
Financial Statements and Report of
Independent Certified Public Accountants

Bayhealth Medical Center, Inc.

June 30, 2013 and 2012

Contents

	Page
Report of Independent Certified Public Accountants	3
Financial statements	
Balance sheets	5
Statements of operations and changes in net assets	6
Statements of cash flows	7
Notes to financial statements	8



Report of Independent Certified Public Accountants

Board of Directors
Bayhealth Medical Center, Inc.

Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080

T 215.561.4200
F 215.561.1066
GrantThornton.com
linkd.in/GrantThorntonUS
twitter.com/GrantThorntonUS

We have audited the accompanying financial statements of Bayhealth Medical Center, Inc. (the Medical Center), which comprise the balance sheets as of June 30, 2013 and 2012, and the related statements of operations and 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 financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 financial position of Bayhealth Medical Center, Inc. as of June 30, 2013 and 2012, and the results of its operations and changes in net assets and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note B18 to the accompanying financial statements, in 2013 the Medical Center changed the presentation of the provision for bad debts on the statements of operations and changes in net assets in accordance with the amendment to the accounting standards.

Grant Thornton LLP

Philadelphia, Pennsylvania

September 27, 2013

BALANCE SHEETS

June 30,

	2013	2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 29,761,191	\$ 27,653,766
Assets limited as to use, held by trustees	5,191,212	4,471,873
Patient accounts receivable, less allowance for uncollectibles of \$23,546,900 in 2013 and \$25,102,800 in 2012	59,448,127	51,487,127
Supplies	9,062,729	7,366,736
Prepaid expenses and other assets	<u>6,818,692</u>	<u>7,014,595</u>
Total current assets	110,281,951	97,994,097
Assets limited as to use		
Internally designated	189,470,681	165,764,913
Held by trustees	<u>12,844,181</u>	<u>12,537,243</u>
	202,314,862	178,302,156
Other investments	226,928,064	205,794,217
Prepaid expenses and other assets	1,422,374	2,043,144
Property and equipment, net	305,205,720	308,314,968
Deferred financing costs, net	2,309,628	2,415,545
Beneficial interest in net assets of Bayhealth Foundation	12,087,334	10,359,012
Beneficial interest in perpetual trusts	<u>5,893,302</u>	<u>5,766,785</u>
TOTAL	<u>\$ 866,443,235</u>	<u>\$ 810,989,924</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and other accrued expenses	\$ 22,061,533	\$ 27,142,045
Construction and retainage payable	296,597	6,414,910
Accrued salaries, wages and benefits	36,994,863	33,688,524
Current portion of long-term debt	3,560,476	1,791,883
Accrued interest payable	3,246,606	3,445,666
Estimated settlements due to third-party payors	<u>6,168,802</u>	<u>11,997,911</u>
Total current liabilities	72,328,877	84,480,939
Interest rate swap	2,704,973	3,960,330
Accrued postretirement benefit costs	46,737,670	60,463,664
Estimated professional liability costs	11,543,882	10,992,393
Estimated workers' compensation costs	4,125,743	4,126,000
Long-term debt, net of current portion	<u>203,230,915</u>	<u>206,871,248</u>
Total liabilities	<u>340,672,060</u>	<u>370,894,574</u>
NET ASSETS		
Unrestricted	515,580,915	429,743,994
Temporarily restricted	4,296,958	4,584,571
Permanently restricted	<u>5,893,302</u>	<u>5,766,785</u>
Total net assets	<u>525,771,175</u>	<u>440,095,350</u>
TOTAL	<u>\$ 866,443,235</u>	<u>\$ 810,989,924</u>

The accompanying notes are an integral part of these statements.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

For the year ended June 30,

	<u>2013</u>	<u>2012</u>
UNRESTRICTED NET ASSETS		
Revenues		
Net patient service revenue	\$ 507,635,497	\$ 479,659,196
Less: provision for bad debts	<u>(36,685,770)</u>	<u>(39,310,218)</u>
Net patient service revenue less provision for bad debts	470,949,727	440,348,978
Other revenue	<u>11,489,276</u>	<u>10,679,149</u>
Total revenues	482,439,003	451,028,127
Expenses		
Salaries and benefits	256,772,259	238,283,549
Supplies and other expenses	151,056,924	145,151,617
Interest	7,963,148	5,663,265
Depreciation and amortization	<u>28,375,464</u>	<u>23,568,786</u>
Total expenses	<u>444,167,795</u>	<u>412,667,217</u>
Operating income	38,271,208	38,360,910
Other income (expense)		
Investment return, net	30,329,211	5,196,658
Change in fair value of interest rate swap	1,255,357	(1,083,527)
Change in beneficial interest in net assets of Bayhealth Foundation	2,007,864	286,804
Other, net	<u>1,992,504</u>	<u>510,694</u>
Total other income, net	<u>35,584,936</u>	<u>4,910,629</u>
Excess of revenues over expenses	73,856,144	43,271,539
OTHER CHANGES IN UNRESTRICTED NET ASSETS		
Change in benefit obligations	<u>11,980,777</u>	<u>(20,111,069)</u>
Increase in unrestricted net assets	<u>85,836,921</u>	<u>23,160,470</u>
TEMPORARILY RESTRICTED NET ASSETS		
Other	(8,071)	43,391
Change in beneficial interest in net assets of Bayhealth Foundation	<u>(279,542)</u>	<u>(39,081)</u>
(Decrease) increase in temporarily restricted net assets	<u>(287,613)</u>	<u>4,310</u>
PERMANENTLY RESTRICTED NET ASSETS		
Change in beneficial interest in perpetual trusts	<u>126,517</u>	<u>(306,035)</u>
Increase (decrease) in permanently restricted net assets	<u>126,517</u>	<u>(306,035)</u>
INCREASE IN NET ASSETS	85,675,825	22,858,745
NET ASSETS, beginning of year	<u>440,095,350</u>	<u>417,236,605</u>
NET ASSETS, end of year	<u>\$ 525,771,175</u>	<u>\$ 440,095,350</u>

The accompanying notes are an integral part of these statements.

