

Carilion Clinic and Subsidiaries

Consolidated Financial Statements as of and for the
Years Ended September 30, 2013 and 2012, and
Independent Auditors' Report

CARILION CLINIC AND SUBSIDIARIES

Roanoke, Virginia
A Nonstock, Nonprofit Corporation
Chartered by the Commonwealth of Virginia

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CARILION CLINIC AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Carilion Clinic
Roanoke, Virginia

We have audited the accompanying consolidated balance sheets of Carilion Clinic and subsidiaries (the "Clinic") as of September 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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.

Auditors' Responsibility

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

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

Opinion

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

Emphasis of Matter

As discussed in Notes 1, 4, and 16 to the consolidated financial statements, the consolidated financial statements include investments valued at \$322,725,000 (18% of total assets) and \$273,957,000 (17% of total assets) as of September 30, 2013 and 2012, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. In addition, the defined benefit postretirement plan assets disclosed in Notes 9 and 16 include investments of \$193,563,000 and \$174,191,000 as of September 30, 2013 and 2012, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on net asset values reported by the fund managers or the general partners.

Deloitte & Touche LLP

January 24, 2014

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2013 AND 2012 (In thousands)

	2013	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,954	\$ 1,792
Accounts receivable — net of allowance for doubtful accounts of \$87,462 in 2013 and \$75,324 in 2012	195,689	191,140
Inventories	13,533	14,256
Prepaid expenses and other current assets	18,823	14,489
Total current assets	230,999	221,677
INVESTMENTS	107,628	137,271
INTEREST RATE SWAPS	1,050	3,935
ASSETS WHOSE USE IS LIMITED	796,805	652,500
PROPERTY AND EQUIPMENT — Net	588,675	606,586
OTHER ASSETS	30,143	27,155
TOTAL	<u>\$1,755,300</u>	<u>\$1,649,124</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 41,437	\$ 40,394
Accounts payable	35,652	41,088
Due to third-party payors	30,882	34,207
Accrued salaries and wages	49,843	43,513
Accrued vacation	37,041	34,589
Other current liabilities	90,687	85,758
Total current liabilities	285,542	279,549
LONG-TERM DEBT — Net of current portion	584,616	598,566
INTEREST RATE SWAPS	48,067	90,954
PENSION AND OTHER LIABILITIES	234,444	394,851
Total liabilities	<u>1,152,669</u>	<u>1,363,920</u>
COMMITMENTS AND CONTINGENCIES (Notes 4, 5, 8, 14, and 15)		
NET ASSETS:		
Unrestricted:		
Carilion Clinic and subsidiaries	576,532	261,649
Noncontrolling interests	3,481	2,793
Total unrestricted net assets	580,013	264,442
Temporarily restricted	10,742	8,886
Permanently restricted	11,876	11,876
Total net assets	<u>602,631</u>	<u>285,204</u>
TOTAL	<u>\$1,755,300</u>	<u>\$1,649,124</u>

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012 (In thousands)

	2013	2012
UNRESTRICTED OPERATING REVENUES AND GAINS:		
Patient service revenue — net of contractual allowances and discounts	\$1,346,093	\$1,266,647
Provision for bad debts	(90,044)	(78,443)
Net patient service revenue	1,256,049	1,188,204
Other operating revenue	175,731	133,269
Net assets released from restrictions	2,299	2,487
Total unrestricted operating revenues and gains	1,434,079	1,323,960
OPERATING EXPENSES:		
Salaries and outside labor	683,634	647,976
Benefits	153,614	142,534
Supplies and other expenses	475,547	415,429
Depreciation	74,412	75,740
Interest expense	26,552	28,858
Total operating expenses	1,413,759	1,310,537
OPERATING INCOME	20,320	13,423
NONOPERATING INCOME:		
Investment income	123,087	60,681
Other nonoperating loss	(423)	(3,235)
Total nonoperating income	122,664	57,446
EXCESS OF UNRESTRICTED REVENUES AND GAINS OVER EXPENSES FROM CONSOLIDATED OPERATIONS	142,984	70,869
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION COST	172,666	(107,356)
DISTRIBUTION TO STONEWALL JACKSON COMMUNITY HEALTH FOUNDATION	(298)	
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASES OF PROPERTY AND EQUIPMENT	219	415
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS FROM CONSOLIDATED OPERATIONS	315,571	(36,072)
CHANGE IN UNRESTRICTED NET ASSETS ATTRIBUTABLE TO NONCONTROLLING INTERESTS	688	384
CHANGE IN UNRESTRICTED NET ASSETS ATTRIBUTABLE TO CARILION CLINIC AND SUBSIDIARIES	\$ 314,883	\$ (36,456)

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012 (In thousands)

	2013	2012
UNRESTRICTED NET ASSETS:		
Excess of unrestricted revenues and gains over expenses from consolidated operations	\$ 142,984	\$ 70,869
Pension-related changes other than net periodic pension cost	172,666	(107,356)
Distribution to Stonewall Jackson Community Health Foundation	(298)	
Net assets released from restrictions for purchases of property and equipment	<u>219</u>	<u>415</u>
Increase (decrease) in unrestricted net assets	<u>315,571</u>	<u>(36,072)</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions	2,360	2,240
Investment income	2,014	1,677
Net assets released from restrictions for purchase of property and equipment	(219)	(415)
Net assets released from restrictions used for operations	<u>(2,299)</u>	<u>(2,487)</u>
Increase in temporarily restricted net assets	<u>1,856</u>	<u>1,015</u>
PERMANENTLY RESTRICTED NET ASSETS — Net assets transferred to Jefferson College of Health Sciences Education Foundation	<u> </u>	<u>(9)</u>
INCREASE (DECREASE) IN NET ASSETS	317,427	(35,066)
NET ASSETS — Beginning of year	<u>285,204</u>	<u>320,270</u>
NET ASSETS — End of year	<u>\$ 602,631</u>	<u>\$ 285,204</u>

See notes to consolidated financial statements.

