CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Northern Arizona Healthcare Corporation and Affiliates
Years Ended June 30, 2013 and 2012
With Report of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

Northern Arizona Healthcare Corporation and Affiliates

Consolidated Financial Statements and Supplementary Information

Years Ended June 30, 2013 and 2012

Contents

Ernst & Young LLP
Ernst & Young Tower
One Renaissance Square
Suite 2300
2 North Central Avenue
Phoenix, AZ 85004

Tel: +1 602 322 3000
Fax: +1 602 322 3023
www.ey.com

Report of Independent Auditors

Board of Directors
Northern Arizona Healthcare Corporation

We have audited the accompanying consolidated financial statements of Northern Arizona Healthcare Corporation and Affiliates, which comprise the consolidated statements of financial position as of June 30, 2013 and 2012, and the related consolidated statements of activities, 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; 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 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 Northern Arizona Healthcare Corporation and Affiliates at June 30, 2013 and 2012, and the consolidated results of their activities and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

September 27, 2013

Northern Arizona Healthcare Corporation and Affiliates

Consolidated Statements of Financial Position

	June 30 2013	June 30 2012
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 79,548**	$ 88,021
Accounts receivable, less allowance for doubtful accounts of $80,716,000 in 2013 and $71,193,000 in 2012	**80,801**	72,598
Inventories	**9,401**	8,609
Prepaid expenses and other	**9,696**	7,844
Total current assets	**179,446**	177,072
Assets whose use is limited	**434,178**	391,066
Property and equipment, net	**234,580**	237,816
Deferred charges and other assets	**19,749**	19,859
Total assets	**$ 867,953**	$ 825,813
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 12,553**	$ 11,836
Accrued expenses	**38,353**	38,849
Current portion of long-term debt	**6,617**	6,585
Third-party payor settlements	**1,953**	2,926
Total current liabilities	**59,476**	60,196
Long-term debt, less current portion	**164,407**	172,632
Accrued pension liability	**70,474**	94,612
Other liabilities	**6,051**	4,451
Total liabilities	**300,408**	331,891
Net assets	**567,545**	493,922
Total liabilities and net assets	**$ 867,953**	$ 825,813

See accompanying notes.

Northern Arizona Healthcare Corporation and Affiliates

Consolidated Statements of Activities

	Year Ended June 30	
	2013	**2012**
	(In Thousands)	
Revenue:		
Net patient service	**$ 623,304**	$ 577,015
Provision for doubtful accounts	**(105,438)**	(71,733)
Net patient service revenue, less provision for doubtful accounts	**517,866**	505,282
Other	**17,129**	12,056
Total revenue	**534,995**	517,338
Expenses:		
Salaries and wages	**220,210**	197,824
Employee benefits	**57,338**	51,985
Professional fees	**20,210**	20,040
Supplies, services and other	**169,368**	160,812
Depreciation and amortization	**34,553**	33,241
Interest	**3,358**	3,954
Total expenses	**505,037**	467,856
Income from operations	**29,958**	49,482
Other income (losses):		
Investment income, net	**24,148**	4,432
Impairment loss	**(1,244)**	–
Loss on extinguishment of debt	**–**	(2,651)
Other	**666**	1,291
Excess of revenue over expenses	**53,528**	52,554
Decrease (increase) in unfunded pension liability	**20,095**	(48,454)
Increase in net assets	**73,623**	4,100
Net assets at beginning of year	**493,922**	489,822
Net assets at end of year	**$ 567,545**	$ 493,922

See accompanying notes.

Northern Arizona Healthcare Corporation and Affiliates

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2013	**2012**
	(In Thousands)	
Operating activities		
Increase in net assets	**$ 73,623**	$ 4,100
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Increase in investments designated as trading	**(43,112)**	(18,913)
Provision for doubtful accounts	**105,438**	71,733
Depreciation and amortization	**34,553**	33,241
Impairment loss	**1,244**	–
Loss on extinguishment of debt	**–**	2,651
Net change in current assets and current liabilities, exclusive of cash and cash equivalents	**(117,037)**	(72,383)
(Decrease) increase in accrued pension liability	**(24,138)**	35,182
Increase (decrease) in other liabilities	**387**	(1,204)
Net cash provided by operating activities	**30,958**	54,407
Investing activities		
Purchases of property and equipment	**(31,318)**	(35,999)
Decrease in deferred charges and other assets	**80**	(2,798)
Net cash used in investing activities	**(31,238)**	(38,797)
Financing activities		
Proceeds from issuance of long-term debt	**–**	78,921
Repayments of long-term debt	**(8,193)**	(82,440)
Net cash used in financing activities	**(8,193)**	(3,519)
(Decrease) increase in cash and cash equivalents	**(8,473)**	12,091
Cash and cash equivalents at beginning of year	**88,021**	75,930
Cash and cash equivalents at end of year	**$ 79,548**	$ 88,021
Supplemental cash flow information		
Cash paid for interest	**$ 4,453**	$ 4,319

See accompanying notes.