STATEMENTS OF CASH FLOWS

For the year ended June 30,

	<u>2013</u>	<u>2012</u>
OPERATING ACTIVITIES		
Increase in net assets	\$ 85,675,825	\$ 22,858,745
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Change in benefit obligations	(11,980,777)	20,111,069
Change in fair value of interest rate swap	(1,255,357)	1,083,527
Net realized and unrealized (gains) losses on investments	(20,917,758)	3,907,678
Depreciation and amortization	28,375,464	23,568,786
Provision for bad debts	36,685,770	39,310,218
Change in beneficial interest in perpetual trusts	(126,517)	306,035
Change in beneficial interest in net assets of Bayhealth Foundation	(1,728,322)	(247,723)
Changes in assets and liabilities		
Patient accounts receivable - net	(44,646,770)	(40,145,228)
Supplies	(1,695,993)	(937,145)
Prepaid expenses and other assets	816,673	(1,406,925)
Accounts payable and other accrued expenses	(5,369,216)	2,146,162
Accrued salaries, wages, and benefits	3,306,339	997,074
Accrued interest payable	(199,060)	(25,965)
Estimated settlements due to third-party payors	(5,829,109)	1,077,321
Accrued postretirement benefit costs	(1,645,217)	(1,279,803)
Estimated professional liability costs	865,646	(242,154)
Estimated workers' compensation costs	(125,710)	(66,000)
	<u>60,205,911</u>	<u>71,015,672</u>
Net cash provided by operating activities before trading securities		
Change in investments - trading securities	<u>(24,934,634)</u>	<u>(21,394,120)</u>
Net cash provided by operating activities	<u>35,271,277</u>	<u>49,621,552</u>
INVESTING ACTIVITIES		
Capital expenditures, net	(31,358,469)	(62,100,528)
Change in investments - other than trading securities	<u>(13,500)</u>	<u>23,651,274</u>
Net cash used in investing activities	<u>(31,371,969)</u>	<u>(38,449,254)</u>
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	-	71,200,000
Financing costs incurred	-	(220,000)
Repayment of long-term debt	<u>(1,791,883)</u>	<u>(74,071,766)</u>
Net cash used in financing activities	<u>(1,791,883)</u>	<u>(3,091,766)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,107,425	8,080,532
CASH AND CASH EQUIVALENTS - beginning of year	<u>27,653,766</u>	<u>19,573,234</u>
CASH AND CASH EQUIVALENTS - end of year	<u>\$ 29,761,191</u>	<u>\$ 27,653,766</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for interest, net of amounts capitalized	<u>\$ 7,764,088</u>	<u>\$ 5,689,230</u>
SUPPLEMENTAL NONCASH INVESTING ACTIVITIES		
Decrease in accrual for the purchase of property and equipment	<u>\$ (6,118,313)</u>	<u>\$ (1,493,969)</u>
Capital lease obligation in exchange for equipment	<u>\$ -</u>	<u>\$ 894,973</u>

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

NOTE A - DESCRIPTION OF ORGANIZATION

Organization

Bayhealth Medical Center, Inc. (the Medical Center) is a not-for-profit, tax-exempt corporation under the control of its parent, Bayhealth, Inc., a not-for-profit Delaware corporation whose primary activities are to provide development and planning support to the Medical Center's two acute care hospitals: Kent General Hospital, Dover, Delaware, and Milford Memorial Hospital, Inc., Milford, Delaware. The Medical Center's primary service area includes Kent and portions of Sussex Counties in Delaware. Other entities affiliated with the Medical Center through common control by Bayhealth, Inc. are Bayhealth Foundation (the Foundation) and Bayhealth Development Corporation.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant management estimates and assumptions relate to the determination of allowance for doubtful accounts and contractual allowances for patient accounts receivable, estimated settlements with third-party payors, fair value of the interest rate swap, useful lives of property and equipment, actuarial estimates for the postretirement benefit plans, professional liability and workers' compensations costs and the assets retirement obligation and the reported fair values of certain of the Medical Center's assets and liabilities. Actual results could differ from those estimates.

2. Fair Value of Financial Instruments

Financial instruments consist of cash equivalents, patient accounts receivable, investments and assets limited as to use, beneficial interest in perpetual trusts, accounts payable and accrued expenses, interest rate swap agreements and long-term debt. The carrying amounts reported in the balance sheets for cash equivalents, patient accounts receivable, investments and assets limited as to use, beneficial interest in perpetual trusts, accounts payable and accrued expenses and the interest rate swap agreement approximate fair value. Management's estimate of the fair value of other financial instruments is described elsewhere in the notes to the financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents include short-term investments purchased with original maturities of three months or less and are stated at fair value.

The Medical Center routinely invests its surplus funds in repurchase agreements and money market funds. These funds generally are collateralized by, or invested in, highly liquid U.S. Government and agency obligations.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

4. Allowance for Doubtful Accounts

The Medical Center provides an allowance for doubtful accounts for estimated losses resulting from the unwillingness or inability of patients to make payments for services. The allowance is determined by analyzing specific accounts and historical data and trends. Patient accounts receivable are charged off against the allowance for doubtful accounts when management determines that recovery is unlikely and the Medical Center ceases collection efforts.

In evaluating the collectability of accounts receivable, the Medical Center analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management reviews data about these major payor 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, the Medical Center analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid). For receivables associated with self-pay patients, the Medical Center records a significant provision for bad debts on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable internal collection efforts have been exhausted is charged off against the allowance for doubtful accounts. The Medical Center in 2013 experienced an approximately 6 percent decrease in the allowance for doubtful accounts due to changes in charity care and improved collection efforts.