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012 (In thousands)

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase (decrease) in net assets	\$ 317,427	\$ (35,066)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation	74,412	75,740
Deferred compensation	4,115	5,068
Provision for bad debts	90,044	78,443
Net realized and unrealized gains on investments and interest rate swaps	(111,085)	(42,030)
Equity in earnings of affiliates	(1,002)	(501)
(Gains) losses on sale of assets	(3,374)	4,612
Restricted contributions and restricted investment income	(4,374)	(3,917)
Pension-related changes other than net periodic pension cost	(172,666)	107,356
Funding in deficit (excess) of net periodic pension cost	12,615	(3,487)
Loss on extinguishment of debt		3,047
Changes in:		
Accounts receivable — net	(94,594)	(89,169)
Inventories, prepaid expenses, and other current assets	(3,611)	(3,757)
Other assets	(1,924)	5,269
Accounts payable and accrued expenses	4,013	8,246
Due to third-party payors	(3,326)	9,337
Other current liabilities	5,142	15,228
Other liabilities	(3,022)	(7,588)
Net cash provided by operating activities	<u>108,790</u>	<u>126,831</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(58,369)	(45,893)
Proceeds from sale of property and equipment	4,363	78
Purchases of investments and assets whose use is limited	(426,634)	(239,326)
Proceeds from sale of investments and assets whose use is limited	<u>383,291</u>	<u>166,368</u>
Net cash used in investing activities	<u>(97,349)</u>	<u>(118,773)</u>

(Continued)

CARILION CLINIC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012 (In thousands)

	2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted contributions and restricted investment income	\$ 4,374	\$ 3,917
Deferred financing costs		(1,022)
Proceeds from issuance of long-term debt		96,349
Change in annuity obligation	48	
Distribution to Stonewall Jackson Community Health Foundation	(298)	
Principal payments and retirements of long-term debt	<u>(14,403)</u>	<u>(109,070)</u>
Net cash used in financing activities	<u>(10,279)</u>	<u>(9,826)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,162	(1,768)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>1,792</u>	<u>3,560</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 2,954</u>	<u>\$ 1,792</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest (net of amount capitalized) in 2013 and 2012 was \$28,471 and \$29,498, respectively.		
Noncash acquisitions of property and equipment in 2013 and 2012 totaled \$666 and \$659, respectively.		

See notes to consolidated financial statements.

(Concluded)

CARILION CLINIC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2013 AND 2012 (In thousands)

1. CORPORATE ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — Carilion Clinic is the sole member of Carilion Medical Center (CMC) (t/a Carilion Roanoke Memorial Hospital and Carilion Roanoke Community Hospital); Carilion New River Valley Medical Center (CNRV); Carilion Franklin Memorial Hospital (CFMH); Carilion Giles Community Hospital (CGCH); Carilion Tazewell Community Hospital (CTCH); Carilion Clinic Properties, LLC (CCP); Carilion Clinic Foundation (CF); and Carilion Services, Inc. (CSI) (collectively, “Carilion”).

Carilion has an 80% interest in Carilion Stonewall Jackson Hospital (CSJH), with the noncontrolling interest remaining with Stonewall Jackson Community Health Foundation. Carilion and Centra Health (“Centra”) have a joint ownership agreement with Bedford Memorial Hospital (BMH) under which Carilion and Centra each have a 50% equity interest in BMH (see Note 6).

Carilion and the entities for which it serves as sole member are not-for-profit, nonstock membership corporations exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). CSI is the sole stockholder of Blue Ridge Indemnity Company, LLC (BRIC), Carilion Clinic Medicare Resources, LLC (CCMR), and CHS, Inc. (CHSI), a holding company for taxable subsidiaries.

CCMR is a health maintenance organization for residents of southwest Virginia that began offering Medicare Advantage health plans as of October 1, 2009 and a Medicaid managed care health plan beginning January 1, 2012. Effective January 1, 2014, CCMR will no longer offer the Medicare Advantage health plans.

The accounts of CMC, CNRV, CFMH, CGCH, CSJH, CCP, and BMH are collectively referred to as the Obligated Group as a result of the Master Trust Indenture executed by and among the members of the Obligated Group in connection with the issuance of certain long-term debt obligations.

Presentation of Consolidated Financial Statements — The consolidated financial statements of Carilion have been prepared under the accrual basis in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) as set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Carilion and changes therein are classified and reported as follows:

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

Temporarily Restricted Net Assets — Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Temporarily restricted net assets held by Carilion as of September 30, 2013 and 2012, were restricted primarily for indigent care, clinical research, trauma operations, and neonatal and pediatric care.

Permanently Restricted Net Assets — Permanently restricted net assets have been restricted by donors to be maintained by Carilion in perpetuity. Permanently restricted net assets held by Carilion as of September 30, 2013 and 2012, were restricted primarily for neonatal and pediatric care.

In the accompanying consolidated statements of operations, all revenues have been reported as increases in unrestricted net assets, unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Cash and noncash contributions are recorded at fair value when made with the exception of unconditional promises, which are recognized on the date the promise is made.

The consolidated statements of operations include excess of unrestricted revenues and gains over expenses. Changes in unrestricted net assets, which are excluded from excess of unrestricted revenues and gains over expenses, include net assets released from restrictions for purchase of property and equipment, pension-related changes other than net periodic pension costs, and distributions to noncontrolling interests.

Consolidation — The consolidated financial statements include all subsidiaries for which Carilion has a controlling financial interest. All significant intercompany accounts and transactions have been eliminated in consolidation.