1. Organization

Description of Business

Northern Arizona Healthcare Corporation (the Corporation) is a not-for-profit tax-exempt corporation that provides home health and hospice operations and administrative and other services to affiliated organizations. The Corporation controls the activities of the following wholly owned affiliates:

- Flagstaff Medical Center, Inc. (FMC), a not-for-profit tax-exempt corporation located in Flagstaff, Arizona, provides general medical and surgical acute care, behavioral health services, and a full range of outpatient services.

- Verde Valley Medical Center (VVMC), a not-for-profit tax-exempt corporation located in Cottonwood, Arizona, provides general medical and surgical acute care, senior behavioral health service, and a full range of outpatient services.

- In Fiscal 2013, the Corporation formed the Northern Arizona Healthcare Provider Group LLC (NAHPG LLC). NAHPG LLC is a physician organization comprising the employed physicians of FMC and VVMC. FMC and VVMC each own a 50% interest in NAHPG LLC. The profit and loss from NAHPG will be allocated between the two investees based on the financial performance of each NAHPG practice and their correlations to FMC and VVMC. As part of the formation of NAHPG LLC, FMC and VVMC transferred approximately $16,038,000 in net assets to NAHPG LLC. The net assets transfer has been recorded as an investment in NAHPG on FMC and VVMC financial statements and as an increase to net assets on NAHPG's financial statements. FMC and VVMC's investment in NAHPG has been eliminated in consolidation, and accordingly there was no financial impact to the consolidated financial statements relating to the net asset transfer.

FMC and VVMC constitute the Obligated Group as defined in the Master Trust Indenture dated November 1, 1996, between Flagstaff Medical Center, Inc., Verde Valley Medical Center and Bank of New York Mellon Trust Company N.A, as Master Trustee.

1. Organization (continued)

The Corporation and its affiliated organizations have investments in joint ventures, which include:

- Northern Arizona Senior Living Community, LLC, d/b/a The Peaks (The Peaks) is 50% owned by the Corporation. The Peaks operates a senior living, mentoring, and skilled nursing facility located in Flagstaff, Arizona. The Peaks is accounted for using the equity method of accounting.

- The Ambulatory Surgi-Center at Flagstaff Medical Center, LLC. (TASC) is an ambulatory surgery center which provides primarily outpatient surgery services to patients as an alternative to providing these services at a hospital facility. As of June 30, 2013, TASC is 71% owned by FMC, and the financial results of TASC have been consolidated in the consolidated financial statements.

Mission Statement

The primary mission of the Corporation is to improve the health of the people and communities that the Corporation serves.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Corporation and each of its wholly owned affiliates. The Corporation also holds a controlling interest in TASC whose joint venture financial results are included in the consolidated financial statements. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the Corporation's consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less, excluding amounts whose use is limited by the Corporation's Board of Directors (the Board) designation or other arrangements under trust agreements.

Fair Value of Financial Instruments

Carrying value of financial instruments classified as current assets and current liabilities approximates fair value based on the liquidity of these financial instruments and the short-term maturities of these instruments. The fair values of other financial instruments are disclosed in their respective notes.

Net Patient Accounts Receivable

Net patient accounts receivable and net patient service revenue have been adjusted to the estimated amounts expected to be received based on contracted rates for the services rendered. These estimated amounts are subject to further adjustments upon review by third-party payors. For uninsured patients that do not qualify for charity care, the Corporation recognizes revenue on the basis of its standard or discounted rates. Historically, a significant portion of the uninsured patients will be unable or unwilling to pay for the services provided. Accordingly, the Corporation records an allowance for doubtful accounts and provision for doubtful accounts, related to uninsured patients, in the period the services were provided using an entity wide assessment based on historical collection experience. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the allowance for doubtful accounts. During 2012 and 2013, the Corporation experienced an increase in self-pay patients and a reduction in self-pay collections, primarily due to reductions in eligibility and coverage enacted by the Arizona Health Care Cost Containment Program (AHCCCS), Arizona's state Medicaid program. These changes resulted in an increase to the provision for doubtful accounts for the years ended June 30, 2013 and 2012.

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost (first-in, first-out method) or market.

2. Summary of Significant Accounting Policies (continued)

Assets Whose Use is Limited

Assets whose use is limited include investments set aside by the Board for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. In addition, assets whose use is limited include assets held by a trustee under bond indenture agreements.

Investments in equity securities, with readily determinable fair values, and all investments in U.S. Treasury securities, corporate debt securities, government agency securities, and registered investment funds are measured at fair value in the accompanying consolidated statements of financial position (see Note 5). The Corporation has determined that all investments held at June 30, 2013 and 2012, are designated as trading securities. Accordingly, investment income, including realized gains and losses on investments, unrealized gains and losses on investments, and interest and dividends, are included in excess of revenues over expenses.

