

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINED FINANCIAL STATEMENTS AND**  
**INDEPENDENT AUDITORS' REPORT**  
**YEARS ENDED JUNE 30, 2013 AND 2012**

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Rex Healthcare, Inc. and Subsidiaries  
Raleigh, North Carolina

### **Report on the Combined Financial Statements**

We have audited the accompanying combined financial statements of Rex Healthcare, Inc. and Subsidiaries ("Rex"), which comprise the combined balance sheets as of June 30, 2013 and 2012, and the related combined statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements.

### ***Management's Responsibility for the Combined Financial Statements***

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

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these combined financial statements based on our 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 audits to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

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

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

## **Opinion**

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Rex as of June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Adoption of New Accounting Pronouncement**

As discussed in Note 2 to the combined financial statements, Rex adopted Governmental Accounting Standards Board Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34* during the year ended June 30, 2013. In accordance with the provisions of that standard, Rex applied the provisions retroactively to all years presented in the combined financial statements.

## **Report on Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 8 and the Schedule of Plan Funding Progress on page 38 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board ("GASB"), who considers it to be an essential part of financial reporting for placing the basic combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## **Report on Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplemental combining schedules on pages 36 and 37 are presented for purposes of additional analysis and are not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.



**CliftonLarsonAllen LLP**

Charlotte, North Carolina  
September 4, 2013

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JUNE 30, 2013 AND 2012**  
**(IN \$000'S)**

**Overview**

The Management's Discussion and Analysis section of the Rex Healthcare, Inc. and Subsidiaries ("Rex") annual financial report is designed to provide a general overview of the financial position and operating results as of and for the fiscal years ended June 30, 2013 and 2012. This discussion and analysis should be read in conjunction with the combined financial statements and related notes which follow this discussion and analysis.

Rex Healthcare, Inc. is a private, not-for-profit health care organization located in Raleigh, North Carolina, and a member of the University of North Carolina Health Care System. The flagship facility is Rex Hospital, Inc., a 433-bed community hospital. Rex has a 119-year history of providing excellent health services. Rex Hospital, Inc. provides comprehensive care, including emergency, general surgery, orthopedics, oncology, vascular, cardiac, gynecology, and obstetric services on its main campus. Rex Hospital, Inc. reaches beyond the hospital setting to provide long-term care and sub-acute rehabilitation in two skilled nursing centers – a 120-bed center in Raleigh and a 107-bed facility in Apex. In Cary, Rex offers wellness and diagnostic services. Rex Surgery Center of Cary provides outpatient surgery services. At its Wakefield campus, Rex provides outpatient surgery, a full cancer center with medical and radiation oncology services, urgent care, diagnostics, family medicine and a wellness center. At its Knightdale campus, Rex provides urgent care, diagnostics, family medicine, wound care and a sleep disorders center. In addition, Rex has a fourth medically supervised wellness center in Garner. Rex operates a home health service, outpatient rehab in three locations, and a senior health center in an underserved market in downtown Raleigh. Rex also provides radiation oncology services in Johnston County. Rex Healthcare of Holly Springs opened during 2012, providing urgent care, diagnostics and physician practices to residents in Southern Wake County.

**Current Year Events**

Rex Healthcare had a successful fiscal year 2013. State regulators granted a Certificate of Need (CON) application for UNC Health Care Heart & Vascular Hospital at Rex's main campus. That project will include the relocation of acute care beds from Rex's aging patient tower, relocation of existing operating rooms, and consolidation of all existing heart and vascular services in to a more convenient and accessible location.

Physician alignment continued to be a priority at Rex during the past fiscal year. Rex Neurosurgery & Spine Specialists and Rex Ear, Nose & Throat Specialists opened their doors in 2013. Rex expanded several of the physician practices with new locations and new physicians including Rex Vascular Surgical Specialists and Rex Pulmonary Specialists.

Rex's footprint continued to expand in 2013. Rex celebrated the opening of the Orthopaedic Surgery Center of Raleigh, a joint venture with physicians from Raleigh Orthopaedic Clinic. Rex relocated the Breast Care Center to a larger, more convenient site with new stereotactic biopsy and additional mammography equipment. Rex also opened a new Rex Bariatric Surgery office.

Rex continued to be recognized with significant accolades. Professional Research Consultants (PRC) nationally recognized Rex Healthcare for its achievements in patient service. Rex Medical Oncology, 4 East, 5 West, and Wakefield Surgery were awarded the PRC Five-Star Award, which recognizes

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
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departments for being in the top 10 percent of departments nationwide. Rex was named a Top 100 Best Hospital in the nation by Becker's Hospital Review for 2013, and one of the 100 great places to work in healthcare.

Rex received an 'A' grade from the Leapfrog Group for Hospital Safety for the second consecutive year. The grade was based on data tracking preventable errors and medical complications. Additional accomplishments during fiscal year 2013 included implementation of a number of quality and safety initiatives such as the Just Culture Program, a readmission prevention clinic and a safe surgery checklist program.

Rex continues to invest in the latest technology including new PET and CT units. Rex also focused efforts on the social media world, introducing three consumer-targeted mobile apps – a Cancer Care app, a Rex Wellness app and a Rex Hospital Open app. Additionally, Rex and UNCHCS began the implementation of the EPIC electronic health record system.

Rex continued to take an active role in the health of our community. Rex offered athletic health screenings at local high schools and oversaw two successful Operation Medicine Drop events collecting nearly 200,000 medications across the county.

Rex's overall credit rating was reaffirmed by rating agencies Standard & Poor, Fitch and Moody's at A+/A1.

### **Using this Financial Report**

Rex's financial statements report information of Rex using accounting methods similar to those used by private-sector health organizations. These statements offer short and long-term financial information about its activities.

#### *Balance Sheet*

The balance sheet shows the financial position of Rex and includes all of Rex's assets (resources), deferred outflows of resources, liabilities (claims to resources), deferred inflows of resources, and net position (equity). The balance sheet also provides the basis for evaluating the capital structure, liquidity and financial flexibility of Rex.

#### *Statement of Revenues, Expenses and Changes in Net Position*

Revenues and expenses are accounted for in the statement of revenues, expenses and changes in net position. This statement measures the success of Rex's operations and can be used to determine whether Rex has successfully recovered all of its costs through its fees and other sources of revenue, profitability and credit worthiness.

#### *Statement of Cash Flows*

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operating, investing and capital and related financing activities, and noncapital related financing activities. It also provides answers to such questions as where cash comes from, what cash was used for and what the change in the cash balance was during the reporting period.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000'S)

*Notes to the Combined Financial Statements*

Notes to the combined financial statements are designed to give the reader additional information concerning Rex and further supports the statements noted above.

**Financial Analysis**

The statement of revenues, expenses and changes in net position reports the net assets of Rex and the changes affecting them. Rex's net position, the difference between assets and liabilities, are a way to measure financial health or financial position. Over time, increases or decreases in Rex's net position are one indicator of whether its financial health is improving or deteriorating. However, one will also need to consider other non-financial factors such as changes in economic conditions, population growth and new or changed governmental legislation.

*Condensed Combined Balance Sheets*

The following condensed combined balance sheets show the combined financial position at June 30, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>			
Current Assets	\$ 176,283	\$ 171,410	\$ 191,366
Capital Assets, Net	283,235	287,299	264,912
Noncurrent Assets	258,738	244,716	221,735
Total Assets	<u>\$ 718,256</u>	<u>\$ 703,425</u>	<u>\$ 678,013</u>
<b>LIABILITIES</b>			
Long-Term Debt, Including Current Portion	\$ 146,032	\$ 155,566	\$ 159,430
Other Liabilities	115,144	99,666	105,118
Total Liabilities	<u>261,176</u>	<u>255,232</u>	<u>264,548</u>
<b>NET POSITION</b>			
Net Investment in Capital Assets	137,203	140,141	106,388
Restricted	5,227	4,082	3,959
Unrestricted	314,650	303,970	303,118
Total Net Position	<u>457,080</u>	<u>448,193</u>	<u>413,465</u>
Total Liabilities and Net Position	<u>\$ 718,256</u>	<u>\$ 703,425</u>	<u>\$ 678,013</u>

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
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Current assets increased \$4,824 (2.8%) and decreased \$19,956 (10.4%) in 2013 and 2012, respectively. The 2013 increase is due to higher cash balances in the operating accounts. The 2012 decrease is a result of transferring \$20,000 of cash to the long-term investment portfolio. The increases result from growth in outpatient volumes, disciplined expense control, and improved reimbursement associated with renegotiated payor contracts.

Noncurrent assets increased \$14,012 (5.7%) in 2013 and \$22,981 (10.4%) in 2012, the result of investment earnings consistent with overall market performance as well as additional investment.