5. Supplies

Supplies are stated at the lower of cost or market. Cost is determined by using the first-in, first-out method of accounting.

6. Investments and Assets Limited as to Use

Investments in debt and equity securities are measured at fair value based on quoted market prices, if available, or estimated quoted market prices for similar securities. A limited partnership is carried at its net asset value per share, as a practical expedient, as provided by the investment managers. The limited partnership is an alternative investment, in which the underlying investments are in limited partnerships, limited liability companies, offshore corporations and other foreign investment vehicles, private equity funds, real estate funds and direct investments in marketable securities and derivative instruments. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. The Medical Center's investments are designated as trading securities, except for assets limited as to use under bond indentures - held by trustee, which are considered other-than-trading securities.

Alternative investments may contain elements of both credit risk and market risk. Such risks include, but are not limited to: limited liquidity, absence of oversight, dependence on key individuals, emphasis on speculative investments, and nondisclosure of portfolio composition. The Medical Center reviews and evaluates the values

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investment. The Medical Center requested, received and reviewed the interim financial information at June 30, 2013 and 2012 from the investment manager.

Investment income includes dividend and interest income; realized gains and losses and unrealized gains and losses on trading securities are included in other income (expense) as a component of excess of revenues over expenses unless such earnings are subject to donor-imposed restrictions; and unrealized gains and losses on other-than-trading securities are recorded as other changes in unrestricted net assets. Realized gains and losses for all investments are determined by the average cost method.

Assets limited as to use include internally designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, assets held by trustees under bond indenture agreements and assets held by a trustee under a malpractice funding arrangement. Amounts required to meet current liabilities have been classified as current assets in the accompanying balance sheets.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the financial statements.

7. Beneficial Interest in Perpetual Trusts

The Medical Center is an irrevocable income beneficiary of certain perpetual trusts administered by independent trustees. Because the trusts are perpetual and the original corpus cannot be violated, these funds are reported at fair value based on the Medical Center's interest in the trusts, as permanently restricted net assets.

8. Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated assets are recorded at their fair value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Equipment under capital lease is amortized by the straight-line method over the shorter 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.

Expenditures for renewals and improvements are charged to the property accounts. Replacements, maintenance and repairs that do not improve or extend the life of the respective assets are expensed when incurred. The Medical Center removes the cost and the related accumulated depreciation from the accounts for assets sold or retired, and resulting gains or losses are included in the accompanying statements of operations and changes in net assets.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Gifts of long-lived assets such as land, building 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 unspent 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.

9. Deferred Financing Costs

Deferred financing costs are amortized over the life of the related bond issue. The accumulated amortization totaled \$390,086 and \$284,169 at June 30, 2013 and 2012, respectively.

10. Derivative Financial Instruments

The Medical Center recognizes all derivative financial instruments in the balance sheets at fair value. Management has determined that the interest rate swap agreement does not qualify as a hedge for financial reporting purposes. Consequently, the change in the fair value of the Medical Center's interest rate swap agreement is included in other income (expense) as a component of excess of revenues over expenses in the statements of operations and changes in net assets.

The interest rate swap agreement is used by the Medical Center to manage interest rate exposures and to hedge the changes in cash flows on variable rate revenue bonds. Derivative financial instruments involve, to a varying degree, elements of market and credit risk. The market risk associated with these instruments resulting from interest rate movements is expected to offset the market risk of the liability being hedged.

11. Estimated Professional Liability Costs

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

12. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose and amounted to \$1,011,063 and \$1,019,134 as of June 30, 2013 and 2012, respectively. In addition, a portion of the beneficial interest in the net assets of Bayhealth Foundation is included in temporarily restricted net assets based on the donors' intention. The temporarily restricted net assets are primarily restricted for capital acquisitions.

Permanently restricted net assets represent the Medical Center's beneficial interest in perpetual trusts. Income received from these trusts is unrestricted.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

13. Excess of Revenues over Expenses

The statements of operations and changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets that are excluded from the excess of revenues over expenses, consistent with industry practice, are changes in benefit obligations.

14. Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires - that is, when a stipulated time restriction ends or purpose restriction is accomplished - temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions, including amounts received and held by Bayhealth Foundation for the benefit of the Medical Center in the accompanying financial statements.

15. Net Patient Service Revenue

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

16. Charity Care and Community Service

The Medical Center provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than its established rates. Criteria for charity care include the patient's family income and net worth. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as net revenue.

The Medical Center maintains records to identify and monitor the level of charity care and community service it provides. These records include the amount of charges foregone based on established rates for services and supplies furnished under its charity care and community service policies and the number of patients receiving services under these policies. The Medical Center provided \$5,696,291 and \$5,510,808 for the years ended June 30, 2013 and 2012, respectively, of charity care at full cost including direct and indirect costs, based on the actual charity population using a cost accounting system.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Additionally, the Medical Center provides a wide range of community services to the general public. These include but are not limited to the following: free health screenings for breast cancer, prostate cancer, skin cancer, diabetes, high blood pressure, high blood cholesterol, hearing loss and glaucoma; free educational programs on a variety of health care topics; health fairs and demonstrations; and networking and coordination of services for the needy, elderly, and disabled. These community services are offered at the Medical Center and at schools, businesses, and other locations throughout the Medical Center's service area.

The Medical Center also participates in the Medicaid program, which makes payment for services provided to financially needy patients at rates which are less than the established charges for such services.