Property and Equipment

Property and equipment are recorded at cost, if purchased, or fair value on the date received, if donated. Depreciation expense is recorded on a straight-line basis over the estimated useful life of each class of depreciable asset, which range from 3 to 40 years. 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 consolidated statement of activities. 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.

Long-Lived Asset Impairment

The Corporation reviews long-lived assets for impairment when events or changes in business conditions indicate that their carrying value may not be recoverable. The Corporation considers assets to be impaired and writes them down to fair value if expected associated cash flows are less than the carrying amounts. Fair value is determined to be the present value of the associated assets cash flows. During 2013, the Corporation recorded an impairment loss of approximately $944,000 related to land held in Camp Verde, Arizona and $300,000 related to land held in Prescott, Arizona. There were no impairment losses recorded during 2012.

2. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, discounts from established charges, and per diem payments.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known. For the years ended June 30, 2013 and June 30, 2012, the Corporation recorded an increase to net patient service revenue of $1,800,000 and $6,600,000 respectively, relating to retroactive adjustments and settled appeals.

Electronic Health Records Incentive Payments

Beginning in 2011, the Medicare and state Medicaid programs are providing an incentive payment to eligible hospitals and professionals if meaningful use certified electronic health care (EHR) technology is adopted and utilized. The incentive payment is recognized when management is reasonably assured that the Corporation has complied with the conditions set forth by Medicare and Medicaid and has demonstrated meaningful use of its EHR technology for the applicable attestation period. Approximately $5,604,000 in Medicare and Medicaid incentive payments were recognized in other revenue for the year ended June 30, 2013. The Corporation's attestation of compliance with the meaningful use criteria is subject to audit by the federal government upon final settlement of the applicable cost report from which payments were initially calculated.

Community Benefit

The Corporation provides a broad range of benefits to the northern Arizona community it serves, including offering various community-based social service programs and a number of health-related educational programs. These services are provided to improve the general standards of health for the community. In addition, the Corporation provides care to all patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. A patient is classified as a charity patient by reference to certain policies established by the

2. Summary of Significant Accounting Policies (continued)

Corporation as to the ability of the patient to pay. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not recorded as revenue. Partial payments to which the Corporation is entitled from public assistance and other programs, on behalf of patients, that meet the charity care policy of the Corporation are reported as net patient service revenue.

The Corporation estimates charity care costs based on the most recent cost to charge ratio reported in FMC's and VVMC's general ledger. The cost to charge ratio includes both direct and indirect costs incurred at FMC and VVMC. For the year ended June 30, 2013 and 2012, costs incurred by the Corporation in the provision of charity care, community benefit services rendered, and the unpaid costs of programs with the AHCCCS and Medicare program amounted to $89,304,000 and $88,240,000, respectively. The following is a summary of the Corporation's net community benefit for the years ended June 30:

	2013	2012
	(In Thousands)	
Charity care provided	**$ 3,292**	$ 2,758
Other community benefit	**8,556**	6,991
Unpaid costs of AHCCCS program	**44,417**	56,870
	56,265	66,619
Unpaid costs of Medicare program	**33,039**	21,621
	$ 89,304	$ 88,240

Tax Status

The Corporation is a not-for-profit corporation and is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is included in the accompanying consolidated financial statements. The Corporation's management is not aware of any events that would cause the Corporation to lose its tax-exempt status. Management has reviewed all open tax years and has determined that the Corporation has no significant uncertain tax positions.

2. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

In May 2011, an accounting standard was released that further amends fair value measurement and disclosure requirements. The accounting standard requires additional disclosures relating to transfers of any financial instruments between Level 1 and Level 2 of the fair value hierarchy, disclosure of the fair value hierarchy level for items that not recorded at fair value in the financial statements but are required to disclose the fair value of the item, and disclosure of additional quantitative information about the unobservable inputs used in the fair value measurement of financial instruments categorized within Level 3 of the fair value hierarchy. The accounting standard was effective for the Corporation on July 1, 2012. The accounting standard has been adopted in the consolidated financial statements.

Subsequent Events

There are two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and nonrecognized subsequent events, which provide evidence about conditions that did not exist at the balance sheet date but arose before the financial statements were issued. Recognized subsequent events are required to be recognized in the financial statements, and nonrecognized subsequent events are required to be disclosed. In the preparation of the consolidated financial statements, the Corporation has evaluated subsequent events through the date the financial statements were available for issuance, September 27, 2013. (See Note 11 for disclosed subsequent events.)

Reclassification

The 2012 consolidated financial statements have been reclassified to conform to the 2013 presentations, primarily relating to the reclassification of $6,800,000 of accounts receivable credit balances to accrued expenses and statement of cash flow reclassification of pension liabilty.

