
Major movable equipment	790,315	681,551	131,903	124,765	1,444	1,200	7,351	7,817	87,764	80,662	109	109	6,356	6,139	(2,748)	(2,748)	1,022,494	899,495
Less allowances for depreciation	1,788,087	1,642,901	346,116	334,468	5,103	4,362	107,314	107,738	290,035	282,352	2,384	2,385	131,768	133,127	(2,748)	(2,748)	2,668,059	2,504,585
and amortization	1,120,415	1,026,657	215,843	196,871	2,127	1,660	61,377	57,090	150,535	139,817	109	109	50,544	45,388	(1,611)	(1,343)	1,599,339	1,466,249
	667,672	616,244	130,273	137,597	2,976	2,702	45,937	50,648	139,500	142,535	2,275	2,276	81,224	87,739	(1,137)	(1,405)	1,068,720	1,038,336
Construction-in-progress	201,488	108,037	8,517	4,929	120	176	499	8	26,179	3,586	-	-	1	(20)	-	-	236,804	116,716
Total Property, Equipment and Leasehold Interests	869,160	724,281	138,790	142,526	3,096	2,878	46,436	50,656	165,679	146,121	2,275	2,276	81,225	87,719	(1,137)	(1,405)	1,305,524	1,155,052
Assets Whose Use Is Limited																		
Held by bond trustee	408,546	96,473	-	-	-	-	-	-	-	-	-	-	-	-	-	-	408,546	96,473
By board for plant replacement and expansion	-	-	-	-	-	-	-	-	79,654	91,226	-	-	2,370,325	2,462,994	-	-	2,449,979	2,554,220
By board for construction projects	-	-	-	-	-	-	-	-	-	-	-	-	490,043	-	-	-	490,043	-
By donor	-	-	10,633	9,851	-	-	-	-	22,658	25,917	47,144	39,763	-	-	-	-	80,435	75,531
For professional liability	74,321	65,677	-	-	-	-	-	-	-	-	-	-	-	-	-	-	74,321	65,677
For health plan liability	-	-	-	-	-	-	-	-	-	-	-	-	11,994	-	-	-	11,994	-
	482,867	162,150	10,633	9,851	-	-	-	-	102,312	117,143	47,144	39,763	2,872,362	2,462,994	-	-	3,515,318	2,791,901
Less amounts required to meet current obligations	(250,010)	(181,900)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(250,010)	(181,900)
Total Assets Whose Use Is Limited	232,857	(19,750)	10,633	9,851	-	-	-	-	102,312	117,143	47,144	39,763	2,872,362	2,462,994	-	-	3,265,308	2,610,001
Other Assets																		
Unrestricted long-term investments	107,330	87,521	842	618	-	-	-	-	-	828	8,535	8,151	-	-	-	-	116,707	97,118
Investments in and receivables from affiliates	3,198	3,126	184	212	5,456	6,264	10	10	19	18	-	-	1,507	-	(6)	-	10,368	9,630
Prepaid pension asset	22,688	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	22,688	-
Goodwill and other intangible assets	11,557	12,081	-	-	-	-	104	146	-	-	-	-	68,606	-	(6,999)	(7,517)	73,268	4,710
Other long-term assets	1,392,751	1,284,015	232,339	187,045	(4,888)	(2,613)	(33,385)	(43,611)	162,441	116,776	1,038	1,757	(1,731,782)	(1,529,693)	4,346	(3,005)	22,860	11,427
Total Other Assets	1,537,524	1,380,128	233,365	187,875	568	3,651	(33,271)	(43,601)	162,460	117,622	9,573	9,908	(1,661,669)	(1,529,693)	(2,659)	(3,005)	245,891	122,885
TOTAL ASSETS	$ 3,337,560	$ 2,766,789	$ 429,880	$ 389,831	$ 7,813	$ 10,672	$ 30,207	$ 23,124	$ 473,158	$ 423,150	$ 62,859	$ 56,298	$ 1,318,867	$ 1,023,886	$ (10,438)	$ (11,387)	$ 5,649,906	$ 4,682,363