17. Tax Status

The Medical Center is a Delaware nonprofit corporation and is exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Medical Center follows the accounting guidance for uncertainties in income tax positions which requires that a tax position be recognized or derecognized based on a "more likely than not" threshold. This applies to positions taken or expected to be taken in a tax return. The Medical Center does not believe its financial statements include any material uncertain tax positions. At June 30, 2013, the Medical Center's tax years ended June 30, 2011 through 2013 for the federal tax jurisdiction remain open.

18. Recently Adopted Accounting Pronouncement

In July 2011, the Financial Accounting Standards Board (FASB) issued authoritative guidance to provide amendments to the presentation of the statement of operations for certain health care entities and enhanced disclosure about net patient service revenue and the related allowance for doubtful accounts. These amendments require certain health care entities to present their provision for bad debts associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts). These amendments also require disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. Additionally, health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. This guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011. The amendments to the presentation of the provision for bad debts related to patient service revenue in the statement of operations should be applied retrospectively to all prior periods presented. The disclosures required by the amendments in this update should be provided for the period of adoption and subsequent reporting periods. The Medical Center adopted this guidance as of and for the year ended June 30, 2013 and retrospectively applied the presentation requirements to all periods presented. The change in presentation and additional disclosures are reflected in the Medical Center's statement of operations and changes in net assets and in Note C. The new guidance did not affect the results of operations and financial position.

19. Reclassifications

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements. These reclassifications had no impact on total assets, total liabilities, and net assets or excess of revenues over expenses previously reported.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE C - NET PATIENT SERVICE REVENUE

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

Medicare and Medicaid - Inpatient acute care services provided to Medicare and Medicaid 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. The Medical Center is reimbursed for certain cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by Medicare. Medicare reimburses for most outpatient services on the Outpatient Prospective Payment System (OPPS). Medicaid outpatient services are paid based on a fee schedule. The Medical Center's Medicare cost reports have been audited and finalized by the Medicare fiscal intermediary through June 30, 2005.

Blue Cross of Delaware - Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed primarily on a discount from established charge basis.

Net revenue from the Medicare and Medicaid programs accounted for approximately 27% and 18%, and 33% and 18%, respectively, of the Medical Center's net patient service revenue for the years ended June 30, 2013 and 2012, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. For the years ended June 30, 2013 and 2012, net patient service revenue reflects a net increase of approximately \$6,127,500 and \$4,458,000, respectively, due to final settlements or estimate changes.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment to the Medical Center under these agreements is primarily on a discount from established charges basis but also includes prospectively determined daily rates and prospectively determined fee schedules.

For uninsured patients who do not qualify for charity care, the Medical Center recognizes revenue based on established rates, subject to certain discounts as determined by the Medical Center. An estimated provision for bad debts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The Medical Center has determined that patient service revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for bad debts related to patient revenue is recorded as a deduction from patient service revenue in the accompanying statements of operations and changes in net assets.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE C - NET PATIENT SERVICE REVENUE - Continued

Patient service revenue for the year ended June 30, 2013, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources based on primary insurance designation, is as follows:

	<u>Third-Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances and discounts)	90%	10%	100%

Deductibles and copayments under third-party payment programs within the third-party payor amount above are patients' responsibility, and the Medical Center considers these amounts in its determination of the provision for bad debts based on collection experience.

NOTE D - ASSETS LIMITED AS TO USE AND OTHER INVESTMENTS

Assets Limited as to Use

As of June 30, assets limited as to use consisted of the following:

	<u>2013</u>	<u>2012</u>
Internally designated		
Cash and cash equivalents	\$ 20,077,333	\$ 19,230,412
Government securities and corporate bonds	98,867,883	94,915,847
Equity securities	69,633,802	50,591,895
Accrued interest receivable	<u>891,663</u>	<u>1,026,759</u>
	<u>\$ 189,470,681</u>	<u>\$ 165,764,913</u>
Held by trustees		
Under bond indenture agreements		
Cash and cash equivalents	\$ <u>4,936,831</u>	\$ <u>4,923,331</u>
Under malpractice funding arrangement		
Cash and cash equivalents	568,746	627,126
Government securities and corporate bonds	6,016,669	5,483,356
Equity securities	<u>6,513,147</u>	<u>5,975,303</u>
	<u>13,098,562</u>	<u>12,085,785</u>
Total held by trustees	18,035,393	17,009,116
Less amounts required for current liabilities	<u>(5,191,212)</u>	<u>(4,471,873)</u>
	<u>\$ 12,844,181</u>	<u>\$ 12,537,243</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE D - ASSETS LIMITED AS TO USE AND OTHER INVESTMENTS - Continued

Other Investments

Other investments at June 30 consisted of:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 9,137,750	\$ 12,894,706
Government securities and corporate bonds	36,314,550	37,105,661
Equity securities	177,012,864	150,992,602
Alternative investments	4,459,819	4,797,959
Accrued interest receivable	<u>3,081</u>	<u>3,289</u>
	<u>\$ 226,928,064</u>	<u>\$ 205,794,217</u>

Investment Return

The following schedule summarizes the Medical Center's investment return on assets limited as to use and other investments in other income (expense) on the statements of operations and changes in net assets for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Investment return, net		
Interest and dividend income	\$ 9,411,453	\$ 9,104,336
Net realized gains on sales of securities	3,790,122	22,274,178
Change in net unrealized gains and losses on trading securities	<u>17,127,636</u>	<u>(26,181,856)</u>
	<u>\$ 30,329,211</u>	<u>\$ 5,196,658</u>

NOTE E - PROPERTY AND EQUIPMENT

Property and equipment at June 30 consisted of:

	<u>Estimated useful life</u>	<u>2013</u>	<u>2012</u>
Land		\$ 12,489,962	\$ 12,317,767
Land improvements	2 to 25 years	3,347,445	3,330,720
Buildings and improvements	5 to 40 years	259,768,636	241,532,525
Major movable and fixed equipment	3 to 20 years	244,809,833	221,767,606
Construction in progress		<u>3,444,665</u>	<u>21,204,270</u>
		523,860,541	500,152,888
Less accumulated depreciation and amortization		<u>(218,654,821)</u>	<u>(191,837,920)</u>
		<u>\$ 305,205,720</u>	<u>\$ 308,314,968</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE E - PROPERTY AND EQUIPMENT - Continued

Depreciation and amortization expense for the years ended June 30, 2013 and 2012 totaled \$28,349,404 and \$23,233,073, respectively.