3. Net Patient Service Revenue

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

Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All outpatient services rendered to Medicare beneficiaries are paid at prospectively determined rates. FMC and VVMC's Medicare reimbursement is subject to final settlement with the Medicare program, based on the annual hospital specific rate per discharge. Final settlement with the Medicare program is determined after submission of annual cost reports by the Corporation and audit thereof by the Medicare fiscal intermediary. Approximately 32% and 33% of the Corporation's net patient service revenue was derived from the Medicare program in 2013 and 2012, respectively.

The Medicare cost reports of the Corporation have been audited by the fiscal intermediary through June 30, 2010 for FMC and June 30, 2009 for VVMC. Management believes that estimated accrued settlements related to unaudited cost reports are adequate. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

AHCCCS – Inpatient and outpatient services rendered to AHCCCS program beneficiaries are reimbursed under per diem and fee schedule or discounted charge methodologies, respectively. Approximately 8% of the Corporation's net patient service revenue was derived from the AHCCCS program in 2013 and 2012.

Other Payors – The Corporation also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per discharge or discounts from established charges. Approximately 45% and 48% of the Corporation's net patient service revenue was derived from other third-party payors in 2013 and 2012, respectively.

3. Net Patient Service Revenue (continued)

Self-pay – Inpatient and outpatient services rendered to self-pay patients are recorded at the Corporation's standard rates. Approximately 15% and 11% of the Corporation's net patient service revenue was derived from self-pay patients in 2013 and 2012, respectively. Self-pay patients include patients without insurance and patients with deductibles and coinsurance associated with third-party payor coverage. Management records a provision for doubtful accounts related to self-pay patients, at the time services are provided, based on historical collection experience.

4. Concentration of Credit Risk

The Corporation grants credit without collateral to its patients, most of whom are insured under third-party payor agreements which include (i) Medicare, (ii) AHCCCS, (iii) private payors (self-pay), and (iv) others, including commercial carriers and health maintenance organizations. The following table summarizes the percent of gross accounts receivable from all payors as of June 30:

	2013	**2012**
Medicare	**31%**	32%
AHCCCS	**15**	16
Self-pay	**18**	19
Other third-party payors	**36**	33
	100%	100%

Self-pay and other amounts due consist of receivables from various payors, including individuals involved in diverse activities subject to differing economic conditions. Management does not believe there are any significant credit risks associated with accounts receivable, except for self-pay accounts. Management continually monitors and adjusts its allowances (contractual and doubtful accounts) associated with these receivables based on recent payment trends and specific identification of uncollectible patient accounts.

5. Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability.

As a basis for considering such assumptions, the Corporation utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- *Level 1*. Pricing is based on observable inputs such as quoted prices in active markets. Financial assets in Level 1 include money markets, U.S. Treasury securities, registered investment funds and listed equity securities.

- *Level 2*. Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets in Level 2 include corporate debt securities and government agency securities.

- *Level 3*. Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates. The Corporation has no assets measured at Level 3.

Assets measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are identified in the tables below. The valuation techniques are as follows:

(a) *Market approach*. Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

(b) *Cost approach*. Amount that would be required to replace the service capacity of an asset (replacement cost).

5. Fair Value Measurements (continued)

(c) *Income approach*. Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing and excess earnings models).

The following table outlines the fair value techniques used for financial assets recorded at fair value, on a recurring basis, as of June 30, by the level of observable input and the valuation technique:

	Balance at June 30	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Valuation Technique (a,b,c)**
2013		*(In Thousands)*			
Assets whose use is limited:					
Cash and cash equivalents	**$ 134,327**	**$ 134,327**	**$ –**	**$ –**	**a**
Equities, primarily U.S. equities	**126,359**	**126,359**	**–**	**–**	**a**
U.S. Treasury securities	**32,323**	**32,323**			**a**
Government agency	**41,262**	**–**	**41,262**	**–**	**a**
Corporate debt securities, primarily U.S. securities	**65,899**	**–**	**65,899**	**–**	**a,c**
Registered investment funds:					
U.S. equities	**8,310**	**8,310**			**a**
International equities	**25,698**	**25,698**	**–**	**–**	**a**
Total assets whose use is limited	**$ 434,178**	**$ 327,017**	**$ 107,161**	**$ –**	
2012					
Assets whose use is limited:					
Money market	$ 149,642	$ 149,642	$ –	$ –	a
Equities, primarily U.S. equities	24,995	24,995	–	–	a
U.S. Treasury securities	34,715	34,715	–	–	a,c
Government agency	81,115	–	81,115	–	a
Corporate debt securities, primarily U.S. securities	18,079	–	18,079	–	a,c
Registered investment funds:					
U.S. equities	60,748	60,748	–	–	a
International equities	21,772	21,772	–	–	a
Total assets whose use is limited	$ 391,066	$ 291,872	$ 99,194	$ –	