During 2013 and 2012, long-term debt decreased \$9,534 (6.1%) and \$3,864 (2.4%), respectively. The decrease in 2013 is the result of making scheduled principal payments. The decrease in 2012 is the result of making scheduled principal payments and the incurrence of \$4,104 of new capital lease obligations.

Net position increased \$8,828 (2.0%) in 2013 and \$34,728 (8.4%) during 2012, primarily the result of strong operating performance and investment earnings. Rex also experienced a loss in 2013 due to the write-off of certain abandoned construction in progress projects. For further information on this change, see the following statement of revenues, expenses and changes in net position.

*Capital Assets*

Rex's investment in capital assets consisted of the following at June 30, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Land and Land Improvements	\$ 51,050	\$ 49,452	\$ 48,934
Buildings and Improvements	257,682	252,777	248,418
Equipment	<u>347,401</u>	<u>321,861</u>	<u>291,263</u>
Total Capital Assets	656,133	624,090	588,615
Accumulated Depreciation	<u>(411,688)</u>	<u>(384,506)</u>	<u>(356,601)</u>
Total Capital Assets, Net	244,445	239,584	232,014
Construction in Progress	<u>38,790</u>	<u>47,715</u>	<u>32,898</u>
Total Capital Assets	<u>\$ 283,235</u>	<u>\$ 287,299</u>	<u>\$ 264,912</u>

Investments in capital assets in 2013 consisted primarily of costs incurred in connection with the ongoing replacement of the central energy plant for the main campus, a new bed tower, and technology and imaging assets. Capital investments in 2012 consisted primarily of costs incurred in conjunction with the construction of Rex Healthcare of Holly Springs, a replacement Central Energy Plant for the main campus, and technology assets.



**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
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*Condensed Combined Statements of Revenues, Expenses and Changes in Net Position*

While the combined balance sheets show the financial position of Rex, the following combined statements of revenues, expenses and changes in net position provides answers to the nature and source of changes in net position for the years ended June 30, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Revenues	\$ 731,381	\$ 706,612	\$ 625,592
Operating Expenses	<u>686,150</u>	<u>654,515</u>	<u>577,156</u>
Operating Income	45,231	52,097	48,436
Nonoperating Income (Loss)	817	(1,807)	26,232
Contributions and Other	<u>(37,161)</u>	<u>(15,562)</u>	<u>(5,609)</u>
Change in Net Position	8,887	34,728	69,059
Net Position, Beginning of Period	<u>448,193</u>	<u>413,465</u>	<u>344,406</u>
Net Position, End of Period	<u>\$ 457,080</u>	<u>\$ 448,193</u>	<u>\$ 413,465</u>

*Operating Income*

The increase in operating revenues in 2013 and 2012 is primarily the result of volume growth, increased reimbursement resulting from renegotiated payor contracts, and effective cost control. In addition, Rex recognized approximately \$11,802 in 2012 operating revenues related to the new Upper Payment Limit plan. Of the \$11,802 recognized in 2012, \$7,332 related to the 2011 Upper Payment Limit Plan year. The increases in operating expenses in each year are the result of changes in patient volumes, inflation and expansion of services offered, mitigated by coordinated cost control measures. The increase in operating income is the net result of all these factors.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
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*Nonoperating Income*

Nonoperating income consisted of the following for the years ended June 30, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Interest Income	\$ 695	\$ 888	\$ 983
Dividend Income	3,991	3,080	1,946
Realized Gains (Losses), Net	8,324	698	3,430
Net Change in Unrealized Gains (Losses) on Investments	9,052	(9,540)	21,990
Brokerage Fees	<u>(1,086)</u>	<u>(912)</u>	<u>(745)</u>
Total Investment Income (Loss)	20,976	(5,786)	27,604
Loss from Abandonment of Construction in Progress	(16,783)	-	-
Other	<u>(3,376)</u>	<u>3,979</u>	<u>(1,372)</u>
Total Nonoperating Income (Loss)	<u>\$ 817</u>	<u>\$ (1,807)</u>	<u>\$ 26,232</u>

**Finance Contact**

Rex's combined financial statements are designed to present users with a general overview of Rex's finances and to demonstrate Rex's financial accountability. If you have any questions about this report or need additional financial information, inquiries may be sent to:

Chief Financial Officer  
Rex Healthcare, Inc.  
4420 Lake Boone Trail  
Raleigh, North Carolina 27607

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINED BALANCE SHEETS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

<b>ASSETS</b>	2013	2012
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 73,998	\$ 67,340
Patient Accounts Receivable, Net of Allowance for Uncollectible		
Accounts of Approximately \$20,987 in 2013 and \$15,064 in 2012	78,678	75,269
Other Receivables	6,933	10,936
Inventories	11,249	10,102
Prepaid Expenses and Other Current Assets	5,425	7,763
Total Current Assets	176,283	171,410
<b>ASSETS LIMITED AS TO USE</b>	245,131	230,948
<b>CAPITAL ASSETS, NET</b>	283,235	287,299
<b>OTHER ASSETS</b>		
Investments in Affiliates	11,687	10,846
Deferred Debt Issuance Costs, Net	1,163	1,286
Other Assets	757	1,636
Total Other Assets	13,607	13,768
Total Assets	\$ 718,256	\$ 703,425
<b>LIABILITIES AND NET POSITION</b>		
<b>CURRENT LIABILITIES</b>		
Current Maturities of Long-Term Debt	\$ 7,399	\$ 6,685
Vendor Accounts Payable	41,834	36,060
Accrued Expenses and Other Liabilities	59,681	58,027
Estimated Third-Party Payor Settlements	13,000	4,417
Total Current Liabilities	121,914	105,189
<b>LONG-TERM DEBT</b> , Net of Current Maturities	138,633	148,881
<b>OTHER NONCURRENT LIABILITIES</b>	629	1,162
Total Liabilities	261,176	255,232
<b>NET POSITION</b>		
Net Investment in Capital Assets	137,203	140,141
Restricted	5,227	4,082
Unrestricted	314,650	303,970
Total Net Position	457,080	448,193
Total Liabilities and Net Position	\$ 718,256	\$ 703,425

See accompanying Notes to Combined Financial Statements.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**YEARS ENDED JUNE 30, 2013 AND 2012**  
(IN \$000's)

	2013	2012
<b>OPERATING REVENUES</b>		
Net Patient Service Revenue (Net of Provision for Uncollectible Accounts of Approximately \$26,594 in 2013 and \$21,375 in 2012)	\$ 701,745	\$ 675,480
Other Operating Revenues	29,636	31,132
Total Operating Revenues	731,381	706,612
<b>OPERATING EXPENSES</b>		
Salaries	295,944	285,008
Employee Benefits	90,703	81,056
Medical Supplies and Other Expenses	263,525	256,297
Depreciation and Amortization	30,813	27,108
Interest	5,165	5,046
Total Operating Expenses	686,150	654,515
<b>OPERATING INCOME</b>	45,231	52,097
<b>NONOPERATING INCOME (LOSS)</b>		
Investment Income, Net	20,976	(5,786)
Other, Net	(20,159)	3,979
Nonoperating Income, Net	817	(1,807)
<b>EXCESS OF REVENUES AND GAINS OVER EXPENSES AND LOSSES</b>	46,048	50,290
<b>CONTRIBUTIONS TO RELATED PARTY</b>	(38,017)	(12,982)
<b>OTHER</b>	856	(2,580)
<b>CHANGE IN NET POSITION</b>	8,887	34,728
Net Position - Beginning of Year	448,193	413,465
<b>NET POSITION - END OF YEAR</b>	\$ 457,080	\$ 448,193

See accompanying Notes to Combined Financial Statements.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2013 AND 2012**  
(IN \$000's)

	2013	2012
<b>OPERATING ACTIVITIES</b>		
Receipts from Third-Party Payors and Patients	\$ 710,922	\$ 657,627
Payments to and on Behalf of Employees	(380,309)	(362,270)
Payments to Suppliers	(264,846)	(257,301)
Other Receipts	30,893	20,219
Net Cash Provided by Operating Activities	96,660	58,275
<b>INVESTING ACTIVITIES</b>		
Purchases and Sales of Investments, Net	(17,105)	(49,876)
Contributions to Related Party	(38,017)	(12,982)
Investment Income	11,924	3,754
Other Nonoperating Income, Net	(3,376)	9,929
Net Cash Used in Investing Activities	(46,574)	(49,175)
<b>CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchases of Capital Assets	(43,246)	(42,731)
Proceeds from Issuance of Long-Term Debt, Net of Premium	1,899	30,072
Principal Repayments of Long-Term Debt	(11,301)	(37,917)
Cash Paid for Interest on Long-Term Debt	(2,754)	(2,076)
Net Cash Used in Capital and Related Financing Activities	(55,402)	(52,652)
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	(5,316)	(43,552)
Cash and Cash Equivalents - Beginning of Year	79,474	123,026
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	\$ 74,158	\$ 79,474
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS TO COMBINED BALANCE SHEETS:</b>		
Cash and Cash Equivalents in Current Assets	\$ 73,998	\$ 67,340
Cash and Cash Equivalents in Assets Limited as to Use	160	12,134
Total Cash and Cash Equivalents	\$ 74,158	\$ 79,474