The net amount of assets under capital leases included in major movable and fixed equipment amounted to \$551,900 and \$730,895 at June 30, 2013 and 2012, respectively.

NOTE F - LONG-TERM DEBT

Long-term debt as of June 30, consisted of:

	<u>2013</u>	<u>2012</u>
Project Revenue Bonds, Series 2009A, net of unamortized discount of \$692,646 and \$612,789 at June 30, 2013 and 2012, respectively, and interest rates ranging from 2.25% to 5.00%	\$ 134,947,354	\$ 136,677,211
Variable Rate Refunding Revenue Bonds, Series 2012, variable rate of interest, 0.74% and 0.77% at June 30, 2013 and 2012, respectively	71,200,000	71,200,000
Capital leases at various interest rates	<u>644,037</u>	<u>785,920</u>
	206,791,391	208,663,131
Less current portion	<u>(3,560,476)</u>	<u>(1,791,883)</u>
	<u>\$ 203,230,915</u>	<u>\$ 206,871,248</u>

Fair Value

The Medical Center uses quoted market prices in estimating the fair value of the revenue bonds. The fair value of the Medical Center's long-term debt, excluding capital leases, was \$207,900,000 and \$210,955,000 at June 30, 2013 and 2012, respectively.

Bonds

Series 2009A Bonds

In October 2009, the Medical Center entered into a financing arrangement with the Delaware Health Facilities Authority (the Authority) to issue \$138,490,000 Revenue Bonds, Bayhealth Medical Center Project, Series 2009A (Series 2009A). The Series 2009A bonds proceeds were used to extinguish the Series 1999 bonds and finance construction projects and renovations to the Medical Center.

The Series 2009A bonds include serial bonds bearing interest at rates ranging from 2.25% to 4.30%, with maturities annually on July 1 through 2024, with principal payment ranging from \$250,000 to \$2,515,000. Term bonds, bearing interest at rates ranging from 4.50% to 5.00%, with maturities occurring on July 1, 2026 through July 1, 2044, are subject to mandatory sinking fund (principal) payments beginning July 1, 2025, ranging from \$2,625,000 to \$12,215,000 as set forth in the bond indenture agreements. The Series 2009A interest is payable semiannually on each January 1 and July 1.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE F - LONG-TERM DEBT - Continued

Series 2012 Bonds

In June 2012, the Medical Center replaced the \$37,865,000 Variable Rate Refunding Revenue Bonds, Bayhealth Medical Center Project, Series 2009B (Series 2009B); and \$37,865,000 Variable Rate Refunding Revenue Bonds, Bayhealth Medical Center Project, Series 2009C (Series 2009C) with Series 2012 \$72,250,000 Variable Rate Refunding Bonds (Series 2012), that are Direct Bank Purchase Bonds with a national bank.

The Series 2012 bonds have annual sinking fund (principal) payments on July 1 through 2039 ranging from \$1,710,000 to \$3,835,000 and bear interest based on a daily LIBOR rate (as defined), payable monthly until July 1, 2019, at which time the Direct Bank Purchase Agreement expires and can either be extended or the bonds may be repurchased by the Medical Center.

Under the terms of the Loan Agreement, the Medical Center has granted the Authority a mortgage lien on certain Medical Center facilities and has pledged its gross revenues, to the extent permitted by law, to the Authority. The Loan Agreement requires the Medical Center to maintain certain financial covenants, including a debt service coverage ratio and days cash on hand, as defined.

As of June 30, 2013, the principal payments on the Medical Center's long-term debt are as follows:

2014	\$ 3,560,476
2015	3,480,000
2016	3,580,000
2017	3,685,000
2018	3,810,000
Thereafter	<u>189,368,561</u>
	<u>\$ 207,484,037</u>

Capitalized Interest

A summary of interest cost and investment income on borrowed funds held by the trustee under the Series 2009A bonds for the year ended June 30, 2012 is as follows:

Interest cost	
Capitalized	\$ 2,913,486
Charged to operations	<u>3,530,882</u>
Total	<u>\$ 6,444,368</u>
Investment income	
Capitalized	\$ -
Credited to investment return	<u>49,873</u>
Total	<u>\$ 49,873</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE F - LONG-TERM DEBT - Continued

Interest Rate Swap

The Medical Center entered into an interest rate swap agreement in April 2003 to manage its exposure to fluctuations in interest rates relating to the Series 2003 bonds. The interest rate swap does not qualify for hedge accounting. The Series 2003 bonds were extinguished in October 2009; however, the interest rate swap agreement remains in place. The notional amount declines annually until the termination of the agreement on July 1, 2023. As of June 30, 2013 and 2012, the notional amount was \$22,785,000 and \$26,865,000, respectively. Under the agreement, the Medical Center receives a floating rate based on 68% of the 30-day U.S. dollar LIBOR rate and pays a fixed rate of 3.53% each month. The Medical Center recorded a noncash gain (loss) on the fair value of the swap of \$1,255,357 and \$(1,083,527) for the years ended June 30, 2013 and 2012, respectively, with such amounts recorded as other income (expense) in the accompanying statements of operations and changes in net assets. The Medical Center has recorded the fair value of the interest rate swap as a liability of \$2,704,973 and \$3,960,330 at June 30, 2013 and 2012, respectively.