6. Assets Whose Use Is Limited

A summary of assets whose use is limited at June 30, follows:

	2013	2012
	(In Thousands)	
Restricted by the Board for capital improvements	**$ 433,594**	$ 390,482
Bond project fund restricted for property construction and equipment acquisition	**584**	584
	$ 434,178	$ 391,066

A summary of investment income, net, for the years ended June 30, follows:

	2013	2012
	(In Thousands)	
Interest income	**$ 5,738**	$ 3,655
Realized gain, net	**4,179**	1,713
Unrealized gain (loss), net	**14,231**	(936)
	$ 24,148	$ 4,432

7. Property and Equipment

A summary of property and equipment, at June 30, follows:

	2013	2012
	(In Thousands)	
Land and improvements	**$ 20,757**	$ 21,146
Buildings and improvements	**273,424**	268,295
Equipment	**249,735**	239,809
	543,916	529,250
Less accumulated depreciation	**326,791**	305,839
	217,125	223,411
Construction in progress	**17,455**	14,405
	$ 234,580	$ 237,816

8. Long-Term Debt

A summary of long-term debt, at June 30, follows:

	2013	2012
	(In Thousands)	
Series 2008A Hospital Revenue Refunding Bonds, collateralized by property and equipment, bearing a variable rate of interest that is based on the Federal Funds Rate as defined by the related bond agreement. Principal is due in semiannual installments ranging from $870,000 to $1,596,705 through July 2033. The average interest rate for the years ended June 30, 2013 and 2012 was 1.0%.	**$ 48,677**	$ 51,322
Series 2008B Hospital Revenue Bonds, collateralized by property and equipment, bearing a variable rate of interest that is determined weekly as defined by the bond agreement. Principal is due in annual installments up to $4,575,000 through December 2039. The average interest rate for the years ended June 30, 2013 and 2012 was 0.60% and 0.91%, respectively.	**47,840**	48,945
Series 2011 Hospital Revenue Bonds, collateralized by property and equipment, bearing interest rates fixed annually ranging from 3% to 5% as defined in the bond agreement. Principal is due in annual installments ranging from $1,000,000 to $6,480,000 through October 2026. The unamortized premium was approximately $5,496,536 at June 30, 2013. The bond premium is amortized using straight-line method over the life of the bonds, which approximates the effective interest method. The average interest rate for the year ended June 30, 2013 and 2012 was 4.7%.	**74,271**	78,382
Other	**236**	568
	171,024	179,217
Less current portion	**6,617**	6,585
Long-term debt	**$ 164,407**	$ 172,632

8. Long-Term Debt (continued)

The bond agreements relating to certain loans place restrictions on the operations of the Obligated Group members, which among other things includes minimum debt service coverage ratios, minimum liquidity ratios, limits on encumbrances and liens, and minimum insurance coverage. At June 30, 2013, the Obligated Group was in compliance with these debt covenants.

The Series 2008B Hospital Revenue Bonds are demand securities that are secured by a direct pay letter of credit. Any draws on the direct pay letter of credit are to be repaid over a two-year period commencing 18 months after the draw date. The direct pay letter of credit terminates in December 2014. There were no draws on the direct pay letter of credit as of June 30, 2013.

In October 2011, the Corporation issued the Series 2011 Hospital Revenue Bonds. The proceeds were used to redeem and repay the Series 1998 Hospital Revenue Bonds and the Series 1996A Hospital Revenue Bonds. A loss on debt extinguishment, amounting to $2,651,000, has been recorded for the year ended June 30, 2012, primarily relating to the write off of the Series 1998 and 1996A Hospital Revenue Bonds unamortized bond issue costs and unamortized discount.

The estimated fair value of the Corporation's long-term debt, at June 30, 2013 and 2012, approximated $173,487,000 and $183,382,000, respectively. The estimated fair value was determined based on quoted market values for identical or comparable debt obligations.

Principal maturities of long-term debt for each of the next five years ended June 30 and in the aggregate thereafter follow:

	(In Thousands)
2014	$ 6,617
2015	7,378
2016	7,603
2017	7,795
2018	8,068
Thereafter	133,563
	$ 171,024

8. Long-Term Debt (continued)

A summary of bond interest costs, for the years ended June 30, follows:

	2013	2012
	(In Thousands)	
Interest cost:		
Charged to operations	**$ 3,358**	$ 3,954
Capitalized	**94**	108
Total	**$ 3,452**	$ 4,062

9. Pension Plans

Defined Benefit Pension Plan

The Corporation has a noncontributory defined benefit pension plan (Pension Plan), which covers substantially all of its employees whose employment began prior to July 1, 2000. The Pension Plan is frozen to employees that commenced employment after July 1, 2000. The Pension Plan provides a defined benefit based on years of service and final average salary. The Corporation uses a measurement date of June 30 for the Pension Plan.