See accompanying Notes to Combined Financial Statements.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINED STATEMENTS OF CASH FLOWS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2013 AND 2012**  
(IN \$000's)

	2013	2012
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating Income	\$ 45,231	\$ 52,097
Interest Expense Considered Capital Financing Activity	5,165	5,046
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Provision for Uncollectible Accounts	26,594	21,375
Depreciation and Amortization	30,873	27,108
(Gain) Loss on Disposal of Capital Assets	(179)	(2,482)
Changes in Assets and Liabilities:		
Patient and Other Receivables, Net	(26,000)	(33,394)
Accounts Payable and Accrued Expenses	5,017	12,014
Estimated Third-Party Payor Settlements	8,583	(20,223)
Other Assets and Liabilities, Net	1,376	(3,266)
Net Cash Provided by Operating Activities	\$ 96,660	\$ 58,275
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION</b>		
Net Change in Unrealized Gains (Losses) on Investments	\$ 9,052	\$ (9,540)
Additions to Capital Assets Included in Current Liabilities	\$ -	\$ 5,762
Capital Assets Acquired through Capital Lease Obligations	\$ -	\$ 4,104
Loss on Abandonment of Construction in Progress	\$ (16,783)	\$ -

See accompanying Notes to Combined Financial Statements.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
**(IN \$000's)**

**NOTE 1 ORGANIZATION**

Rex Healthcare, Inc. ("Rex") is a North Carolina not-for-profit corporation organized to provide a broad range of health care services to residents of the Triangle area of North Carolina. Acting through its network of operating affiliates, Rex provides health care to patients from several locations through continued development of acute care and non-hospital programs.

Rex's sole member is the University of North Carolina Health Care System ("UNCHCS"). UNCHCS appoints eight of the thirteen seats on Rex's Board of Trustees. Additionally, UNCHCS reviews and approves Rex's annual operating and capital budgets. Rex's financial data is incorporated into the comprehensive annual financial report of UNCHCS.

As required by accounting principles generally accepted in the United States of America, the combined financial statements of Rex present the financial position and results of operations of the primary enterprise and its blended component units which are described below:

*Rex Hospital, Inc.* – Rex Hospital, Inc. (the "Hospital"), located in Raleigh, North Carolina, is a 433-bed hospital. The Hospital provides inpatient, outpatient and emergency services primarily to the residents of Wake County, North Carolina. The Hospital operates on its main campus Rex Cancer Center, Rex Women's Center and Rex Rehabilitation and Nursing Care Center of Raleigh, a 120-bed nursing facility. The Hospital provides urgent care and diagnostics at its Cary, North Carolina campus, and outpatient surgery, oncology and wellness services, urgent care, family medicine and diagnostics at its Wakefield campus. Rex's Knightdale campus provides urgent care, diagnostics, family medicine, wound care and a sleep disorders center. Rex also operates Rex Rehabilitation and Nursing Care Center of Apex, a 107-bed nursing facility located in Apex, North Carolina. Rex's Holly Springs campus, opened December 2011, provides urgent care, diagnostics and physician practice services.

*Rex Holdings, LLC* – Rex formed and became the sole member of Rex Holdings, LLC ("Holdings"), a single member limited liability company. Holdings was formed to hold membership interest in various limited liability companies. During fiscal year 2012, there was no activity related to this entity.

*Rex Physicians, LLC* – Holdings formed and became the sole member of Rex Physicians LLC ("Physicians"), a single member limited liability company which has elected to be treated as a taxable corporation. Physicians was formed to operate specialty physician practices serving the residents of Wake County and surrounding areas. Physicians currently operates physician practices in the areas of general surgery, heart and vascular services, and thoracic surgery.

*Rex Enterprises Company, Inc.* – Rex Enterprises Company, Inc. ("Enterprises") is a North Carolina for-profit corporation organized to hold investments in various affiliates and to promote the development of real property in support of the mission of Rex.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
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**(IN \$000's)**

**NOTE 1 ORGANIZATION (CONTINUED)**

*Rex Wakefield Enterprises, LLC* – Rex Wakefield enterprises (formerly known as Rex CDP Ventures, LLC) (“RWE”), is a limited liability company organized to own and develop real estate in the Wakefield community of northern Wake County. At June 30, 2013, RWE was the sole member of the following limited liability companies:

*Rex Wakefield Wellness, LLC* – RWE is the sole member of Rex Wakefield Wellness, LLC (“Wellness”), a single member limited liability company. Wellness was created to develop a wellness center building on the Wakefield campus of the Hospital. The Hospital leases the building from Wellness.

*Rex Wakefield MOB, LLC* – RWE is the sole member of Rex Wakefield MOB (formerly known as Wakefield Rex Investors MOB, LLC) (“MOB”), a single member limited liability company. MOB was formed to develop a medical office building on the Wakefield campus of the Hospital. The Hospital leases space from MOB.

*Rex CDP Ventures – HT, LLC* – RWE was the sole member of Rex CDP Ventures – HT, LLC (“HT”), a single member limited liability company formed to develop a retail unit of the Wakefield campus of the Hospital. During 2012, Ventures sold essentially all of HT’s assets to an unrelated party and transferred the remaining assets to RWE in 2013.

*Rex CDP Ventures – Retail, LLC* – RWE was the sole member of Rex CDP Ventures – Retail, LLC (“Retail”), a single member limited liability company formed to develop a retail unit of the Wakefield campus of the Hospital. During 2012, Ventures sold approximately 63% of Retail’s capital assets to an unrelated party and transferred the remaining assets to Enterprises in 2013.

*Rex Healthcare Foundation, Inc.* – Rex Healthcare Foundation, Inc. (the “Foundation”) is a North Carolina not-for-profit corporation organized to promote the health and welfare of the people of the Triangle area by promoting philanthropic contributions and public support of Rex.

*Rex Home Services, Inc.* – The Hospital formed Rex Home Services, Inc. (“Home Services”), a North Carolina not-for-profit corporation, organized to provide home health services primarily to the residents of Wake County, North Carolina. During 2013, all of Home Services assets and services were transferred to the Hospital.



**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 1 ORGANIZATION (CONTINUED)**

*Rex Health Ventures* – In April 2012, Rex created Rex Health Ventures, LLC, Rex Health Ventures GP I, LLC and Rex Health Ventures I, LLP (collectively “Rex Health Ventures” or “RHV”). RHV was formed as a venture capital fund to invest in and partner with health care startup companies and entrepreneurs. RHV invests in organizations that support the discovery and development of new treatments, tools, products and services that foster innovation and positively impact the provision of health care. Rex has committed to investing up to \$10,000 in RHV. Following is the organizational structure of the RHV entities:

*Rex Health Ventures GP I, LLC* – The Hospital is the sole member of Rex Health Ventures GP I, LLC (“RHV GP”).

*Rex Health Ventures I, LLP* – The Hospital is the sole limited partner in Rex Health Ventures I, LLP (“RHVI”) and RHV GP is the sole general partner. RHVI is the venture capital fund and invests in startup companies. At June 30, 2013 and 2012, RHVI had invested \$1,498 and \$500, respectively, for a 6% and 3% interest, respectively, in an unrelated pharmaceutical startup company. RHV accounts for this investment utilizing the cost method of accounting. Management has determined there is no impairment of this investment at June 30, 2013 and 2012.

*Rex Health Ventures, LLC* – Enterprises is the sole member of Rex Health Ventures, LLC (“RHVLLC”), which provides management services to RHVI.

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

As a result of the transfer of the membership interest to UNCHCS, an agency of the State of North Carolina, Rex is subject to the application of accounting pronouncements issued by the Governmental Accounting Standards Board (GASB). In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board Statements and other pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This statement became effective for Rex’s fiscal year ended June 30, 2013.

The accompanying basic combined financial statements have been presented in conformity with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”) in accordance with the American Institute of Certified Public Accountants’ audit and accounting guide, *Health Care Entities*, and other pronouncements applicable to health care organizations and guidance from the GASB, where applicable. The basic combined financial statements include all of the accounts of Rex. Intercompany accounts and transactions have been eliminated in combination.

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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Use of Estimates**

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, all highly liquid investments with an original maturity of three months or less, and which are not designated as investments, are considered to be cash equivalents and are recorded at cost which approximates market value.

**Inventories**

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

**Investments**

Investments in marketable debt and equity securities with readily determinable fair values, including assets whose use is limited, are measured at fair value in the accompanying balance sheets. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in nonoperating income (loss) in the accompanying combined financial statements. The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments.