Patient Service Revenue — Carilion recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. Carilion has agreements with third-party payors that provide for payments to Carilion 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 under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

For uninsured patients that do not qualify for charity care, Carilion recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of Carilion's uninsured patients will be unable or unwilling to pay for the services provided. Thus, Carilion records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Allowance for Doubtful Accounts — Accounts receivable are reduced by an allowance for amounts that could become uncollectible in the future. Carilion estimates the allowance for doubtful accounts by reserving a percentage of all self-pay accounts receivable by aging category, based on collection history, adjusted for expected recoveries and, if present, anticipated changes in trends. The percentage used to reserve for all self-pay accounts is based on Carilion's collection history. Carilion collects substantially all of its third-party insured receivables, which include receivables from governmental agencies.

Carilion's allowance for doubtful accounts increased as a percentage of patient accounts receivable (net of contractals) from September 30, 2012 (35%), to 2013 (37%). The increase in the balance was largely the result of a 4% increase in accounts receivable due from patients in 2013 as compared to 2012.

Premium Revenues and Claims Expense — Premiums for Medicare Advantage and Medicaid managed care health plans are recognized as other operating revenues over the contract period (see Note 10). Claims expense is recognized as incurred and is reported within supplies and other expenses. CCMR incurred claims expense of \$74,414 and \$31,559 for the years ended September 30, 2013 and 2012, respectively.

Electronic Health Records (EHR) Incentives — The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified EHR technology. The EHR incentive payments to hospitals include a base amount, plus a discharge-related portion, which is calculated by the Centers for Medicare and Medicaid Services based on the hospital's most recently filed cost report and are subject to adjustment upon settlement of the cost report for the hospital's fiscal year that begins after the beginning of the payment year. A hospital may receive incentive payments for up to four years, provided that it successfully demonstrates meaningful use for each applicable EHR reporting period. Carilion recognizes revenue for EHR incentive payments in the period in which it is reasonably assured that it will comply with the applicable EHR meaningful use requirements. EHR incentive revenues are recognized ratably over the applicable meaningful use reporting period and are included in other operating revenues in the consolidated statements of operations. Carilion recognized EHR incentive revenues of \$10,885 and \$16,078 for the years ended September 30, 2013 and 2012, respectively. Carilion's attestations regarding the meaningful use of EHR technology are subject to audit by the federal government or its designee.

Charity Care — Carilion provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because Carilion does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue or included in patient accounts receivable. Carilion estimates the direct and indirect costs to provide charity care using a calculated ratio of costs to gross charges for each facility.

Cash and Cash Equivalents — Cash and cash equivalents consist primarily of demand deposits, temporary investments in bank repurchase agreements, certificates of deposit, and overnight master notes with banks. Carilion considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents.

Carilion's cash deposits are held at local and regional banks. Carilion had short-term investments of approximately \$3,834 and \$40,095 at September 30, 2013 and 2012, respectively, at a regional bank, which are included in the system-wide investment pool (see Note 4) and, therefore, are classified as noncurrent assets.

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

Investments and Assets Whose Use Is Limited — Carilion combines its investments, including investments and assets whose use is limited, are held in a system-wide investment pool. Assets whose use is limited primarily includes assets designated by the board of directors (the "Board") for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Carilion's investments and assets whose use is limited, excluding alternative investments, are classified as trading securities and measured at fair value in the consolidated balance sheets with the related interest and dividends and realized and unrealized holding gains and losses reported in investment income in the consolidated statements of operations, unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. Management determined that the trading security

category is appropriate based on Carilion's investment strategy and policies. Investment managers may execute individual purchases and sales of investments without prior approval from Carilion, as long as they comply with Carilion's investment strategy and policies.

Alternative investments, which are not readily marketable and are less liquid compared to Carilion's other investments, include hedge funds, limited partnerships, limited liability corporations, and offshore investment funds, and represent 36% and 35% of total investments and assets whose use is limited as of September 30, 2013 and 2012, respectively (see Notes 4 and 16). These instruments may contain elements of both credit and market risk. Such risks could include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments (both interest rate swaps and nonmarketable investments), and nondisclosure of portfolio composition. Investments of the limited partnerships include certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments, which involve varying degrees of off-balance-sheet risk for the limited partnerships, limited liability corporations, and offshore investment funds, may result in a loss due to changes in the market (market risk).

Carilion has elected the fair value option to account for its alternative investments. Management estimates the fair value of its alternative investments based on information provided by the fund managers or the general partners.

U.S. GAAP permits, as a practical expedient, a reporting entity to measure the fair value of certain investments without readily determinable fair values by using the reported net asset value (NAV) per share of the investment without further adjustment if the investment is in an entity that meets the description of an investment company whose underlying investments are measured at fair value as set forth in the ASC. Accordingly, Carilion generally estimates the fair value of its alternative investments using the NAV per share reported by the respective fund managers or the general partners.

The estimated fair value of certain alternative investments, such as private equity interests, is based on valuations performed prior to the balance sheet date by the external investment managers and adjusted for cash receipts, cash disbursements, and securities distributions through September 30. Because alternative investments are not readily marketable, their estimated fair 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. Such differences could be material.

Carilion's management, with the assistance of a third-party investment consultant, where appropriate, evaluates the valuations provided by external fund managers or general partners for appropriateness through review of the most recently available annual audited financial statements and unaudited interim reporting for the fund, review of the methodologies used to determine fair value, and comparisons of fund performance to market benchmarks.

Equity Method Investments — The equity method of accounting is used for investments in entities for which Carilion has the ability to exercise significant influence over the operating and financial policies of the investee, but does not have a controlling financial interest via majority voting rights, sole corporate membership, or by other means. The carrying value of equity method investments is adjusted for Carilion's proportionate share of changes in net assets of the investee, with adjustments as applicable for intraentity profit and losses, amortization of basis differences, investee capital transactions, and the effect of investee cumulative preferred stock.

Carilion's proportionate share of the earnings of equity method investees is reported in investment income (loss) in the consolidated statements of operations. Carilion's proportionate share of the

investee's extraordinary items, changes in accounting principle, and pension-related changes other than net periodic pension cost are recognized within the corresponding line item in Carilion's consolidated statements of operations and statements of changes in net assets (as applicable).