Inova Health System
Consolidating Balance Sheets (continued)
December 31, 2012 and 2011
(In thousands)

	Inova Health Care Services		Alexandria Health Services Corporation		Inova Holdings, Inc.		Inova Health System Services		Loudoun Healthcare, Inc.		Foundation		System Offices		Eliminations and Consolidating Entries		Totals	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
LIABILITIES AND NET ASSETS																		
Current Liabilities																		
Accounts payable and accrued expenses	$ 158,348	$ 138,285	$ 6,530	$ 7,248	$ 2,667	$ 1,939	$ 8,564	$ 8,555	$ 10,907	$ 8,494	$ 172	$ 130	$ 6,854	$ 2,542	$ (3,044)	$ 4,512	$ 190,998	$ 171,705
Accrued salaries, wages and related items	94,203	86,598	11,417	10,993	942	648	2,803	2,443	9,440	7,771	499	566	987	178	-	-	120,291	109,197
Third-party settlements	41,136	44,996	7,122	6,402	-	-	-	69	5,453	4,650	-	-	-	-	-	-	53,711	56,117
Notes payable and other liabilities	105,281	103,578	603	368	2,778	2,526	475	396	478	148	105	108	11,654	-	(663)	(6)	120,711	107,118
Current portion of long-term debt	278,751	206,228	-	-	-	-	344	320	1,008	1,873	-	-	-	-	(1,047)	(986)	279,056	207,435
Total Current Liabilities	677,719	579,685	25,672	25,011	6,387	5,113	12,186	11,783	27,286	22,936	776	804	19,495	2,720	(4,754)	3,520	764,767	651,572
Non-current Liabilities																		
Long-term debt, less current portion	1,132,107	789,656	-	-	-	-	11,751	12,095	1,404	2,412	-	-	-	-	(4,931)	(5,985)	1,140,331	798,178
Post employment health care benefits	10,661	11,094	-	-	-	-	-	-	-	-	-	-	-	-	-	-	10,661	11,094
Interest rate swap liability	62,390	73,303	-	-	-	-	-	-	-	-	-	-	-	-	-	-	62,390	73,303
Estimated professional liability	35,597	36,410	-	-	-	-	-	-	-	-	-	-	-	-	-	-	35,597	36,410
Other non-current obligations	31,941	25,844	1,371	-	1,018	1,004	559	521	8,354	6,607	-	-	57	138	-	-	43,300	34,114
Total Non-current Liabilities	1,272,696	929,788	1,371	-	1,018	1,004	12,310	12,095	9,758	7,201	-	-	57	138	(4,931)	(5,985)	1,292,279	953,099
Net Assets																		
Unrestricted	1,387,123	1,250,775	389,724	352,504	408	4,555	5,711	(1,275)	411,907	369,599	8,535	8,151	1,299,315	1,021,028	(753)	(8,922)	3,501,970	2,996,415
Temporarily restricted	22	22	7,815	7,228	-	-	-	-	4,241	2,593	43,588	38,858	-	-	-	-	55,666	48,701
Permanently restricted	-	-	5,298	5,088	-	-	-	-	19,966	19,003	9,960	8,485	-	-	-	-	35,224	32,576
Total Net Assets	1,387,145	1,250,797	402,837	364,820	408	4,555	5,711	(1,275)	436,114	391,195	62,083	55,494	1,299,315	1,021,028	(753)	(8,922)	3,592,860	3,077,692
TOTAL LIABILITIES AND NET ASSETS	$ 3,337,560	$ 2,766,789	$ 429,880	$ 389,831	$ 7,813	$ 10,672	$ 30,207	$ 23,124	$ 473,158	$ 423,150	$ 62,859	$ 56,298	$ 1,318,867	$ 1,023,886	$ (10,438)	$ (11,387)	$ 5,649,906	$ 4,682,363

Inova Health System
Consolidating Statements of Operations
For the Years Ended December 31, 2012 and 2011
(In thousands)