**Investments in Affiliates**

*Quality Textile Services, Inc.* - Enterprises own a 50% interest in Quality Textile Services, Inc. ("QTS"), a Raleigh, North Carolina company that provides laundry services to local hospitals. Enterprises exercises significant influence over QTS; however, it does not control it through a majority voting interest. This investment is accounted for using the equity method of accounting; accordingly, Enterprises' investment has been adjusted for its share of QTS's operations. Enterprises' equity in the net income of this affiliate totaled approximately \$(34) and \$60 for the years ended June 30, 2013 and 2012, respectively, and is included in net nonoperating income. Enterprises received no cash distributions from QTS during 2013 or 2012. Enterprises' investment in QTS totaled approximately \$2,323 and \$2,313 as of June 30, 2013 and 2012, respectively. Separate financial statements for QTS are not publicly available.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Investments in Affiliates (Continued)**

*Rex Cary MOB, LLC* - Enterprises owns a 32.5% interest in Rex Cary MOB, LLC, a company that in July 2003, built and began leasing a medical office building in Cary, North Carolina. Enterprises' investment has been adjusted for its share of Rex Cary MOB, LLC's operations. Enterprises accounts for its investment in the affiliate under the equity method of accounting since it exercises significant influence over the affiliate, but does not have financial accountability. Enterprises' equity in the net income of this affiliate totaled approximately \$294 and \$303 for the years ended June 30, 2013 and 2012, respectively, and is included in net nonoperating income. Additionally, Enterprises received cash distributions from Rex Cary MOB, LLC totaling approximately \$311 and \$121 during 2013 and 2012, respectively. Enterprises' investment in Rex Cary MOB, LLC totaled approximately \$778 and \$795 as of June 30, 2013 and 2012, respectively. Separate financial statements for Rex Cary MOB, LLC are not publicly available.

*JRH Ventures, LLC* – On February 1, 2012, the Hospital assigned 100% of its membership interest in Smithfield Radiation Oncology to JRH Ventures, LLC ("JRH"), a limited liability company organized to own and operate linear accelerators, in exchange for a 50% member interest in JRH. The Hospital accounts for its investment in JRH under the equity method of accounting since it exercises significant influence over JRH, but does not have financial accountability. The Hospital's equity in the net income of this affiliate totaled approximately \$(213) and \$(422) for the years ended June 30, 2013 and 2012, respectively, and is included in net nonoperating income. The Hospital's investment in JRH totaled approximately \$2,590 and \$286 as of June 30, 2013 and 2012, respectively. Separate financial statements for JRH are not publicly available.

*Rex Surgery Center of Cary, LLC* – Rex Surgery Center of Cary, LLC ("CSC") is a limited liability company organized to own and operate an ambulatory surgery center. CSC was formed and began operations on February 28, 2011. The Hospital owned 55% and 79.5% of the membership interests at June 30, 2013 and 2012, respectively. Per the membership agreement, both the Hospital and the unrelated party now maintain 50/50 voting rights, regardless of the ownership structure. Prior to 2013, the Hospital accounted for CSC as a blended component unit, with a non-controlling interest. Upon adoption of GASB No. 61, CSC is now treated as an equity investment of the Hospital. In accordance with the standard, this treatment has been retroactively applied to all periods presented in the combined financial statements, and resulted in no change to previously reported change in net position. The Hospital's equity in the net income of this affiliate totaled approximately \$5,264 and \$4,420 for the years ended June 30, 2013 and 2012, respectively, and is included in net nonoperating income. The Hospital's investment in CSC totaled approximately \$2,011 as of June 30, 2013 and 2012. Separate financial statements for CSC are not publicly available.

*Rex MOB Partners, LLC* - Enterprises owns less than a 5% interest in Rex MOB Partners, LLC, a company that operates a multi-tenant medical office building in Raleigh, North Carolina on land leased from the Hospital. Enterprises does not exercise significant influence over the affiliate, and accounts for the investment using the cost method of accounting. Enterprises' investment in Rex MOB Partners, LLC totaled approximately \$300 as of June 30, 2013 and 2012. Management has determined there is no impairment of this

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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Investments in Affiliates (Continued)**

investment at June 30, 2013 and 2012. Separate financial statements for Rex MOB Partners, LLC are not publicly available.

**Capital Assets**

Capital asset acquisitions are recorded at cost and include interest on funds used to finance the acquisition or construction of major capital projects. Assets under capital lease are stated at the present value of the minimum lease payments at the inception of the lease. Depreciation is provided on both straight-line and accelerated methods over the estimated useful lives of the depreciable assets which is generally 5 to 15 years for equipment, 5 to 15 years for building improvements, and 30 to 40 years for buildings.

Assets under capital leases and leasehold improvements are depreciated over the estimated useful life or the related lease term, whichever is shorter; generally periods ranging from 5 to 7 years. Depreciation of assets under capital leases and leasehold improvements is included in depreciation and amortization expense in the accompanying statements of revenues, expenses and changes in net assets.

**Deferred Debt Issuance Costs**

Deferred debt issuance costs are amortized over the term of the related bond issuance under a method which approximates the effective interest method over the life of the bonds. Amortization of deferred debt issuance costs totaled approximately \$122 and \$119 for years ended June 30, 2013 and 2012. Cumulative amortization of deferred debt issuance costs totaled approximately \$336 and \$214 as of June 30, 2013 and 2012, respectively.

**Other Assets**

Other assets consisted primarily of long-term notes receivable and deferred lease assets at June 30, 2013 and 2012:

**Proprietary Fund Accounting**

Rex utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

**Net Position**

In accordance with GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, net position is categorized as net investment in capital assets, restricted and unrestricted. Net investment in capital assets is intended to reflect the portion of net position that is associated with nonliquid capital assets less outstanding capital-related debt. Restricted net position is assets generated from revenues that have third-party limitations as to their use. Unrestricted net position has no third-party restrictions as to use.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Net Position (Continued)**

Restricted net position included the following at June 30, 2013 and 2012:

	2013	2012
Restricted Net Position:		
Expendable:		
Various Scholarships, Lectureships and Buildings	\$ 1,157	\$ 1,184
Various Supplies, Equipment and Patient Charity Care	3,691	2,573
Total Expendable:	4,848	3,757
Nonexpendable:		
Endowments	379	325
Total Restricted Net Position	\$ 5,227	\$ 4,082

**Net Patient Service Revenue**

Net patient service revenue is recorded at established rates when services are provided with contractual adjustments, estimated bad debt expenses, and services qualifying as charity care deducted to arrive at net patient service revenue. Contractual adjustments arise under reimbursement agreements with certain insurance carriers, health maintenance organizations and preferred provider organizations, which provide for payments that are generally less than established billing rates. Contractual adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in the future as final settlements are determined. Total contractual adjustments were approximately \$1,209,000 and \$1,141,000, respectively, for the years ended June 30, 2013 and 2012.

**Medicare and Medicaid Programs**

Services rendered to Medicare program beneficiaries and inpatient services rendered to Medicaid program beneficiaries are paid primarily at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors and cover both operating and capital costs. Outpatient services rendered to Medicaid beneficiaries are reimbursed based on a percentage of actual costs incurred. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by fiscal intermediaries. Final settlements are based on regulations established by the respective programs and as interpreted by fiscal intermediaries. The classification of patients under the Medicare and Medicaid programs, and the appropriateness of their admission, are subject to review by an independent peer review organization.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Medicare and Medicaid Programs (Continued)**

Accounts receivable and patient service revenue relating to these programs are stated at estimated net realizable amounts in the accompanying combined financial statements. The Hospital's Medicare cost reports have been audited through June 30, 2007. During 2013, the Hospital filed the 2012 Medicare cost report, resulting in a tentative cash settlement of approximately \$389. During 2012, the Hospital filed the 2011 Medicare cost report, resulting in a tentative cash settlement of approximately \$410. For the years ended June 30, 2013 and 2012, net patient service revenue increased by approximately \$8,613 and \$20,190, respectively, as a result of changes in estimates related to various third-party accruals and reserves.

The Hospital has historically participated in the voluntary North Carolina Medicaid Reimbursement Initiative Program (the "MRI Program"). The MRI Program allowed the Hospital to receive additional annual Medicaid funding for its disproportionate share costs. In March 2012, the Center for Medicare and Medicaid Services ("CMS") approved two new disproportionate share plans for North Carolina.

The first plan covers the UNCHCS hospitals (The UNC Upper Payment Limit or "UPL Plan"), including Rex. The second plan covers all other non-state government hospitals and private hospitals in North Carolina (the "GAP Plan") and is essentially a supplemental upper payment limit plan to the existing MRI Program. Under the UNC UPL Plan, Rex does not participate in the GAP Plan and no longer participates in the MRI Program.