Equity method investments are initially measured at cost. Carilion evaluates the carrying value of equity method investments for other-than-temporary impairment. If the equity method investment is determined to be other-than-temporarily impaired, an impairment charge would be recognized for the amount by which the carrying amount exceeds fair value.

Property and Equipment — Property and equipment are stated at cost, less accumulated depreciation. Donated property and equipment are recorded at fair value at the date of donation. Depreciation is computed on the straight-line method over the estimated useful lives of the depreciable assets, except for leasehold improvements, which are amortized over the shorter of the expected useful life of the improvement or the term of the related lease. The estimated useful life of buildings is 39 years. The estimated useful life of fixed equipment is 10 to 20 years. The estimated useful life of movable equipment is 3 to 15 years.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate that their carrying amount may not be recoverable. The recoverability of long-lived assets is evaluated by comparing the carrying amount to the estimated undiscounted cash flows. If the carrying amount exceeds the estimated undiscounted cash flows, an impairment charge would be recognized for the amount by which the carrying amount exceeds the fair value of the long-lived asset. Management determined there was no impairment of long-lived assets as of or during the years ended September 30, 2013 and 2012.

Interest Costs — Interest costs incurred on borrowed funds, net of interest income earned on the unexpended bond proceeds during the period of construction of capital assets, are capitalized as a component of the costs of acquiring those assets. Such amounts were not material to the consolidated financial statements as of and for the years ended September 30, 2013 and 2012.

Bond Issue Costs and Original Issue Bond Premium and Discount — Unamortized bond issue costs of \$6,862 and \$7,233 at September 30, 2013 and 2012, respectively, are included in other assets in the accompanying consolidated balance sheets. Unamortized original issue premiums and discounts are netted against long-term indebtedness in the accompanying consolidated balance sheets. Bond issue costs, original issue premiums, and original issue discounts are amortized over the period the obligation is outstanding.

Derivative Instruments — Carilion uses interest rate swap instruments to manage its exposure to movements in interest rates. Interest rate swaps are contractual agreements between two parties for the exchange of interest payments on a notional principal amount at agreed-upon fixed or floating rates for defined periods. Interest rate swaps are measured at fair value in the accompanying consolidated balance sheets, with the change in fair value recorded as realized gains (losses) and included in investment income in the accompanying consolidated statements of operations. Carilion does not enter into derivative financial instruments for trading purposes.

Income Taxes — The Internal Revenue Service has determined that Carilion Clinic, the members of the Obligated Group, CTCH, CF, and CSI qualify under Section 501(c)(3) of the IRC and are, therefore, not generally subject to income taxes under present tax laws. CCMR and CHSI and its subsidiaries are taxable corporations.

Carilion recognizes a tax liability or asset for the estimated taxes payable or refundable on tax returns for current and prior years. Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to temporary differences between the financial statement carrying amounts of

existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A tax benefit from an uncertain tax position is recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Uncertain tax positions may include the characterization of income, such as a characterization of income as passive, a decision to exclude reporting taxable income in a tax return, or a decision to classify a transaction, entity, or other position in a tax return as tax exempt.

Carilion had no material unrecognized tax benefits and no adjustments to its consolidated financial statements were required as of and for the years ended September 30, 2013 and 2012. Carilion does not expect that unrecognized tax benefits will materially increase within the next 12 months.

Interest and penalties related to uncertain tax positions, if any, would be reported in the consolidated financial statements as income tax expense. Fiscal years from 2010 through 2012 are subject to examination by the federal and state taxing authorities. There are no income tax examinations currently in process.

Use of Estimates — The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. Significant estimates and assumptions are used for, but not limited to, recognition of net patient service revenue; valuation of accounts receivable, including contractual allowances and provisions for doubtful accounts; liabilities for losses and expenses related to employee health care and professional and general liability risks; valuation of investments and interest rate swap instruments; depreciation of property and equipment; and estimated third-party settlements. Future events and their effects cannot be predicted with certainty; accordingly, management's accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of the accompanying consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as the operating environment changes. Management regularly evaluates the accounting policies and estimates it uses. In general, management relies on historical experience and on other assumptions believed to be reasonable under the circumstances and may employ outside experts to assist in the evaluation, as considered necessary. Although management believes all adjustments considered necessary for fair presentation have been included, actual results may vary from those estimates.

Subsequent Events — Carilion has evaluated subsequent events from the end of the most recent fiscal year through January 24, 2014, the date of issuance of the consolidated financial statements.

Adoption of New Accounting Pronouncements — In April 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU No. 2011-04 results in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. ASU No. 2011-04 is effective for fiscal years beginning after December 15, 2011. The adoption of this guidance did not have a material effect on the consolidated financial statements.

Recently Issued Accounting Guidance — In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities (Topic 210)*. ASU No. 2011-11 requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the consolidated statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The requirements of ASU No. 2011-11 are required for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. Carilion is currently evaluating the provisions of this update and their impact on its consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*, providing guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. The new guidance requires entities to measure these obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The new guidance is effective for fiscal years ending after December 15, 2013. Carilion is currently evaluating the impact on its consolidated financial statements from the adoption of this guidance.

2. CHARITY CARE AND COMMUNITY SERVICES

Carilion is committed to providing quality health care to all, regardless of ability to pay. Under Carilion's charity care policy, patients meeting certain criteria receive care without charge or at a significant discount. The estimated cost of providing charity care to patients was \$67,816 and \$67,080 for 2013 and 2012, respectively.

Also, management believes that a portion of the provision for bad debts relating to patient service revenue represents amounts due from patients who would otherwise qualify for charity benefits, but do not respond to attempts to obtain the necessary financial information. The cost of providing these services is not included in the charity care amounts disclosed above.