The Corporation recognizes the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligation) of its Pension Plan on the consolidated statements of financial position, with a corresponding adjustment to net assets. The following table sets forth the Corporation's defined benefit pension plan funded status as of June 30 (using measurement dates of June 30, 2013 and 2012, respectively), as provided by consulting actuaries:

	2013	2012
	(In Thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 213,125**	$ 159,648
Service cost	**6,619**	5,260
Interest cost	**8,955**	9,170
Actuarial (gain) loss	**(8,785)**	43,848
Benefit payments	**(16,391)**	(4,801)
Benefit obligation at end of year	**$ 203,523**	$ 213,125

9. Pension Plans (continued)

	2013	2012
	(In Thousands)	
Change in plan assets:		
Fair value of plan assets at beginning of year	**$ 118,513**	$ 100,218
Actual return on plan assets	**12,453**	535
Employer contribution	**18,474**	22,561
Benefit payments	**(16,391)**	(4,801)
Fair value of plan assets at end of year	**$ 133,049**	$ 118,513
Accrued pension liability	**$ (70,474)**	$ (94,612)
Unrecognized net actuarial loss	**88,077**	108,155
Unrecognized prior service cost	**95**	112

The accumulated benefit obligation for the defined benefit plan was $181,863,000 and $184,017,000 at June 30, 2013 and 2012, respectively.

Net pension cost includes the following components for the years ended June 30:

	2013	2012
	(In Thousands)	
Service cost	**$ 6,619**	$ 5,260
Interest cost	**8,955**	9,170
Expected return on plan assets	**(9,162)**	(9,124)
Recognized net actuarial loss	**8,002**	3,964
Amortization of prior service cost	**17**	17
Net periodic pension cost	**$ 14,431**	$ 9,287

Weighted-average assumptions used to determine benefit obligations, at June 30, were:

	2013	2012
Discount rate	**4.8%**	4.3%
Rate of compensation increase	**3.0**	3.0
Expected return on plan assets	**7.5**	7.5

9. Pension Plans (continued)

The Pension Plan's asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors, and manager style to minimize the risk of large losses. The Corporation uses investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines, which include allowable and/or prohibited investment types. The Corporation regularly monitors manager performance and compliance with investment guidelines.

The target allocations for plan assets are 50-80% equity securities, 20-40% fixed income securities, and 0-10% cash. Equity and registered investment fund securities include U.S. and international investments and range from large-cap to small-cap companies. Fixed income securities include corporate debt securities of companies from diversified industries, mortgage-backed securities, and U.S. Treasury securities. The expected rate of return actuarial assumption considers the historical long-term rate of return of assets across all of these asset classes.

The fair values of the Pension Plan's assets at June 30, by asset category and fair value hierarchy level, are as follows:

Asset Category	Balance at June 30, 2013	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a,b,c)
		(In Thousands)			
Money market	$ 8,822	$ 8,822	$ –	$ –	a
U.S. Treasury securities	11,380	11,380	–	–	a
Government agency	8,426	–	8,426	–	a,c
Municipal bonds	2,036	–	2,036	–	a,c
Corporate debt securities, primarily U.S. securities	482	–	482	–	a
Equities, primarily U.S. equities	17,050	17,050	–	–	a
Registered investment funds:					
Bond fund	15,000	–	15,000	–	a
U.S. equities	48,683	48,683	–	–	a
International equities	21,170	21,170	–	–	a
	$ 133,049	$ 107,105	$ 25,944	$ –	

9. Pension Plans (continued)

Asset Category	Balance at June 30, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a,b,c)
	(In Thousands)				
Money market	$ 26,990	$ 26,990	$ –	$ –	a
U.S. Treasury securities	12,214	12,214	–	–	a,c
Government agency	17,498	–	17,498	–	a
Municipal bonds	2,325	–	2,325	–	a,c
Corporate debt securities, primarily U.S. securities	2,249	–	2,249	–	a,c
Equities, primarily U.S. equities	12,772	12,772	–	–	a
Registered investment funds:					
U.S. equities	33,432	33,432	–	–	a
International equities	11,033	11,033	–	–	a
	$ 118,513	$ 96,441	$ 22,072	$ –	

The Corporation will be required to contribute $9,403,000 to its Pension Plan in fiscal year 2014.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

2014	$ 6,404
2015	7,118
2016	7,916
2017	8,758
2018	9,610
Years 2019 – 2024	61,258

During 2013, the Corporation settled certain participants vested pension obligations. The Corporation paid $11,020,000 in benefit payments to the participants in connection with this settlement.