Under the provisions of the UPL Plan, Rex is assessed an inter-governmental transfer ("IGT Payment") by the North Carolina Medicaid program ("Medicaid"), in return Medicaid makes an upper payment limit payment to Rex. When both amounts are reasonably estimable and probable of payment, Rex recognizes the revenues related to the UPL Plan as net patient service revenue.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Medicare and Medicaid Programs (Continued)**

Both the UPL Plan and the GAP Plan were approved in March 2012; however, the provisions were retroactively effective to October 1, 2010 and January 1, 2011, respectively. Thus, Rex has recognized approximately nine months of revenue in 2012 that related to the 2011 federal fiscal UPL plan year. The following table summarizes the revenue recognized by Rex related to these plans for the years ended June 30, 2013 and 2012:

	2013	2012
UPL Plan Year - 2011:		
IGT Payment	\$ -	\$ (17,150)
UPL Revenue	-	24,950
	-	7,800
Reserve for future settlements	-	(234)
	-	7,566
UPL Plan Year - 2012:		
IGT Payment	-	(16,622)
UPL Revenue	-	21,230
	-	4,608
Reserve for future settlements	-	(297)
	-	4,311
UPL Plan Year - 2013:		
IGT Payment	(9,996)	-
UPL Revenue	18,426	-
	8,430	-
Reserve for future settlements	(430)	-
	8,000	-
	\$ 8,000	\$ 11,877

**Other Payors**

Rex has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Rex under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

**Concentrations of Credit Risk**

Rex provides services primarily to residents of Wake and surrounding counties without collateral or other proof of ability to pay. Concentrations of credit risk with respect to patient accounts receivable are limited due to large numbers of patients served and formalized agreements with third-party payors. Rex has significant accounts receivable whose collectability is dependent upon the performance of certain governmental programs, primarily Medicare. Management does not believe there are significant credit risks associated with these governmental programs.

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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Concentrations of Credit Risk (Continued)**

The aggregate mix of accounts receivable from patients and third-party payors was as follows at June 30, 2013 and 2012:

	2012	2011
Medicare	25 %	25 %
Medicaid	3	3
Managed Care	53	52
Self Pay	19	20
Total	100 %	100 %

**Charity Care**

Rex provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because Rex does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue or accounts receivable in the accompanying financial statements. Rex maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The amount of charity care provided, based on charges foregone, was approximately \$89,000 and \$91,000 for the years ended June 30, 2013 and 2012, respectively.

**Functional Expenses**

Rex does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Further, since Rex receives substantially all of its resources from providing health care services in a manner similar to a business enterprise, other indicators contained in these financial statements are considered important in evaluating how well management has discharged its stewardship responsibilities.

**Operating Income**

Rex classifies all revenues and expenses earned or incurred in the course of providing health care to patients as operating activities.



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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Nonoperating Income (Loss)**

Nonoperating income (loss) consists primarily of investment income and other miscellaneous income and expense items. Income (loss) related to Rex's equity investments in affiliates, excluding CSC, are included in other nonoperating income (loss). Earnings related to CSC are reported in other operating income. Nonoperating income (loss) consisted of the following for the years ended June 30, 2013 and 2012:

	2013	2012
Interest Income	\$ 695	\$ 888
Dividend Income	3,991	3,080
Realized Gains (Losses), Net	8,324	698
Net Change in Unrealized Gains (Losses) on Investments	9,052	(9,540)
Brokerage Fees	(1,086)	(912)
Total Investment Income (Loss)	20,976	(5,786)
Loss from Abandonment of Construction in Progress	(16,783)	-
Other	(3,376)	3,979
Total Nonoperating Income, Net	\$ 817	\$ (1,807)

**Capitalized Interest**

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest of approximately \$408 was capitalized during the year ended June 30, 2012.

**Electronic Health Record Incentive Payments**

As discussed in Note 10, Rex received funds under the Electronic Health Records (EHR) Incentive Program during 2012. The Hospital recognizes revenue at the completion of the EHR reporting period and all meaningful use objectives and any other specific grant requirements that are applicable (such as electronic transmission of quality measures in the second and subsequent payment years) are met.

**Risk Management**

Rex is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; employee health, dental, and accident benefits; and medical malpractice (see Note 9). Commercial insurance and stop loss coverage is purchased for claims arising from such matters, subject to various deductibles.

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**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Tax-Exempt Status**

Rex, the Hospital, the Foundation, and Home Services are exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code. Enterprises is a taxable corporation that previously had net operating loss carryforwards which expired in 2012. Physicians is a single member limited liability company that has elected to be taxed as a for-profit corporation. Physicians had a net operating loss in 2013 and 2012.

Enterprises is the sole member of RWE, and RWE is the sole member of Wellness, MOB and RHVLLC. As such, these entities are considered disregarded entities for tax purposes.

**Significant Future Accounting Pronouncements**

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The objective of this statement is to establish new accounting and financial reporting requirements for governments that provide their employees with pensions. The requirements in this statement will change how governments calculate and report the costs and obligations associated with pensions and improve the decision-usefulness of reported pension information and increase the transparency, consistency, and comparability of pension information across governments. This statement will be effective for Rex's fiscal year ending June 30, 2015. Management is currently evaluating the impact of adopting this statement, but it could be significant to the combined balance sheet.

**Reclassifications**

Certain amounts in the 2012 combined financial statements have been reclassified to conform to the 2013 presentation. These reclassifications had no effect on previously reported changes in net position.

**NOTE 3 CASH, CASH EQUIVALENTS AND INVESTMENTS**

**Assets Limited as to Use**

At June 30, 2013 and 2012, Rex had the following investments, all of which were held by custodians that are agents of Rex:

	2013	2012
Cash and Cash Equivalents	\$ 160	\$ 12,134
Certificates of Deposit	450	300
Mutual Funds	58,810	153,960
Equities	114,249	11,104
Alternative Investments	71,462	53,450
	\$ 245,131	\$ 230,948

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**NOTE 3 CASH, CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)**

**Assets Limited as to Use (Continued)**

As of June 30, 2013, all of these investments had maturities of one year or less.

Interest rate risk – Rex has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The policy requires that the duration of the portfolio shall not exceed six years and its average maturity shall range between two and six years.

Credit risk – Rex's investment policy allows it to invest in (i) direct obligations or obligations on which the principal and interest are unconditionally guaranteed by the United States government; (ii) obligations issued by an approved agency or corporation wholly-owned by the United States government; (iii) interest-bearing time deposits, certificates of deposit or other approved forms of deposits in any bank or trust company in North Carolina which satisfies insurance and, if necessary, collateral requirements for holding Company money; and (iv) corporate notes and bonds.

Alternative investments are investments in the common stock of limited investment companies that offer a pattern of returns different from that of the overall market and occasionally have lesser levels of liquidity. Examples of alternative investments include non-publicly traded companies, real estate and hedge funds.

Concentration of credit risk – Rex limits the amount it may invest in any single issuer. Fixed income holdings in a single issuer (excluding obligations of the United States Government, its agencies and government sponsored entities) shall be limited to 5 percent of the portfolio measured at market value at the time of purchase. Treasuries, agencies and government-sponsored entities have no issuer limits. Securities rated under "A-" are limited to 3% per issuer.

Custodial credit risk – At year end, Rex's investments were not exposed to custodial credit risk.

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**NOTE 3 CASH, CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)**

**Assets Limited as to Use (Continued)**

The carrying amount of deposits and investments included in the combined balance sheets are as follows at June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Carrying Amount:		
Deposits	\$ 74,158	\$ 79,474
Investments	244,971	218,814
	<u>\$ 319,129</u>	<u>\$ 298,288</u>
Included in the Following Balance Sheet Captions:		
Cash and Cash Equivalents	\$ 73,998	\$ 67,340
Assets Limited as to Use:		
Restricted by Contributors and Grantors	5,227	4,082
Bond Funds Held by Trustee	-	7,333
Designated for Long-Term Investment	239,904	219,533
	<u>245,131</u>	<u>230,948</u>
	<u>\$ 319,129</u>	<u>\$ 298,288</u>

All investments in securities are on deposit with Rex's fiduciary agent, which holds these securities by book entry in its fiduciary Federal Reserve accounts. Rex's ownership of these securities is identified through the internal records of the fiduciary agent. Certain of these securities are optionally callable at par by the issuer on specified dates.