To support its mission to improve the health of the communities it serves, Carilion continues to work with key partners in its service area to respond to the findings of the Carilion-led Roanoke Community Health Needs Assessment (the "Assessment"). The Assessment was designed to examine the needs of the community and to identify appropriate solutions to these needs. The Assessment findings focused on three priority areas: (1) access to services; (2) coordination of care; and (3) wellness. Working with community partners, these priorities were used to identify goals and strategies that will help improve the health for residents of communities served by Carilion.

On an ongoing basis, Carilion operates emergency rooms open 24 hours per day, seven days a week; sponsors community health screenings and educational classes; and promotes health and provides preventive care through partnerships with schools, community centers, and medical clinics in

underserved areas. Carilion also provides facilities and subsidizes operations to train medical personnel through support of the Jefferson College of Health Sciences and the Virginia Tech Carilion School of Medicine.

3. NET PATIENT SERVICE REVENUE

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

Medicare — Inpatient acute care services and exempt rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge for all hospitals, except CGCH and CSJH, which are reimbursed based on reasonable cost. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. When the estimated cost of treatment for certain patients is higher than the average, Carilion receives additional “outlier” payments. Inpatient nonacute services and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Certain outpatient service costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology, subject to certain limitations. Pursuant to federal legislation, the Medicare program makes payments for outpatient services on a prospective basis for certain hospitals of Carilion. This payment system classifies outpatient procedures into predetermined groups, ambulatory payment classifications (APCs), with each APC having a predetermined payment amount. Capital costs are paid on a prospective basis based on a predetermined rate per discharge. Carilion is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medicare fiscal intermediary has audited and final settled the Medicare cost reports for CMC through September 30, 2008, for CNRV, CGCH, CFMH, and CTCH through September 30, 2009, and for CSJH through September 30, 2010.

Medicaid — Inpatient acute care services rendered to 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. Outpatient services and certain other costs are reimbursed based on a percentage of reasonable cost. Carilion is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by Medicaid. All hospitals’ Medicaid cost reports have been final settled through September 30, 2012.

Laws and regulations governing the Medicare and Medicaid programs are 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. The effect of settlement adjustments was not material to the consolidated financial statements as of and for the years ended September 30, 2013 and 2012.

Anthem — Services rendered to Anthem subscribers are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Carilion also has agreements with Medicare, Medicaid, and Anthem to provide physician services, which are primarily reimbursed based on established fee schedules and/or predetermined percentages of covered charges, within certain limitations, and are not subject to retroactive adjustment.

In addition, Carilion has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations, and other third-party payors. The basis for payment to Carilion under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined rates.

Net patient service revenue for the years ended September 30, 2013 and 2012, is summarized as follows:

	2013	2012
Third-party payors	\$ 1,251,601	\$ 1,182,621
Self pay	<u>94,492</u>	<u>84,026</u>
Patient service revenue — net of contractual allowances and discounts	1,346,093	1,266,647
Provision for bad debts	<u>(90,044)</u>	<u>(78,443)</u>
Net patient service revenue	<u>\$ 1,256,049</u>	<u>\$ 1,188,204</u>

4. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Carilion combines its investments in a system-wide investment pool, which includes investments and assets whose use is limited. BMH's investments totaling \$5,651 and \$5,566 and assets whose use is limited totaling \$11,144 and \$10,072 as of September 30, 2013 and 2012, respectively, are also included in the investment pool. The carrying values of the components of the system-wide investment pool at September 30, 2013 and 2012, are summarized as follows:

	2013	2012
Investments	\$ 113,279	\$ 142,837
Assets whose use is limited	<u>807,949</u>	<u>662,572</u>
	<u>\$ 921,228</u>	<u>\$ 805,409</u>

The assets in the system-wide investment pool at September 30, 2013 and 2012, are summarized as follows:

	2013	2012
Short-term money market investments	\$ 3,834	\$ 63,008
Domestic common stocks	78,966	60,135
Mutual funds:		
Fixed income	149,133	100,007
Global equity	59,065	45,451
Multi-strategy	116,057	81,212
International equity	112,963	90,957
Alternative investments (Note 1):		
Core hedge funds	130,135	106,622
Low volatility hedge funds	9,381	11,707
Real estate limited partnerships	95,395	85,138
Inflation sensitive funds	28,794	22,410
Macro trading funds	23,249	18,191
Private equity limited partnerships and limited liability corporations	<u>35,771</u>	<u>29,889</u>
 Total investment pool	 842,743	 714,727
 Less amounts held for BMH	 <u>(16,795)</u>	 <u>(15,638)</u>
 Total investment pool — net of amounts held for BMH	 825,948	 699,089
 Assets whose use is limited under interest rate swap agreements	 268	 22,903
Assets held by BRIC	33,984	30,004
Assets whose use is limited under rabbi trust agreement	37,233	33,249
Assets on deposit with regulatory authorities	2,000	2,000
Assets held by CCMR	<u>5,000</u>	<u>2,526</u>
 Investments and assets whose use is limited	 <u>\$ 904,433</u>	 <u>\$ 789,771</u>

At September 30, 2013, Carilion was committed to invest an additional \$29,603 in limited partnership funds at an unspecified future date. There were no other unfunded investment commitments at September 30, 2013.