9. Pension Plans (continued)

401(k) Plan

The Corporation sponsors a 401(k) plan (the 401(k) Plan) for the Corporation's employees. The 401(k) plan allows employees to contribute funds through a pre-tax option and an after-tax option. Both options follow the same guidelines for employee and Corporation contributions. All of the Corporation's employees may participate in the 401(k) Plan; however, only employees with hire dates subsequent to June 30, 2000, are eligible for contributions from the Corporation. For employees with hire dates subsequent to June 30, 2000, the Corporation will match 50% of each employee's contribution up to 4% of his or her salary. For employees with hire dates subsequent to June 30, 2000, the Corporation also contributes 2% of each employee's salary to the 401(k) Plan, regardless of the employee's contribution. This 2% contribution is a discretionary contribution and employees must still be employed on December 31st of that year in order to be eligible for the discretionary contribution. Employees immediately vest in their own contributions to the 401(k) Plan, vest in the employer pay period match after three years, and vest in the year-end discretionary employer contributions after three years of qualifying service. The Corporation's contributions to the 401(k) Plan totaled $4,762,000 in 2013 and $4,352,000 in 2012.

10. Commitments and Contingent Liabilities

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Other than normative operational or licensure citations or shortcomings of the nature commonly found in surveys of hospitals and other customary regulatory matters that are subject to the active attention of the Corporation's administration and legal department, management believes the Corporation is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

10. Commitments and Contingent Liabilities (continued)

Insurance

The Corporation retains a layer of liability for employee health and dental benefits up to $200,000 per employee, or dependent, and has purchased insurance for claims incurred per employee or dependent in excess of this amount. The Corporation has recorded $3,301,000 and $3,943,000 for employee health and dental benefit obligations as of June 30, 2013 and 2012, respectively.

The Corporation purchases professional and general liability insurance to cover medical malpractice claims for physicians and professional and general liability insurance for the hospitals and physician liabilities. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Through June 30, 2002, the Corporation's professional and general liability insurance had a per claim self-insured retention of $50,000 under a claims-made insurance policy. Effective July 1, 2002, the Corporation began retaining liability for professional and general liability claims up to $1,000,000 per claim under a claims-made insurance policy. In August 2012, the Corporation added an additional $1,000,000 per claim buffer. The Corporation also purchased insurance to cover physician's professional and general liability with a per claim self-insured retention of $100,000 under a claims-made insurance policy.

The Corporation records a liability for estimates of future payments related to professional and general claims that have not been paid as of year-end. A portion of this estimated payable represents an estimate of claims incurred but not reported (IBNR) to the Corporation. The IBNR claims estimate is developed using actuarial assumptions based upon payment patterns, historical development, and other relevant factors. Those estimates are subject to the effects of trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves of unpaid claims are adequate. The estimates are periodically reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations. Related to professional and general liability claims, at June 30, 2013 and 2012, the Corporation recorded an undiscounted estimated self-insurance obligation of approximately $5,936,000 and $5,260,000, respectively, in accrued expenses and other liabilities in the consolidated statements of financial position, which includes the liability to be paid by the Corporation's excess insurance carrier. The Corporation purchases excess insurance coverage for claims in excess of the Corporation's self insured retention limit of $1,000,000 per claim and $2,000,000 in aggregate. The Corporation recorded a

10. Commitments and Contingent Liabilities (continued)

liability and a corresponding insurance recovery of approximately $2,058,000 and $500,000 as of June 30, 2013 and 2012, respectively, relating to the estimated professional and general liability claims to be covered by the excess insurance carriers.

The Corporation is insured for workers compensation claims under a first dollar coverage plan whereby the insurer has assumed full risk for the workers compensation claims. Accordingly, the Corporation has not recorded any insurance recovery or claim liability associated with workers compensation claims.

11. Subsequent Event

On July 1, 2013, the Corporation purchased $72,750,000 of alternative investments from the cash and cash equivalents included in the Corporation’s investment portfolio (see Note 5). There are no redemption restrictions or lock-up period associated with the alternative investment agreements. In addition, there are no capital call requirements.

Supplementary Information

1308-1119523

ERNST & YOUNG

Ernst & Young LLP
Ernst & Young Tower
One Renaissance Square
Suite 2300
2 North Central Avenue
Phoenix, AZ 85004

Tel: +1 602 322 3000
Fax: +1 602 322 3023
www.ey.com

Independent Auditors' Report on Supplementary Information

Board of Directors
Northern Arizona Healthcare Corporation

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating statement of financial position and the consolidating statement of activities are presented for purposes of additional analysis and are not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 consolidated financial statements as a whole.