**NOTE 4 CAPITAL ASSETS AND ACCUMULATED DEPRECIATION**

A summary of changes in the historical cost of capital assets and accumulated depreciation and amortization related to capital assets for the year ended June 30, 2013 is as follows:

	<u>June 30,</u> <u>2012</u>	<u>Transfers/</u> <u>Additions</u>	<u>Transfers/</u> <u>Retirements</u>	<u>June 30,</u> <u>2013</u>
<b>CAPITAL ASSETS AT COST</b>				
Land	\$ 29,912	\$ -	\$ -	\$ 29,912
Land Improvements	19,540	1,598	-	21,138
Buildings and Improvements	252,777	6,551	(1,646)	257,682
Equipment	321,861	37,537	(11,997)	347,401
Construction in Progress	47,715	42,156	(51,081)	38,790
Total	<u>671,805</u>	<u>87,842</u>	<u>(64,724)</u>	<u>694,923</u>
<b>ACCUMULATED DEPRECIATION</b>				
Land Improvements	7,506	634	30	8,170
Buildings and Improvements	127,297	10,467	(16)	137,748
Equipment	249,703	17,653	(1,586)	265,770
Total	<u>384,506</u>	<u>28,754</u>	<u>(1,572)</u>	<u>411,688</u>
Capital Assets, Net	<u>\$ 287,299</u>	<u>\$ 59,088</u>	<u>\$ (63,152)</u>	<u>\$ 283,235</u>

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
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**NOTE 4 CAPITAL ASSETS AND ACCUMULATED DEPRECIATION (CONTINUED)**

A summary of changes in the historical cost of capital assets and accumulated depreciation and amortization related to capital assets for the year ended June 30, 2012 is as follows:

	June 30, 2011	Transfers/ Additions	Transfers/ Retirements	June 30, 2012
<b>CAPITAL ASSETS AT COST</b>				
Land	\$ 32,475	\$ 7,280	\$ (9,843)	\$ 29,912
Land Improvements	16,459	3,081	-	19,540
Buildings and Improvements	248,418	12,318	(7,959)	252,777
Equipment	291,263	31,215	(617)	321,861
Construction in Progress	32,898	25,645	(10,828)	47,715
Total	<u>621,513</u>	<u>79,539</u>	<u>(29,247)</u>	<u>671,805</u>
<b>ACCUMULATED DEPRECIATION</b>				
Land Improvements	6,677	829	-	7,506
Buildings and Improvements	117,042	10,779	(524)	127,297
Equipment	232,882	17,416	(595)	249,703
Total	<u>356,601</u>	<u>29,024</u>	<u>(1,119)</u>	<u>384,506</u>
Capital Assets, Net	<u>\$ 264,912</u>	<u>\$ 50,515</u>	<u>\$ (28,128)</u>	<u>\$ 287,299</u>

The capital acquisitions' figures above are presented net of transfers from construction in progress to operating asset categories and sales and other dispositions. Depreciation expense related to Ventures and its related entities is included in other nonoperating income. Depreciation and amortization expense totaled approximately \$30,813 and \$27,108 for the years ended June 30, 2013 and 2012, respectively. The expense shown in the table above is net of decreases in accumulated depreciation for sales and other dispositions of capital assets. During the year ended June 30, 2013, Rex abandoned certain CIP projects resulting in losses of approximately \$16,783. These losses are reported as non-operating loss in the accompanying combined financial statements.

At June 30, 2013 and 2012, equipment under capital obligations had a cost of approximately \$7,394 and accumulated amortization of approximately \$2,494 and \$2,314, respectively.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

**NOTE 5 ACCOUNTS RECEIVABLE AND ACCRUED EXPENSES**

Accounts receivable, accrued expenses and other liabilities consisted of the following at June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Gross Receivables:		
Medicare	\$ 45,732	\$ 42,557
Medicaid	5,677	5,174
Managed Care	93,862	84,646
Self Pay	41,425	32,141
	<u>186,696</u>	<u>164,518</u>
Less:		
Contractual Allowances	(87,031)	(74,185)
Allowance for Doubtful Accounts	(20,987)	(15,064)
	<u>\$ 78,678</u>	<u>\$ 75,269</u>
Accrued Salaries, Wages and Withholdings	\$ 30,695	\$ 29,451
Accrued Paid Time Off	14,790	14,856
Reserve for Workers' Compensation Claims	2,373	1,804
Reserve for Employee Health Benefit Claims	2,456	2,805
Reserve for Medical Malpractice Claims	624	2,152
Other	8,743	6,959
	<u>\$ 59,681</u>	<u>\$ 58,027</u>

**NOTE 6 LONG-TERM DEBT**

A summary of long-term debt and changes in long-term debt for the years ended June 30, 2013 and 2012 is as follows:

	<u>June 30,</u>		<u>Payments</u>	<u>June 30,</u>		<u>Payments</u>	<u>June 30,</u>
	<u>2011</u>	<u>Borrowings</u>	<u>and</u>	<u>2012</u>	<u>Borrowings</u>	<u>and</u>	<u>2013</u>
			<u>Amortization</u>			<u>Amortization</u>	
Series 2010A Bonds	\$ 122,965	\$ -	\$ (3,118)	\$ 119,847	\$ -	\$ (4,647)	\$ 115,200
Construction Loan	32,683	-	(32,683)	-	-	-	-
Notes Payable	-	30,072	(262)	29,810	1,899	(4,898)	26,811
Obligations Under Capital Lease	1,333	4,104	(1,854)	3,583	-	(1,756)	1,827
	<u>156,981</u>	<u>34,176</u>	<u>(37,917)</u>	<u>153,240</u>	<u>1,899</u>	<u>(11,301)</u>	<u>143,838</u>
Bond Premium, Net	4,230	-	(379)	3,851	-	(366)	3,485
Deferred Loss on Refunding	(1,781)	-	256	(1,525)	-	234	(1,291)
	<u>\$ 159,430</u>	<u>\$ 34,176</u>	<u>\$ (38,040)</u>	<u>\$ 155,566</u>	<u>\$ 1,899</u>	<u>\$ (11,433)</u>	<u>\$ 146,032</u>

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

**NOTE 6 LONG-TERM DEBT (CONTINUED)**

**Bonds Payable**

In October 2010, Rex issued \$122,965 Series 2010A Health Care Facilities Revenue and Revenue Refunding Bonds (2010A Bonds) through the North Carolina Medical Care Commission ("Commission"). The proceeds were used to refund the previously outstanding 1998 Bonds, fund costs of construction and equipment related to the relocation of Rex's power plant, pay construction period interest, and pay for issuance costs for the 2010A Bonds.

The 2010A Bonds mature annually in amounts ranging from \$1,000 to \$8,130 and bear interest at rates between 2.00% and 5.00% for amounts maturing between 2011 and 2030. Under the agreements, the Obligated Group must also maintain a defined level of income available for debt service.

The 2010A Bonds are secured by a pledge of and a lien on the accounts receivable and the proceeds thereof derived from the ownership and operation of the Obligated Group. In the Master Indenture agreements for the 2010A Bonds, the Obligated Group includes Rex and the Hospital. Under the terms of the Master Indenture agreement for the 2010A Bonds, the Obligated Group is subject to certain financial covenants including but not limited to limitations on the transfer or sale of the Obligated Group's assets, limitations on the incurrence of additional indebtedness, maintenance of adequate insurance coverage on property, and maintenance of its tax-exempt status. Under the agreements, the Obligated Group must also maintain a defined level of income available for debt service. Rex believes the Obligated Group is in compliance with all debt covenants at June 30, 2013.

As a result of the early extinguishment of the 1998 Bonds, Rex incurred a loss of approximately \$1,947 during 2011. The loss has been deferred and is being amortized over the remaining life of the 1998 Bonds. At June 30, 2013 and 2012, accumulated amortization of the deferred loss was approximately \$656 and \$422, respectively.

**Construction Loan**

Ventures entered into a construction loan agreement with Wellness, HT, Retail and MOB as "Co-Borrowers" to fund the construction of the Wakefield campus. The loan bears interest at the BBA LIBOR daily floating rate plus 1.45% (1.69% and 1.64% at June 30, 2012 and 2011, respectively) and required interest only payments through April 2011. Beginning May 2011, all net cash flow from the Rex CDP properties will be applied to the outstanding principal balance of the construction loan through December 2011. Beginning in January 2012, 50% of the net cash flow from properties will be applied to the outstanding principal balance of the construction loan until the note matures and all outstanding balances are due in March 2012. On March 28, 2012, the loan was paid in full with the proceeds from a promissory note.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

**NOTE 6 LONG-TERM DEBT (CONTINUED)**

**Lines of Credit**

The Hospital entered into a note agreement for a short-term revolving line of credit with a financial institution for an amount up to \$50,000 to support short-term normal operating expenses and to enhance liquidity. The line of credit is collateralized by the Hospital's accounts receivable. Interest is due and payable monthly at the monthly London Inter-Bank Offered Rate ("LIBOR") plus 1.25 percent. The outstanding principal amount along with any accrued interest will be due upon the maturity date of March 31, 2014. The Hospital has not drawn any proceeds on this line of credit, thus, at June 30, 2013 and 2012, there was no outstanding balance.