	Inova Health Care Services		Alexandria Health Services Corporation		Inova Holdings, Inc.		Inova Health System Services		Loudoun Healthcare, Inc.		Foundation		System Offices		Eliminations and Consolidating Entries		Totals	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Operating Revenues																		
Net patient service revenue	$ 1,670,694	$ 1,642,526	$ 337,825	$ 327,367	$ 12,069	$ 4,804	$ 67,575	$ 63,601	$ 279,156	$ 271,456	$ -	$ -	$ -	$ -	$ (799)	$ (56)	$ 2,366,520	$ 2,309,698
Provision for bad debts	62,916	58,229	18,223	15,127	443	26	813	419	10,664	9,191	-	-	-	-	-	-	93,059	82,992
	$ 1,607,778	1,584,297	$ 319,602	312,240	$ 11,626	4,778	$ 66,762	63,182	$ 268,492	262,265	$ -	-	$ -	-	$ (799)	(56)	$ 2,273,461	$ 2,226,706
Other operating revenue	53,997	62,512	2,046	2,242	26,945	25,567	6,579	5,517	2,438	2,692	475	533	31,354	17,906	(35,778)	(35,392)	88,056	81,577
Total Operating Revenues	1,661,775	1,646,809	321,648	314,482	38,571	30,345	73,341	68,699	270,930	264,957	475	533 0	31,354	17,906	(36,577)	(35,448)	2,361,517	2,308,283
Operating Expenses																		
Salaries and benefits	842,636	826,652	132,137	144,643	15,869	9,724	37,294	36,407	108,547	113,304	3,432	3,599	1,280	746	-	-	1,141,195	1,135,075
Other operating expenses	565,287	555,385	122,289	110,199	29,551	25,625	21,414	17,562	107,302	95,795	2,719	2,675	21,740	9,656	(36,578)	(35,447)	833,724	781,450
Depreciation and amortization	90,609	91,355	24,326	23,159	486	392	5,519	5,499	15,077	14,905	10	6	5,788	5,965	(785)	(1,064)	141,030	140,217
Interest	21,361	24,321	6,233	5,832	(1)	-	1,386	1,410	3,676	3,845	-	-	4	1	-	-	32,659	35,409
Loss on extinguishment of debt and swap termination	7,216	544	-	-	-	-	-	-	-	-	-	-	-	-	-	-	7,216	544
Total Operating Expenses	1,527,109	1,556,486	284,985	298,960	45,905	35,767	65,613	61,297	234,602	237,040	6,161	6,280	28,812	16,368	(37,363)	(36,511)	2,155,824	2,092,695
Operating Income	134,666	148,552	36,663	30,649	(7,334)	(5,396)	7,728	7,821	36,328	37,108	(5,686)	(5,747)	2,542	1,538	786	1,063	205,693	215,588
Non-operating Revenues (Expenses)																		
Investment income (loss) and other, net	(13,588)	(30,147)	135	131	3,187	1,840	(763)	(558)	3,510	2,436	6,736	6,754	150,601	148,765	7,391	8	157,209	129,229
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	$ 121,078	$ 118,405	$ 36,798	$ 30,780	$ (4,147)	$ (3,556)	$ 6,965	$ 7,263	$ 39,838	$ 39,544	$ 1,050	$ 1,007	$ 153,143	$ 150,303	$ 8,177	$ 1,071	$ 362,902	$ 344,817

Supplemental Reports – Federal and State Financial Assistance Programs

Inova Health System
Year Ended December 31, 2012
With Report of Independent Auditors

Ernst & Young

Inova Health System

Supplemental Reports – Federal and State Financial Assistance Programs

Year Ended December 31, 2012

Contents

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Report of Independent Auditors on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

The Board of Trustees
Inova Health System

Report on Compliance for Each Major Federal Program

We have audited Inova Health System's (the System) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the System's major federal programs for the year ended December 31, 2012. The System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the System's major federal programs based on our audit of the types of compliance requirements referred to above.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the System's compliance.