The fair values of Carilion's assets whose use is limited at September 30, 2013 and 2012, are summarized as follows:

	2013	2012
Assets whose use is limited under board designations	\$ 723,320	\$ 564,344
Assets whose use is limited under interest rate swap agreements	268	22,903
Assets whose use is limited for BRIC	33,984	30,004
Assets whose use is limited under rabbi trust agreement	37,233	33,249
CCMR assets on deposit with regulatory authorities	<u>2,000</u>	<u>2,000</u>
 Assets whose use is limited	 <u>\$ 796,805</u>	 <u>\$ 652,500</u>

Unrestricted investment income for the years ended September 30, 2013 and 2012, is summarized as follows:

	2013	2012
Dividends and interest	\$ 11,000	\$ 17,993
Net realized gains (losses) on investments	9,680	(4,766)
Net change in unrealized gains in investments and hedges	61,403	48,476
Equity in gains of affiliates	1,002	501
Net change in unrealized gains (losses) in interest rate swaps	<u>40,002</u>	<u>(1,523)</u>
Unrestricted investment income	<u>\$ 123,087</u>	<u>\$ 60,681</u>

5. PROPERTY AND EQUIPMENT — NET

Property and equipment — net at September 30, 2013 and 2012, consist of the following:

	2013	2012
Land and improvements	\$ 40,936	\$ 40,142
Buildings and fixed equipment	913,664	905,151
Movable equipment	<u>780,210</u>	<u>755,914</u>
	1,734,810	1,701,207
Less accumulated depreciation and amortization	<u>(1,152,956)</u>	<u>(1,099,839)</u>
	581,854	601,368
Construction in progress	<u>6,821</u>	<u>5,218</u>
Property and equipment — net	<u>\$ 588,675</u>	<u>\$ 606,586</u>

Depreciation expense totaled \$74,412 and \$75,740 for the years ended September 30, 2013 and 2012, respectively.

Unexpended contractual commitments for projects under construction at September 30, 2013 and 2012, approximated \$2,599 and \$668, respectively.

6. EQUITY INVESTMENTS IN AFFILIATES

BMH and Carilion have a joint ownership agreement with Centra. Under the terms of the agreement, Carilion has a 50% equity interest in BMH that is accounted for under the equity method. Carilion's investment in BMH was \$7,870 and \$4,584 at September 30, 2013 and 2012, respectively, and is included in other assets in the accompanying consolidated balance sheets.

At September 30, 2013 and 2012, Carilion owned approximately 15.5% and 16%, respectively, of the common stock of Luna Innovations, Inc. ("Luna"), which is accounted for under the equity method, as well as certain other interests in convertible preferred stock and warrants. Since Carilion's investment in Luna was reduced to zero due to Luna's continued operating and cash flow losses, Carilion has not

recorded an asset for any of its interests in Luna, at September 30, 2013 and 2012. The quoted market price of Luna's common stock was \$1.35 and \$1.66 per share as of September 30, 2013 and 2012, respectively.

As of September 30, 2013 and 2012, Carilion owned 90.3% and 80.2% of the common units outstanding of Laboratories Group Holding, LLC (LGH). The remaining equity interests in LGH include preferred units held primarily by a private equity investor. Both the common units and the preferred units are nonvoting. Carilion's investment in LGH is accounted for under the equity method as it has the ability to exercise significant influence over the entity through its right to appoint three of nine members of LGH's board of managers, but does not have a controlling financial interest. The carrying amount of Carilion's investment in LGH was reduced to zero through equity method losses in fiscal year 2011. Additional losses are not recognized as Carilion is not further obligated or committed financially to LGH.

7. NET ASSETS

A summary of changes in consolidated unrestricted net assets attributable to Carilion Clinic and subsidiaries and to the noncontrolling interest for the year ended September 30, 2013, is as follows:

	Total	Carilion Clinic and Subsidiaries	Noncontrolling Interests
Balance — beginning of year	\$264,442	\$261,649	\$2,793
Excess of unrestricted revenues and gains over expenses	142,984	142,021	963
Pension-related changes other than net periodic pension cost	172,643	172,643	
Pension-related changes other than net periodic pension cost related to noncontrolling interest	23		23
Distribution to Stonewall Jackson Community Health Foundation	(298)		(298)
Net assets released from restrictions for purchases of property and equipment	<u>219</u>	<u>219</u>	<u> </u>
Balance — end of year	<u>\$580,013</u>	<u>\$576,532</u>	<u>\$3,481</u>

A summary of changes in consolidated unrestricted net assets attributable to Carilion Clinic and subsidiaries and to the noncontrolling interest for the year ended September 30, 2012, is as follows:

	Total	Carilion Clinic and Subsidiaries	Noncontrolling Interests
Balance — beginning of year	\$ 300,514	\$ 298,105	\$2,409
Excess of unrestricted revenues and gains over expenses	70,869	70,503	366
Pension-related changes other than net periodic pension cost	(107,356)	(107,356)	
Pension-related changes other than net periodic pension cost related to noncontrolling interest	-	(18)	18
Net assets released from restrictions for purchases of property and equipment	<u>415</u>	<u>415</u>	<u> </u>
Balance — end of year	<u>\$ 264,442</u>	<u>\$ 261,649</u>	<u>\$2,793</u>

8. LONG-TERM DEBT

Long-term debt at September 30, 2013 and 2012, consists of the following:

	2013	2012
Hospital Revenue Bonds — Series 2012 — Serial Bonds, 4.0% to 5.0% fixed rate interest, maturing from 2014 to 2030	\$ 75,578	\$ 80,238
Hospital Revenue Bonds — Series 2010 — Term Bonds, 5.0% fixed rate interest, maturing from 2021 to 2033	95,740	95,740
Hospital Revenue Bonds — Series 2008A — Variable Rate Demand Bonds, variable rate interest (.04% at September 30, 2013), maturing from 2027 to 2042	50,000	50,000
Hospital Revenue Bonds — Series 2008B — Variable Rate Demand Bonds, variable rate interest (.06% at September 30, 2013), maturing from 2027 to 2042	110,000	110,000
Hospital Revenue Bonds — Series 2005A — Variable Rate Demand Bonds, variable rate interest (.10% at September 30, 2013), maturing from 2028 to 2036	123,110	123,110
Hospital Revenue Bonds — Series 2005B — Serial Bonds, 3.0% to 5.0% fixed rate interest, maturing from 2014 to 2020	24,705	27,360
Hospital Revenue Bonds — Series 2005B — Term Bonds, 4.375% to 5.0% fixed rate interest, maturing from 2026 to 2038	65,310	65,310
Hospital Revenue Bonds — Series 2005C — Serial Bonds, 5.0% fixed rate interest, maturing from 2014 to 2020	18,201	21,013
Hospital Revenue Bonds — Series 2005C — Term Bonds, 4.0% to 5.0% fixed rate interest, maturing from 2024 to 2027	26,039	26,039
Other long-term debt	<u>19,619</u>	<u>20,555</u>
	608,302	619,365
Unamortized bond premium	17,751	19,595
Scheduled payments due within one year	(13,126)	(12,083)
Additional current portion of Series 2008A and B Bonds	(16,000)	(16,000)
Additional current portion of Series 2005A Bonds	<u>(12,311)</u>	<u>(12,311)</u>
Long-term debt — net of current portion	<u>\$ 584,616</u>	<u>\$ 598,566</u>