The Medical Center has established policies and procedures to limit the potential for counterparty credit risk, including establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. As a matter of practice, the Medical Center will enter into transactions only with counterparties whose obligations are rated "A-" or above as rated by Standard & Poor's, or "A3" or above as rated by Moody's.

The Medical Center's exposure to credit risk, associated with its derivative financial instruments, is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. As of September 27, 2013, the Medical Center was not exposed to any risk of loss.

NOTE G - POSTRETIREMENT BENEFIT PLANS

The Medical Center sponsors a noncontributory defined benefit pension plan (Pension Plan), covering substantially all employees, which was frozen for all participants effective January 1, 2008, except those whose age and years of vesting service total 65 or more as of December 31, 2007. These grandfathered participants will continue to add to the Pension Plan benefits in the future based on current plan provisions. For all other employees, Pension Plan benefits will not increase after December 31, 2007. Effective January 1, 2008, employees who are not grandfathered in the Pension Plan benefits will be eligible to receive a 3 percent annual retirement saving contribution and an improved matching contribution of 50 percent up to the first 6 percent of eligible compensation for the Bayhealth Medical Center, Inc. 401(k) Savings Plan. The Medical Center's policy is to fund benefit costs accrued subject to limitations under the Employee Retirement Income Security Act of 1974. The actuarial cost method used to compute funding levels is the Projected Unit Credit Method.

In addition, the Medical Center provides certain reimbursement for health care benefits for eligible retirees (Other benefits). Certain employees who retire at age 65, or at age 55 with 10 consecutive years of service, and who are insured under the Medical Center's health insurance plan while an active employee, are eligible for coverage. Effective June 30, 2012, the Medical Center revised its assumption related to the percentage of future retirees that elect coverage and continue to elect coverage post-age 65 based on the updated historical experience. Effective January 1, 2013, the other benefits plan was amended to exclude all new hires, including rehires.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - POSTRETIREMENT BENEFIT PLANS - Continued

The following table summarizes information about the benefit plans:

	Pension benefits		Other benefits	
	June 30,			
	2013	2012	2013	2012
Accumulated benefit obligation	<u>\$ 160,731,516</u>	<u>\$ 158,795,687</u>	<u>N/A</u>	<u>N/A</u>
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 166,248,732	\$ 138,513,336	\$ 12,494,862	\$ 17,145,490
Service cost	2,229,927	2,125,685	539,663	1,006,220
Interest cost	7,748,463	7,839,730	475,470	956,145
Plan amendments	-	-	(1,242,728)	-
Actuarial (gain) loss	(6,028,998)	22,324,708	624,736	(5,877,080)
Benefits paid	<u>(5,089,449)</u>	<u>(4,554,727)</u>	<u>(710,727)</u>	<u>(735,913)</u>
Benefit obligation at end of year	<u>165,108,675</u>	<u>166,248,732</u>	<u>12,181,276</u>	<u>12,494,862</u>
Change in plan assets				
Fair value of the plan assets at beginning of year	117,579,930	113,326,428	-	-
Actual return on plan assets	9,156,688	3,139,236	-	-
Contributions by the Medical Center	8,105,112	5,668,993	710,727	735,913
Benefits paid	<u>(5,089,449)</u>	<u>(4,554,727)</u>	<u>(710,727)</u>	<u>(735,913)</u>
Fair value of the plan assets at end of year	<u>129,752,281</u>	<u>117,579,930</u>	<u>-</u>	<u>-</u>
Funded status at year end	<u>\$ (35,356,394)</u>	<u>\$ (48,668,802)</u>	<u>\$ (12,181,276)</u>	<u>\$ (12,494,862)</u>
Net amounts recognized in the balance sheets consist of				
Current liabilities, as accrued salaries, wages and benefits	\$ -	\$ -	\$ (800,000)	\$ (700,000)
Noncurrent liabilities	<u>(35,356,394)</u>	<u>(48,668,802)</u>	<u>(11,381,276)</u>	<u>(11,794,862)</u>
Accrued retirement benefits	<u>\$ (35,356,394)</u>	<u>\$ (48,668,802)</u>	<u>\$ (12,181,276)</u>	<u>\$ (12,494,862)</u>
Amounts recognized in unrestricted net assets but not yet recognized in net periodic benefit costs consist of				
Net actuarial loss (gain)	\$ 56,760,389	\$ 68,172,762	\$ 423,676	\$ (201,060)
Prior service cost (credit)	<u>43,098</u>	<u>60,448</u>	<u>(1,175,790)</u>	<u>-</u>
	<u>\$ 56,803,487</u>	<u>\$ 68,233,210</u>	<u>\$ (752,114)</u>	<u>\$ (201,060)</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - POSTRETIREMENT BENEFIT PLANS - Continued

	Pension benefits		Other benefits	
	June 30,			
	2013	2012	2013	2012
Components of net periodic benefit cost				
Service cost	\$ 2,229,927	\$ 2,125,685	\$ 539,633	\$ 1,006,220
Interest cost	7,748,463	7,839,730	475,470	956,145
Expected return on plan assets	(8,528,542)	(9,481,015)	-	-
Amortization of prior service cost (credit)	17,350	17,350	(66,908)	-
Amortization of actuarial loss	<u>4,755,229</u>	<u>2,369,836</u>	<u>-</u>	<u>291,152</u>
	6,222,427	2,871,586	948,195	2,253,517
Other changes in benefit obligations recognized in other changes in unrestricted net assets				
Prior service (credit) cost	(17,350)	(17,350)	(1,175,790)	-
Net (gain) loss	<u>(11,412,373)</u>	<u>26,296,651</u>	<u>624,736</u>	<u>(6,168,232)</u>
	(11,429,723)	26,279,301	(551,054)	(6,168,232)
Total recognized in net benefit cost and other changes in unrestricted net assets	<u>\$ (5,207,296)</u>	<u>\$ 29,150,887</u>	<u>\$ 397,141</u>	<u>\$ (3,914,715)</u>