Opinion on Each Major Federal Program

In our opinion, the System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of the System is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the System's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

A *deficiency in internal control* over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control* over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control* over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of the System as of and for the year ended December 31, 2012, and have issued our report thereon dated March 14, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst + Young LLP

July 25, 2013

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Inova Health System

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Inova Health System (the System), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 14, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

March 14, 2013

Ernst & Young

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Report of Independent Auditors

The Board of Trustees
Inova Health System

We have audited the accompanying consolidated financial statements of Inova Health System (the System), which comprise the consolidated balance sheet as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2012 and 2011, and the results of its operations, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated March 14, 2013, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Ernst & Young LLP

March 14, 2013
(except for schedule of expenditures of
federal and state awards for which the
date is July 25, 2013)

Inova Health System

Schedule of Expenditures of Federal and State Awards

For the Year Ended December 31, 2012

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
Federal Awards			
U.S. Health Resources and Services Administration, Department of Health and Human Services (HRSA):			
Ryan White Comprehensive AIDS Resources Emergency (CARE) Act of 1990			
Pass-through Northern Virginia Regional Commission:			
HIV Emergency Relief Project Grants (Part A)	93.914	11 U 023	$ 1,493,183
HIV Emergency Relief Project Grants (Part A)	93.914	12V023	2,339,882
HIV Emergency Relief Project Grants (Part A-MAI)	93.914	11 U 023	79,954
HIV Emergency Relief Project Grants (Part A-MAI)	93.914	12V023	248,644
Subtotal			4,161,663
HIV Care Formula Grants (Part B)	93.917	DDP-611AX-45416-09-CON-5	708,710
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease (Part C)	93.918		731,122
Coordinated Services and Access to Research for Women, Infants, Children and Youth (Part D)	93.153		623,765
Total CARE Program			6,225,260
Pass-through Virginia Department of Health:			
HIV Care Formula Grants (Part B-MAI)	93.917	DDP-611BA-45416-12-MAI-Inova	27,689
HIV Prevention Activities Health Department Based	93.940	DDP-611CB-93941-12-Inova	24,679
HIV Prevention Activities Health Department Based	93.940	DDP-611CB-93941-12-POS-INOVA	56,347
HIV Prevention Activities Health Department Based	93.940	DDP-611CC-93942-12-INOVA	141,180
Maternal and Child Health Services Block Grant to the States	93.994	706B82480	860,853
Maternal and Child Health Services Block Grant to the States	93.994	705Z82666	177,156
Total VDH			1,287,904
Pass-through University of Pittsburgh:			
AIDS Education and Training Centers (AETC)	93.145	5 H4AHA00060-10-00	194,147
AIDS Education and Training Centers (AETC)	93.145	5 H4AHA00060-11-00	94,379
Total AETC			288,526
Total Department of Health and Human Services			7,801,690

Inova Health System

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
Federal Awards (continued)			
Pass-through Northern Virginia Hospital Alliance:			
Homeland Security Grant Program	97.067	8UASI019	$ (16,176)
Pass-through District of Columbia Homeland Security and Emergency Management Agency:			
Homeland Security Grant Program	97.067	9NSGP625	5,591
Non-profit Security Program	97.008	11NSGP625-01	24,933
Non-profit Security Program	97.008	11NSGP919-01	74,983
Subtotal			105,507
Pass-through University of Virginia:			
State and Community Highway Safety	20.600	GG11313-135765	235,199
Pass-through UCLA:			
Substance Abuse and Mental Health Services_Projects of Regional and National Significance	93.243	1U79TI023450	42,146
Research & Development Cluster:			
Department of Defense, U.S. Army Medical Command:			
Pass-through The Henry M. Jackson Foundation for the Advancement of Military Medicine, Inc.			
Uniformed Services University of the Health Sciences	N/A	HU000105D0005	132,253
Military Medical Research and Development	12.420		30,178
Pass-through Neuren Pharmaceuticals:			
Military Medical Research and Development	12.420	W81-XWH-09-1-0496	22,893