On February 9, 2012, the Obligated Group issued \$88,460 of Hospital Revenue Bonds (“Series 2012 Bonds”) through the Economic Development Authority of the City of Roanoke, Virginia. The proceeds of the issue were used to refund all of the outstanding Series 2000 Hospital Revenue Bonds and Series 2002A Hospital Revenue Bonds, as well as provide funds to finance a portion of the costs of renovating certain portions of CMC and acquiring certain capital equipment for use in CMC. The Series 2012 Bonds are Serial Bonds with a fixed interest rate of 1% to 5% and mature from 2012 to 2030.

The resulting loss on extinguishment of debt was \$3,047 for the year ended September 30, 2012, and is included in other nonoperating loss in the consolidated statement of operations.

Each member of the Obligated Group is jointly and severally liable for the repayment of the principal and interest as they become due on the Hospital Revenue Bonds (collectively, the “Bonds”), including \$3,740 of the Series 2005 A, B, and C Bonds and \$2,982 of the Series 2012 Bonds related to Bedford at September 30, 2013, that is not included in the debt of Carilion in the accompanying consolidated

balance sheet. The Bonds are governed by a Master Trust Indenture, as amended and restated (the “Indenture”), by and among the members of the Obligated Group and U.S. Bank (the “Master Trustee”). The repayment of principal and interest on the Series 2005A, B, and C Bonds is guaranteed by a municipal bond insurance policy.

The Bonds are collateralized by a pledge of revenues of the Obligated Group, and the Master Trustee holds a security interest in the gross receipts of the Obligated Group. During 2010, a deed of trust was established for the benefit of the Master Trustee to secure all current and future obligations issued under the Indenture with substantially all land, buildings, and fixtures of CMC. The deed of trust is supported by \$45,000 of title insurance acquired by CMC. In addition, CNRV has pledged that it will not create, or permit to exist, a lien against its land, buildings, and fixtures.

The Series 2008A and B Bonds and Series 2005A Bonds are puttable variable rate demand obligations and are remarketed daily. The Obligated Group has entered into two separate standby bond purchase agreements for the Series 2008A and 2005A bonds and a letter of credit for the 2008B bonds (collectively, the “Liquidity Facilities”) to provide credit and liquidity support for the respective bonds. In the event the bonds are tendered for purchase and cannot be remarketed, the Liquidity Facilities provide that the respective bank will provide funds to purchase the unremarketed bonds. Bonds purchased with Liquidity Facility funds bear interest at variable rates determined based on the London InterBank Offered Rate (LIBOR) index plus 100 to 200 basis points and are payable to the bank in equal quarterly installments over five years. Principal payments are due beginning the first business day of the seventh calendar month following the bank purchase. Accordingly, Carilion has included \$16,000 of the Series 2008A and B Bonds and \$12,311 of the Series 2005A Bonds within the current portion of long-term debt as of September 30, 2013, to reflect the principal that would be payable to the Liquidity Facility providers if the bonds were tendered for purchase as of the balance sheet date and not remarketed during fiscal year 2014. The Obligated Group may prepay Liquidity Facility funds at any time without penalty. The Liquidity Facilities supporting the Series 2008A and B Bonds and the Series 2005A Bonds expire on July 16, 2015, June 30, 2014, and August 31, 2015, respectively. In the event the Liquidity Facility agreements are not extended or replaced with an alternative liquidity facility prior to expiration, the Indenture provides for mandatory tender of the bonds for purchase with Liquidity Facility funds repayable to the respective bank in equal quarterly installments over five years.

The aggregate principal maturities of long-term debt, including the additional current portion of Series 2008A and B Bonds and Series 2005A Bonds at September 30, 2013, are as follows:

**Years Ending
September 30**

2014	\$ 41,437
2015	68,893
2016	69,566
2017	70,057
2018	70,298
Thereafter	<u>288,051</u>
	<u>\$ 608,302</u>

Sinking Fund Requirements — The Series 2012 Bonds are subject to mandatory annual sinking fund requirements through 2030 in varying amounts ranging from \$1,325 to \$8,337. The Series 2010 Bonds are subject to mandatory annual sinking fund requirements beginning in 2021 through 2033 in varying amounts ranging from \$5,025 to \$13,435. The Series 2008A and B Bonds are subject to mandatory

annual sinking fund requirements beginning in 2027 through 2042 in varying amounts ranging from \$425 to \$32,870. The Series 2005A, B, and C Bonds are subject to mandatory annual sinking fund requirements through 2038 in varying amounts ranging from \$2,370 to \$22,355.

Debt Service Reserve Fund — The Obligated Group is required to maintain with the Master Trustee a debt service reserve fund to secure all obligations under the Indenture in the event that (a) the Obligated Group's days' cash on hand falls below 120 days at any semiannual test date or (b) the Obligated Group's long-term debt service coverage ratio is below 1.35 for fiscal year 2012 and 1.40 for fiscal year 2013 and thereafter. The debt service reserve fund amount, if required, would be equal to the maximum annual debt service for the obligations then outstanding under the Indenture and must be deposited within 90 days of the applicable test date or constitute an event of default under the Indenture, unless such requirement is waived by the bond insurers.