**Notes Payable**

During the year ended June 30, 2012, RWE entered into a note agreement with a financial institution for \$30,000 to pay off the remaining balance of the construction loan described above. The note is payable in monthly principal and interest payments of \$153 from April 5, 2012 through March 5, 2022. The note is collateralized by certain property of RWE.

Rex Physicians entered into a note agreement with a financial institution for \$72. The outstanding principal amount along with any accrued interest will be due in November 2014. The outstanding balance of the loan was \$37 and \$62 at June 30, 2013 and 2012, respectively.

**Obligations Under Capital Lease**

Rex has entered into non-cancellable capital lease obligations for several pieces of equipment as of June 30, 2013 which expire at various dates through 2016.

Total future debt service requirements subsequent to June 30, 2013 are as follows

	Bonds	Notes Payable	Obligations Under Capital Lease	Interest	Total
Year Ending June 30:					
2014	\$ 4,835	\$ 1,837	\$ 727	\$ 6,196	\$ 13,595
2015	4,980	1,698	752	5,978	13,408
2016	5,175	842	348	5,714	12,079
2017	5,435	876	-	5,443	11,754
2018	5,645	909	-	5,166	11,720
2019-2023	32,435	20,649	-	17,281	70,365
2024-2028	33,470	-	-	11,223	44,693
2029-2032	23,225	-	-	3,117	26,342
	<u>115,200</u>	<u>26,811</u>	<u>1,827</u>	<u>(60,118)</u>	<u>203,956</u>
Unamortized Bond Premium, Net	3,485	-	-	-	3,485
Deferred Loss on Refunding, Net	(1,291)	-	-	-	(1,291)
	<u>\$ 117,394</u>	<u>\$ 26,811</u>	<u>\$ 1,827</u>	<u>\$ (60,118)</u>	<u>\$ 206,150</u>



**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
**(IN \$000's)**

**NOTE 7 RELATED PARTY TRANSACTIONS**

UNCHCS provides and receives certain services with Rex. Rex paid UNCHCS approximately \$4,995 and \$3,115 for such services during the years ended June 30, 2013 and 2012, respectively. UNCHCS paid Rex approximately \$839 and \$844 for such services during the years ended June 30, 2013 and 2012, respectively.

Under a management agreement effective January 1, 2000, UNCHCS assumed responsibility for the management and day-to-day operations of Rex Home Services, Inc., which became a division of the Hospital during 2013. During the years ended June 30, 2013 and 2012, this agreement resulted in approximately \$0 and \$152, respectively, paid to UNCHCS.

Rex contributed approximately \$34,273 and \$7,561 to UNCHCS during 2013 and 2012, respectively, to help fund working capital needs at UNC Physicians Network, LLC ("UNCPN"), of which UNCHCS is the sole member. UNCPN provides health care to patients throughout the Triangle and surrounding counties in North Carolina. Rex also contributed \$3,744 and \$5,421 during the years ended June 30, 2013 and 2012, respectively, to the UNCHCS Enterprise Fund to support the ongoing health care mission of UNCHCS.

Net payables due to UNCHCS were approximately \$6,438 and \$4,571 as of June 30, 2013 and 2012, respectively, and are included in accrued expenses and other liabilities in the accompanying combined balance sheets.

The Hospital paid QTS approximately \$1,508 and \$1,437 for laundry services during the years ended June 30, 2013 and 2012, respectively.

The Hospital paid Rex Cary MOB, LLC approximately \$296 and \$261 in rent expenditures for the use of surgical and office suites during the years ended June 30, 2013 and 2012, respectively.

Rex MOB Partners, LLC paid the Hospital approximately \$282 and \$259 for rent during the years ended June 30, 2013 and 2012, respectively.

**NOTE 8 EMPLOYEE BENEFITS**

*Rex Employees' Retirement Plan*

The Hospital sponsors the Rex Employees' Retirement Plan (the "Plan"), a single-employer defined benefit retirement plan available to eligible employees. The benefit formula is based on the highest five consecutive years of an employee's compensation during the 10 plan years preceding retirement.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

**NOTE 8 EMPLOYEE BENEFITS (CONTINUED)**

During the year ended June 30, 2009, the Hospital amended the Plan to (1) reduce early retirement benefits by increasing the retirement age from 62 to 65, and (2) freeze access to the Plan for eligible employees hired after February 1, 2009. In addition, the Hospital revised certain actuarial assumptions to (1) change the amortization period for gains and losses from 10 to 30 years and (2) change the asset valuation method from 20% to 30% above and below market value.

Funding amounts for the Plan are based upon actuarial calculations. The Plan utilized the projected unit-credit method to determine the annual contributions. The Hospital contributed approximately \$10,040 and \$8,020 to the Plan in 2013 and 2012, respectively. There are no employee contributions to the Plan.

Plan assets held in trust on behalf of the Plan participants consisted primarily of equity securities, U.S. Treasury securities and corporate bonds at June 30, 2013 and 2012. The actuarial value of Plan assets was determined by using a five-year moving average method.

The following table shows the trend in Rex's annual pension cost (APC), percentage of APC contributed, and net pension asset:

	Trend Information		
	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Asset
<u>Fiscal Year Ending:</u>			
June 30, 2013	\$ (10,040)	100.00 %	\$ -
June 30, 2012	(8,020)	100.00	-
June 30, 2011	(7,475)	100.00	-

As of January 1, 2013, the most recent actuarial valuation date, the Plan was 71.0% funded. The actuarial accrued liability for benefits was approximately \$250,134 and the actuarial value of assets was approximately \$177,497 resulting in an unfunded actuarial accrued liability of approximately \$72,637. The covered payroll was approximately \$184,796 and the ratio of the unfunded actuarial accrued liability to the covered payroll was 39.3%.

The schedule of funding progress, presented as Required Supplementary Information following the Notes to the Combined Financial Statements, presents multi-year trend information about whether the actuarial value of Plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The following assumptions were used in the January 1, 2013 and 2012 actuarial variations:

	2013	2012
Inflation Rate	3.00%	3.00%
Investment Rate of Return	7.50%	8.00%
Projected Salary Increases	3.00%	3.75%

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
(IN \$000's)

**NOTE 8 EMPLOYEE BENEFITS (CONTINUED)**

*Tax Deferred Annuity Retirement Plan*

The Hospital sponsors a defined contribution retirement plan covering substantially all employees. The Hospital matches one-half of each participant's voluntary contributions on a graduated scale based on length of service not to exceed 5% of the participant's annual salary. Employer contributions totaled approximately \$7,813 and \$6,470 for the years ended June 30, 2013 and 2012, respectively.

**NOTE 9 COMMITMENTS AND CONTINGENCIES**

*Commitments*

The Hospital has entered into certain agreements, in connection with ongoing development and support of its electronic medical records system. Future minimum payment commitments subsequent to June 30, 2013 are approximately \$1,899.

The Hospital has entered into a lease with Wellness to lease the wellness center. In addition, the Hospital entered into a lease with MOB for part of the medical office building. Rex has certain other noncancellable operating leases for the rental of office space and equipment. Future rent payments under these leases subsequent to June 30, 2013 are as follows:

Year Ending June 30:	Wellness Center	Medical Office Building	Office Space and Equipment	Total
2014	\$ 835	\$ 2,221	\$ 6,883	\$ 9,939
2015	862	2,253	6,001	9,116
2016	862	2,286	5,616	8,764
2017	862	2,300	5,237	8,399
2018	862	2,314	4,985	8,161
2019-2023	4,556	9,344	15,349	29,249
2024-2028	4,920	9,229	7,308	21,457
2029	1,424	1,170	-	2,594
	<u>\$ 15,183</u>	<u>\$ 31,117</u>	<u>\$ 51,379</u>	<u>\$ 97,679</u>

Total rental expense, including rental expense under noncancellable leases, was approximately \$15,852 and \$13,668 for the years ended June 30, 2013 and 2012, respectively.

*Contingencies*

The Hospital self-insures a portion of its workers' compensation exposure up to \$350 per claim. An accrual for the self-insurance program is established to provide for estimated claims and losses and applicable legal expenses for claims incurred through June 30, 2013 but not reported. This accrual was determined by an actuary and totaled approximately \$2,373 and \$1,804 at June 30, 2013 and 2012, respectively. The accrual is included in accrued expenses and other liabilities in the accompanying combined balance sheets. Commercial insurance has been obtained for coverage in excess of the self-insured amounts.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
**(IN \$000's)**

**NOTE 9 COMMITMENTS AND CONTINGENCIES (CONTINUED)**

The Hospital self-insures a portion of its employee health benefits exposure up to \$200 per incident. An accrual for the self-insurance program is established to provide for estimated claims and losses and applicable legal expenses for claims incurred through June 30, 2013 but not reported. This accrual was determined by an actuary and totaled approximately \$2,456 and \$2,805 at June 30, 2013 and 2012, respectively. The accrual is included in accrued expenses and other liabilities in the accompanying balance sheets. Commercial insurance has been obtained for coverage in excess of the self-insured amounts.