At June 30, 2013, the expected estimated amount from unrestricted net assets into net periodic benefit cost for the next year is:

	Pension benefits		Other benefits	
	2013	2012	2013	2012
Net actuarial loss	\$ 4,328,000		\$ -	
Prior service cost (credit)	<u>17,350</u>		<u>(89,210)</u>	
	<u>\$ 4,345,350</u>		<u>\$ (89,210)</u>	
	Pension benefits		Other benefits	
	June 30,			
	2013	2012	2013	2012
Weighted-average assumptions used to determine benefit obligations were				
Discount rate	5.07%	4.70%	4.59%	4.46%
Rate of compensation increase	3.00%	4.59%	N/A	N/A
Measurement date	June 30	June 30	June 30	June 30

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - POSTRETIREMENT BENEFIT PLANS - Continued

	Pension benefits		Other benefits	
	June 30,			
	2013	2012	2013	2012
Weighted-average assumptions used to determine net periodic benefit costs were				
Discount rate	4.70%	5.76%	4.46%	5.65%
Expected long-term return on plan assets	7.25%	8.25%	N/A	N/A
Rate of compensation increase	4.59%	4.59%	N/A	N/A

The expected long-term rate of return on Pension benefits' total assets is developed based on applying historical average total returns by asset class to the Pension benefits' current asset allocation.

The current health care cost trend rates used to measure the future benefits under the postretirement health care plans are, (1) 8% for pre-65 year old retirees, decreasing to 5% by 2018 and remaining at that level thereafter; and (2) 7% for retirees age 65 and older, decreasing to 5% by 2016 and remaining at that level thereafter. A one percentage-point change in assumed health care cost trend rates would have the following effects on the year ended June 30, 2013:

	<u>1% increase</u>	<u>1% (decrease)</u>
Incremental effect on total service and interest cost components of benefit cost	\$ 91,248	\$ 74,683
Incremental effect on postretirement benefit obligation	\$ 598,953	\$ 502,526

The Pension benefits' weighted average asset allocation as of the measurement dates of June 30, 2013 and 2012, by asset category, follows:

	<u>2013</u>	<u>2012</u>
Asset category		
Cash and cash equivalents	7%	9%
Fixed income	34	38
Equity securities	<u>59</u>	<u>53</u>
Total	<u>100%</u>	<u>100%</u>

The target asset allocation is 60% in equity securities, 35% in fixed income and 5% in cash and cash equivalents.

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - POSTRETIREMENT BENEFIT PLANS - Continued

Fair Value of the Plan Assets

The following fair value hierarchy table presents information about each major category of the Pension benefits' financial assets measured at fair value using the market approach on a recurring basis as of June 30, 2013 and 2012:

		<u>Fair value measurement at report date using</u>		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<u>2013</u>	<u>Total</u>			
Cash and cash equivalents	\$ 8,144,597	\$ 8,144,597	\$ -	\$ -
Fixed income (a)	44,481,848	-	44,481,848	-
Equity securities (b)	<u>77,125,836</u>	<u>77,125,836</u>	<u>-</u>	<u>-</u>
	<u>\$ 129,752,281</u>	<u>\$ 85,270,433</u>	<u>\$ 44,481,848</u>	<u>\$ -</u>
<u>2012</u>				
Cash and cash equivalents	\$ 12,021,074	\$ 12,021,074	\$ -	\$ -
Fixed income (a)	38,955,341	-	38,955,341	-
Equity securities (b)	<u>66,603,515</u>	<u>66,603,515</u>	<u>-</u>	<u>-</u>
	<u>\$ 117,579,930</u>	<u>\$ 78,624,589</u>	<u>\$ 38,955,341</u>	<u>\$ -</u>

(a) Comprised of investment grade bonds of U.S. issuers from various industries and a commingled trust fund.

(b) Comprised of mutual funds investing in at least 90% of assets in common stock of companies with large market capitalizations similar to companies in the Standard & Poor's (S&P) 500 Index.

Investment Strategies

The funding obligations of the Pension benefits are long-term in nature; consequently, the investment of the Pension benefits' assets should have a long-term focus. The Pension benefits' assets are invested in accordance with sound investment practices that emphasize long-term fundamentals. The investment objectives for the plan's assets are:

- To achieve a positive rate of return over the long term that significantly contributes to meeting the Pension benefits' obligations, including actuarial interest and benefit payment obligations;
- To earn long-term returns that keep pace with or exceed the long-run inflation rate;
- To diversify the Pension benefits' assets in order to reduce the risk of wide swings in market value from year to year, or of incurring large losses; and

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - POSTRETIREMENT BENEFIT PLANS - Continued

- To achieve investment results over the long term that compare favorably with those of other benefit plans and of appropriate market indices.

It is expected that these objectives can be obtained through a well-diversified portfolio structure in a manner consistent with this investment policy.