Ernst & Young LLP

September 27, 2013

Northern Arizona Healthcare Corporation and Affiliates

Consolidating Statement of Financial Position

(In Thousands)

June 30, 2013

	VVMC	FMC	Subtotal Obligated Group	NAHPG	NAHC Administration	NAHC Home Health and Hospice	Intercompany Eliminations	Consolidated
Assets								
Current assets:								
Cash and cash equivalents	$ 17,196	$ 34,892	$ 52,088	$ 19,162	$ 5,560	$ 2,738	$ –	$ 79,548
Accounts receivable, net	18,441	58,449	76,890	3,498	–	413	–	80,801
Inventories	2,409	6,967	9,376	–	–	25	–	9,401
Prepaid expenses and other	15,823	27,256	43,079	(30,658)	2,964	–	(5,689)	9,696
Total current assets	53,869	127,564	181,433	(7,998)	8,524	3,176	(5,689)	179,446
Assets whose use is limited	120,928	313,250	434,178	–	–	–	–	434,178
Property and equipment, net	67,715	134,787	202,502	3,129	28,664	285	–	234,580
Deferred charges and other assets	4,900	1,269	6,169	–	3,473	–	10,107	19,749
Total assets	$ 247,412	$ 576,870	824,282	$ (4,869)	$ 40,661	$ 3,461	$ 4,418	$ 867,953
Liabilities and net assets								
Current liabilities:								
Accounts payable	$ 2,299	$ 9,839	12,138	$ 373	$ 39	$ 3	$ –	$ 12,553
Accrued expenses	14,005	22,371	36,376	2,688	4,592	386	(5,689)	38,353
Current portion of long-term debt	1,843	4,774	6,617		–	–	–	6,617
Third-party payor settlements	653	1,300	1,953		–	–	–	1,953
Total current liabilities	18,800	38,284	57,084	3,061	4,631	389	(5,689)	59,476
Long-term debt, less current portion	50,404	114,003	164,407	–	–	–	–	164,407
Accrued pension liability	21,495	43,553	65,048	–	5,426	–	–	70,474
Other liabilities	1,726	3,378	5,104	936	11	–	–	6,051
Total liabilities	92,425	199,218	291,643	3,997	10,068	389	(5,689)	300,408
Net assets	154,987	377,652	532,639	(8,866)	30,593	3,072	10,107	567,545
Total liabilities and net assets	$ 247,412	$ 576,870	$ 824,282	$ (4,869)	$ 40,661	$ 3,461	$ 4,418	$ 867,953

1308-1119523

Northern Arizona Healthcare Corporation and Affiliates

Consolidating Statement of Activities

(In Thousands)

Year Ended June 30, 2013

	VVMC	FMC	Subtotal Obligated Group	NAHPG	NAHC Administration	NAHC Home Health and Hospice	Intercompany Eliminations	Consolidated
Revenue:								
Net patient service	$ 174,990	$ 419,382	$ 594,372	$ 24,445	$ –	$ 4,487	$ –	$ 623,304
Provision for doubtful accounts	(34,854)	(68,369)	(103,223)	(2,138)	–	(77)	–	(105,438)
Net patient service revenue less provision for doubtful accounts	140,136	351,013	491,149	22,307	–	4,410	–	517,866
Other	4,028	10,919	14,947	587	1,595	–	–	17,129
Total revenue	144,164	361,932	506,096	22,894	1,595	4,410	–	534,995
Expenses:								
Salaries and wages	50,754	117,760	168,514	31,211	17,534	2,951	–	220,210
Employee benefits	14,019	33,149	47,168	6,196	3,226	748	–	57,338
Professional fees	2,527	13,690	16,217	2,895	1,057	41	–	20,210
Supplies, services and other	34,472	96,011	130,483	7,723	29,941	1,221	–	169,368
Depreciation and amortization	10,730	15,566	26,296	669	7,586	2	–	34,553
Interest	755	2,603	3,358	–	–	–	–	3,358
Corporate expense allocation from NAHC	17,572	39,724	57,296	355	(58,350)	699	–	–
Total expenses	130,829	318,503	449,332	49,049	994	5,662	–	505,037
Income (loss) from operations	13,335	43,429	56,764	(26,155)	601	(1,252)	–	29,958
Investment income	4,715	19,430	24,145	–	3	–	–	24,148
Impairment loss	(944)	–	(944)	–	(300)	–	–	(1,244)
Loss from equity investment	(11,043)	(15,102)	(26,145)	–		–	26,145	–
Other	423	534	957	10	(304)	3	–	666
Excess (deficiency) of revenue over expenses	6,486	48,291	54,777	(26,145)	–	(1,249)	26,145	53,528
Decrease in unfunded pension obligation	5,099	13,767	18,866		–	1,229	–	20,095
Increase (decrease) in net assets	11,585	62,058	73,643	(26,145)	–	(20)	26,145	73,623
Net assets at beginning of year	132,307	332,203	464,510	–	26,146	3,266	–	493,922
Net asset transfers from (to) affiliates	11,095	(16,609)	(5,514)	17,279	4,447	(174)	(16,038)	-
Net assets at end of year	$ 154,987	$ 377,652	$ 532,639	$ (8,866)	$ 30,593	$ 3,072	$ 10,107	$ 567,545

Ernst & Young LLP

Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit www.ey.com

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. This Report has been prepared by Ernst & Young LLP, a client serving member firm located in the United States.