Inova Health System

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
Federal Awards (continued)			
U.S. Health Resources and Services Administration, Department of Health and Human Services (HRSA):			
National Institutes of Health:			
National Heart, Lung and Blood Institute	N/A	HHSN268200700032C	$ 185,473
Pass-through Georgetown University:			
Microbiology and Infectious Diseases Research	93.856	5 U01 A1034994-19	112,997
Pass-through National Childhood Cancer Foundation (NCCF):			
Cancer Treatment Research	93.395	5 U10 CA 098543	224,532
ARRA: Pass-through The Children's Hospital in Philadelphia:			
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	5 U01 DK066174	8,432
Pass-through University of Virginia:			
Cardiovascular Diseases Research	93.837	7 U01 HL088942	7,284
Pass-through Medical University of South Carolina:			
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	MUSC08-080	4,666
Pass-through Medical College of Ohio:			
Graduate Psychology Education Program and Patient Navigator and Chronic Disease Prevention Program	93.191	NS 2005-032	3,712
Trans-NIH Recovery Act Research Support	93.701	NS 2011-81	3,401
Pass-through American College of Radiology:			
Cancer Treatment Research	93.395	U10 CA021661	40,837

Inova Health System

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
Federal Awards (continued)			
Pass-through Healthcare Technologies and Methods:			
Aging Research	93.866	1R43AG034736-01A1	$ 3,874
Pass-through George Mason University:			
Cancer Detection and Diagnosis Research	93.394	E2015311	5,487
Cancer Detection and Diagnosis Research	93.394	E2024301	23,260
Pass-through International Genomics Consortium:			
The Expression Project for Oncology	N/A	HHSN261201000059C	5,706
Special Projects of National Significance	93.928		44,242
Total Research & Development Cluster			859,227
Total Expenditures of Federal Awards			$ 9,027,593
State Awards			
Virginia Department of Health:			
HIV Prevention	N/A	A601201112303002-60201847	$ 97,550
HIV Prevention	N/A	A601201301233105-60202201	63,754
Total State Awards			161,304
Total Federal and State Awards			$ 9,188,897

Inova Health System

Notes to the Schedule of Expenditures of Federal and State Awards

December 31, 2012

1. Scope of Audit Pursuant to OMB Circular A-133

All federal grant operations of the System are included in the scope of the Office of Management and Budget (OMB) Circular A-133 audit (the Single Audit).

The total amount of federal funds awarded to sub-recipients was $52,976.

2. Fiscal Period Audited

For program transactions occurring during the fiscal year ended December 31, 2012, the System is required to undergo a Single Audit pursuant to OMB Circular A-133.

3. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying schedule of expenditures of federal and state awards (the Schedule) includes all federal and state grants to the System that had expenditure activity during fiscal year 2012. The Schedule has been prepared in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and on the accrual basis of accounting.

Inova Health System

Schedule of Findings and Questioned Costs

Year Ended December 31, 2012

Part I – Summary of Auditor's Results

Financial Statement Section

	Unqualified Opinion	
Type of auditor's report issued		
Internal control over financial reporting:		
Material weakness(es) identified?	____ Yes	X No
Significant deficiency(ies) identified?	____ Yes	X None reported
Noncompliance material to financial statements noted?	____ Yes	X No

Federal and State Awards Section

Internal control over major programs:		
Material weakness(es) identified?	____ Yes	X No
Significant deficiency(ies) identified?	____ Yes	X None reported

	Unmodified Opinion	
Type of auditor's report on compliance for major programs:		
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	____ Yes	X No

Part I – Summary of Auditor's Results (continued)

Identification of major programs:

CFDA number(s)	Name of federal program or cluster
93.914	HIV Emergency Relief Project Grants (Part A)

Dollar threshold used to distinguish between Type A and Type B programs:	$300,000
Auditee qualified as low-risk auditee?	X Yes ___ No

Part II – Financial Statement Findings Section

No significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts, grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit were identified.

Part III – Federal and State Award Findings and Questioned Costs Section

No material weaknesses, significant deficiencies and material instances of noncompliance including questioned costs as well as any abuse findings involving federal awards that are material to a major program related to the financial statements required to be reported by Circular A-133 section .510(a) were identified.

Ernst & Young LLP

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