Cash Flows

The Medical Center expects to contribute \$2,500,000 to Pension benefits and \$800,000 to the Other benefits plan for the year ending June 30, 2014. The following benefit payments, which reflect expected future service, as appropriate, are expected to be made in future years:

<u>Years ending June 30,</u>	<u>Pension benefits</u>	<u>Other benefits</u>
2014	\$ 6,300,000	\$ 800,000
2015	6,900,000	900,000
2016	7,600,000	900,000
2017	8,300,000	1,000,000
2018	8,900,000	1,100,000
2019-2023	53,100,000	5,300,000

Defined Contribution Plan

The Medical Center also offers a defined contribution savings plan to all full-time and part-time employees of the Medical Center. The Medical Center matches participant contributions for active participants as of December 31 that have completed at least 1,000 hours of service during the calendar year. The match is 50% of the first 4% of compensation. Effective on January 1, 2008, grandfathered participants will continue to receive a match of 50% of the first 4% of compensation, and for non-grandfathered participants, 50% of the first 6% of compensation. Additionally, non-grandfathered participants also receive a 3% contribution of compensation. The Medical Center's contribution expense for the years ended June 30, 2013 and 2012 was \$7,418,306 and \$6,824,035, respectively.

NOTE H - ESTIMATED PROFESSIONAL LIABILITY COSTS

The Medical Center maintains medical malpractice insurance coverage under an annual claims-made policy with a deductible amount of \$3,000,000 on a per-claim basis and \$9,000,000 in the aggregate. The Medical Center provides for estimated losses which have been reported and losses which have been incurred but not reported. At June 30, 2013 and 2012, the malpractice claims liability totaled \$13,529,411 and \$12,663,765, respectively, including the estimated current portion of this liability, totaling \$1,985,529 and \$1,159,828, reported in accounts payable and other accrued expenses. There is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE I - COMMITMENTS AND CONTINGENCIES

Litigation

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

Operating Leases

The Medical Center leases equipment through lease agreements expiring on various dates through June 2019. Certain of these leases contain options to extend the lease terms. Lease expense for the years ended June 30, 2013 and 2012 was \$2,368,485 and \$2,668,453, respectively. Future minimum lease payments are as follows for the years ending June 30:

2014	\$ 2,257,409
2015	1,943,749
2016	1,456,790
2017	1,138,946
2018	734,764
Thereafter	111,020

NOTE J - CONCENTRATIONS OF CREDIT RISK

The Medical Center grants credit without collateral to patients, most of whom are local residents and are insured under third-party agreements. The mix of net accounts receivable from patients and third-party payors at June 30, 2013 and 2012 was as follows:

	<u>2013</u>	<u>2012</u>
Medicare	21%	20%
Blue Cross	20	18
Medicaid	14	14
Managed care	12	13
Self-pay	14	16
Workers' compensation	7	9
Other	<u>12</u>	<u>10</u>
Total	<u>100%</u>	<u>100%</u>

In addition, the Medical Center invests its cash and cash equivalents primarily with banks and financial institutions. These deposits may be in excess of federally insured limits. Management believes that the credit risk related to these deposits is minimal.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE K - FUNCTIONAL EXPENSES

The Medical Center provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended June 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Healthcare services	\$ 312,734,437	\$ 296,333,954
General and administrative services	<u>131,433,358</u>	<u>116,333,263</u>
	<u>\$ 444,167,795</u>	<u>\$ 412,667,217</u>

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Medical Center measures fair value as the price that would be received to sell an asset or paid to transfer a liability (the exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures.

The fair value hierarchy is broken down into three levels based on the source of inputs: Level 1 - defined as observable inputs such as quoted prices in active markets; Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

In determining fair value, the Medical Center uses the market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

In determining fair value, the Medical Center uses quoted prices and observable inputs. Observable inputs are inputs that market participants would use in pricing the assets or liabilities based on market data obtained from sources independent of the Medical Center.

Financial assets and liabilities carried at fair value are classified in the table below:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>June 30, 2013</u>				
Assets				
Cash and cash equivalents	\$ 64,481,851	\$ -	\$ -	\$ 64,481,851
Equity securities	253,159,813	-	-	253,159,813
Government securities and corporate bonds	141,199,102	-	-	141,199,102
Limited partnership	-	4,459,819	-	4,459,819
Beneficial interest in perpetual trusts	<u>-</u>	<u>-</u>	<u>5,893,302</u>	<u>5,893,302</u>
Total assets	<u>\$ 458,840,766</u>	<u>\$ 4,459,819</u>	<u>\$ 5,893,302</u>	<u>\$ 469,193,887</u>

(Continued)

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>June 30, 2013</u>				
Liabilities				
Interest rate swap	\$ -	\$ 2,704,973	\$ -	\$ 2,704,973
Total liabilities	<u>\$ -</u>	<u>\$ 2,704,973</u>	<u>\$ -</u>	<u>\$ 2,704,973</u>
<u>June 30, 2012</u>				
Assets				
Cash and cash equivalents	\$ 65,329,341	\$ -	\$ -	\$ 65,329,341
Equity securities	207,559,800	-	-	207,559,800
Government securities and corporate bonds	137,504,864	-	-	137,504,864
Limited partnership	-	4,797,959	-	4,797,959
Beneficial interest in perpetual trusts	-	-	5,766,785	5,766,785
Total assets	<u>\$ 410,394,005</u>	<u>\$ 4,797,959</u>	<u>\$ 5,766,785</u>	<u>\$ 420,958,749</u>
Liabilities				
Interest rate swap	\$ -	\$ 3,960,330	\$ -	\$ 3,960,330
Total liabilities	<u>\$ -</u>	<u>\$ 3,960,330</u>	<u>\$ -</u>	<u>\$ 3,960,330</u>

The limited partnership is categorized as Level 2 in the hierarchy above, based on the Medical Center's ability to liquidate at any time with 90 days' notice on a monthly basis.

Net unrealized gains (losses) on the Level 3 assets were \$126,517 and (\$306,035) for the years ended June 30, 2013 and 2012, respectively.

NOTE M - SUBSEQUENT EVENTS

The Medical Center evaluated its June 30, 2013 financial statements for subsequent events through September 27, 2013, the date the financial statements were available to be issued. The Medical Center is not aware of any subsequent events which would require recognition or disclosure in the financial statements.