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

The Hospital has entered into an agreement whereby patients without insurance that meet contractually specified criteria can apply for medical loans from a third-party lender. Under this medical loan program, approved patients owe the third-party lender and the Hospital receives payment and recognizes revenue at the time medical services are provided. The Hospital is then contingently obligated to repurchase accounts receivable balances once the borrower does not make three scheduled monthly payments. Total accounts which the Hospital could possibly be required to repurchase were approximately \$239 and \$248 at June 30, 2013 and 2012, respectively. The Hospital establishes a reserve for accounts it believes it will have to repurchase based on historical experience with this program. The Hospital reserved approximately \$26 and \$30 for potential recourse that was included in the net accounts receivable, at June 30, 2013 and 2012, respectively.

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 necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Management believes Rex is in compliance with fraud and abuse 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. 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 repayment for patient services previously billed.

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**JUNE 30, 2013 AND 2012**  
**(IN \$000's)**

**NOTE 10 ELECTRONIC HEALTH RECORD INCENTIVE PROGRAM**

The Electronic Health Record (EHR) incentive program was enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA) and the Health Information Technology for Economic and Clinical Health (HITECH) Act. These Acts provided for incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified EHR technology. The incentive payments are made based on a statutory formula and are contingent on Rex's continuing to meet the escalating meaningful use criteria. For the first payment year, Rex must attest, subject to an audit, that it met the meaningful use criteria for a continuous 90-day period. For the subsequent payment year, Rex must demonstrate meaningful use for the entire year. The incentive payments are generally made over a 4-year period.

Rex demonstrated meaningful use to the 90-day period ended September 30, 2011, and received the first tentative incentive payments of approximately \$2,512 in March 2012. Of the \$2,512 received, \$2,012 is recognized as other operating revenue in the statement of revenues, expenses, and changes in net assets. The final amount of this payment will be determined based on audit of the information from Rex's Medicare cost report for the year ending June 30, 2012. Events could occur that would cause the final payment to differ materially upon final settlement.

**NOTE 11 COMMUNITY BENEFITS**

In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, Rex also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced rates. Rex sponsors many community health initiatives, including breast and prostate cancer screenings, cardiovascular and pulmonary awareness and diabetes education programs that ultimately result in the overall improved health of our community. The Rex Healthcare Emergency Response Team provides emergency aid and medical treatment at special events in the Wake County area. Rex also provides contributions, cash and in-kind, to various charitable and community organizations. The costs of these programs are included in operating expenses in the accompanying statements of revenues, expenses and changes in net assets.

**SUPPLEMENTARY INFORMATION**

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINING BALANCE SHEET**  
**JUNE 30, 2013**  
(IN \$000's)

<b>ASSETS</b>	<u>Obligated Group</u>	<u>Nonobligated Group</u>	<u>Eliminations</u>	<b>Combined Rex Healthcare, Inc. and Subsidiaries</b>
<b>CURRENT ASSETS</b>				
Cash and Cash Equivalents	\$ 65,764	\$ 8,234	\$ -	\$ 73,998
Patient Accounts Receivable, Net	70,599	8,079	-	78,678
Other Receivables	51,993	230	(45,290)	6,933
Inventories	11,249	-	-	11,249
Prepaid Expenses and Other Current Assets	4,531	894	-	5,425
Total Current Assets	<u>204,136</u>	<u>17,437</u>	<u>(45,290)</u>	<u>176,283</u>
<b>ASSETS LIMITED AS TO USE</b>	240,284	4,847	-	245,131
<b>CAPITAL ASSETS, NET</b>	253,215	30,020	-	283,235
<b>OTHER ASSETS</b>				
Investment in Affiliates	6,099	7,086	(1,498)	11,687
Deferred Debt Issuance Costs, Net	1,163	-	-	1,163
Other Assets	461	2,945	(2,649)	757
	<u>7,723</u>	<u>10,031</u>	<u>(4,147)</u>	<u>13,607</u>
Total Assets	<u>\$ 705,358</u>	<u>\$ 62,335</u>	<u>\$ (49,437)</u>	<u>\$ 718,256</u>
<b>LIABILITIES AND NET POSITION</b>				
<b>CURRENT LIABILITIES</b>				
Current Maturities of Long-Term Debt	\$ 6,282	\$ 1,117	\$ -	\$ 7,399
Vendor Accounts Payable	40,009	1,825	-	41,834
Accrued Expenses and Other Liabilities	53,987	50,984	(45,290)	59,681
Estimated Third-Party Settlements	11,386	1,614	-	13,000
Total Current Liabilities	<u>111,664</u>	<u>55,540</u>	<u>(45,290)</u>	<u>121,914</u>
<b>LONG-TERM DEBT, Net of Current Maturities</b>	114,655	23,978	-	138,633
<b>OTHER NONCURRENT LIABILITIES</b>	3,278	-	(2,649)	629
Total Liabilities	<u>229,597</u>	<u>79,518</u>	<u>(47,939)</u>	<u>261,176</u>
<b>NET POSITION</b>				
Net Investment in Capital Assets	132,278	4,925	-	137,203
Restricted	1,012	4,215	-	5,227
Unrestricted	342,471	(26,323)	(1,498)	314,650
Total Net Position	<u>475,761</u>	<u>(17,183)</u>	<u>(1,498)</u>	<u>457,080</u>
Total Liabilities and Net Position	<u>\$ 705,358</u>	<u>\$ 62,335</u>	<u>\$ (49,437)</u>	<u>\$ 718,256</u>

**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**YEAR ENDED JUNE 30, 2013**  
(IN \$000's)

	Obligated Group	Nonobligated Group	Eliminations	Rex Healthcare, Inc. and Subsidiaries
<b>OPERATING REVENUES</b>				
Net Patient Service Revenue	\$ 643,755	\$ 57,990	\$ -	\$ 701,745
Other Operating Revenues	26,918	2,718	-	29,636
Total Operating Revenues	<u>670,673</u>	<u>60,708</u>	-	<u>731,381</u>
<b>OPERATING EXPENSES</b>				
Salaries	247,618	48,326	-	295,944
Employee Benefits	82,203	8,500	-	90,703
Medical Supplies and Other Expenses	251,327	15,772	(3,574)	263,525
Depreciation and Amortization	29,843	970	-	30,813
Interest	3,188	1,977	-	5,165
Total Operating Expenses	<u>614,179</u>	<u>75,545</u>	<u>(3,574)</u>	<u>686,150</u>
<b>OPERATING INCOME (LOSS)</b>	56,494	(14,837)	3,574	45,231
<b>NONOPERATING INCOME (LOSS)</b>				
Investment Income (Loss), Net	20,197	779	-	20,976
Other, Net	(17,184)	599	(3,574)	(20,159)
Nonoperating Income (Loss), Net	<u>3,013</u>	<u>1,378</u>	<u>(3,574)</u>	<u>817</u>
<b>EXCESS OF REVENUES AND GAINS OVER EXPENSES AND LOSSES</b>	59,507	(13,459)	-	46,048
<b>CONTRIBUTIONS TO RELATED PARTY</b>	(38,017)	-	-	(38,017)
<b>OTHER</b>	<u>3,437</u>	<u>234</u>	<u>(2,815)</u>	<u>856</u>
<b>CHANGE IN NET POSITION</b>	24,927	(13,225)	(2,815)	8,887
Net Position - Beginning of Year	<u>450,834</u>	<u>(3,958)</u>	<u>1,317</u>	<u>448,193</u>
<b>NET POSITION - END OF YEAR</b>	<u>\$ 475,761</u>	<u>\$ (17,183)</u>	<u>\$ (1,498)</u>	<u>\$ 457,080</u>



**REX HEALTHCARE, INC. AND SUBSIDIARIES**  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF FUNDING PROGRESS FOR REX EMPLOYEES' RETIREMENT PLAN**  
**(UNAUDITED)**  
**JUNE 30, 2013**  
**(IN \$000's)**

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
January 1, 2013	\$ 177,497	\$ 250,134	\$ 72,637	71.00 %	\$ 184,796	39.30 %
January 1, 2012	166,265	215,516	49,251	77.15	185,343	26.57
January 1, 2011	158,693	188,633	29,940	84.13	190,434	15.72
January 1, 2010	149,019	171,627	22,608	86.83	199,427	11.34
January 1, 2009	140,562	155,914	15,352	90.15	173,000	8.87
January 1, 2008	139,324	151,747	12,423	91.81	152,626	8.14

The actuarial accrued liability is being amortized over a ten-year period on an open basis using the level-dollar method.