Debt Covenants — The Obligated Group is subject to certain covenants under the Indenture, the municipal bond insurance policies, and the Liquidity Facility agreements that, among other covenants, place restrictions on the members of the Obligated Group relative to operating ratios, the incurrence of additional indebtedness, and limitations on transfers of cash and investments from the Obligated Group. The Indenture requires that the Obligated Group maintain a debt-to-capitalization ratio of not more than 66% for fiscal year 2012, and 65% for fiscal year 2013 and thereafter. In addition, the Liquidity Facility agreements require that the Obligated Group maintain a minimum long-term debt service coverage ratio of not less than 1.25, with fiscal year-to-date testing performed quarterly. The Obligated Group has maintained compliance with these covenants as of and during the years ended September 30, 2013 and 2012.

Interest Rate Swap Agreements — At September 30, 2013 and 2012, Carilion had interest rate swap agreements with financial institutions to hedge a portion of the interest rate risk related to certain Hospital Revenue Bonds. Under the terms of the interest rate swap agreements in place at September 30, 2013, Carilion receives and pays interest based on the following:

Current Notional Amount (in thousands)	Hedged Bonds	Maturity Date	Type of Derivative	Pay Rate	Receive Rate	Collateral Posting Threshold
\$62,500	2005A	2036	Fixed payor	3.43%	67% 1m LIBOR(1)	
62,500	2005A	2036	Fixed payor	3.43%	67% 1m LIBOR(1)	
46,850	2005B	2031	Fixed payor	3.22%	67% 1m LIBOR(1)	
62,500	2008A/B	2042	Fixed payor	3.29%	67% 1m LIBOR(1)	10,000
62,500	2008A/B	2042	Fixed payor	3.29%	67% 1m LIBOR(1)	10,000
17,900	2005C	2020	Fixed payor	4.25%	68% 3m LIBOR + 0.23% (2)	5,000
29,945	2002A	2023	Basis swap	SIFMA Municipal Swap Index (3)	67% 3m LIBOR + 0.43% (2)	
29,945	2002A	2023	Basis swap	SIFMA Municipal Swap Index (3)	67% 3m LIBOR + 0.43% (2)	
69,969	2005B-C, 2010	2038	Basis swap	SIFMA Municipal Swap Index (3)	67% 3m LIBOR + 0.57% (2)	
95,217	2005B-C, 2010	2038	Basis swap	SIFMA Municipal Swap Index (3)	67% 3m LIBOR + 0.62% (2)	

(1) The 1m LIBOR was .18% and .21% at September 30, 2013 and 2012, respectively.

(2) The 3m LIBOR was .25% and .36% at September 30, 2013 and 2012, respectively.

(3) The SIFMA Municipal Swap Index was .07% and .18% at September 30, 2013 and 2012, respectively.

At September 30, 2013 and 2012, the Obligated Group posted \$268 and \$22,903, respectively, in collateral as part of the fixed payor swap agreements associated with the Series 2008 bonds (see Note 4).

The estimated fair values of the interest rate swap agreements at September 30, 2013 and 2012, are as follows:

Type of Derivative	Fair Value of Asset Derivatives		Fair Value of Liability Derivatives		Amount of Gain (Loss) Recognized	
	2013	2012	2013	2012	2013	2012
Fixed payor	\$ -	\$ -	\$ 47,986	\$ 90,954	\$ 42,968	\$ (6,236)
Basis swap	1,050	3,935	81		(2,966)	4,675
Floating rate payor						38
	<u>\$ 1,050</u>	<u>\$ 3,935</u>	<u>\$ 48,067</u>	<u>\$ 90,954</u>	<u>\$ 40,002</u>	<u>\$ (1,523)</u>

9. EMPLOYEE BENEFIT PLANS

Carilion maintains a funded, defined benefit pension plan (the “Plan”), which covers substantially all employees of Carilion and BMH. The benefits are based on years of service and the employee’s highest average of total earnings for five consecutive Plan years or the employee’s compensation during 5 of the last 10 years of employment. Carilion contributes to the Plan annually based on actuarially determined funding guidelines. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

Carilion maintains two nonqualified pension plans, a restoration plan for key members of management, and a supplemental plan for certain retired employees of CMC. Net periodic pension cost for the nonqualified plans was \$1,925 and \$597 for the years ended September 30, 2013 and 2012, respectively. The net pension liability for the plans was \$5,049 and \$8,388 as of September 30, 2013 and 2012, respectively, and is included in pension and other liabilities in the accompanying consolidated balance sheets.

The amounts reported in the accompanying consolidated financial statements related to Carilion’s defined benefit plans reflect the net periodic pension cost, pension-related changes other than net periodic pension cost, and the funded status of the three plans described above, excluding amounts related to employees of BMH (as applicable).

The Plan's change in benefit obligation, change in plan assets, current funded status, components of net periodic benefit cost, and pension-related changes other than net periodic pension cost as of and for the years ended September 30, 2013 and 2012, are as follows:

	2013	2012
Change in benefit obligation:		
Benefit obligation — beginning	\$ 908,387	\$ 716,429
Assumption changes	(129,439)	116,547
Service cost	39,182	31,907
Interest cost	39,827	37,742
Actuarial (gain) loss	(5,117)	24,739
Effect of acquisitions	214	214
Benefit payments	<u>(20,794)</u>	<u>(19,191)</u>
Benefit obligation — ending	<u>\$ 832,260</u>	<u>\$ 908,387</u>
Change in plan assets:		
Fair value of plan assets — beginning	\$ 552,659	\$ 466,855
Actual return on plan assets	56,495	61,987
Employer contributions	48,956	43,008
Benefit payments	<u>(20,794)</u>	<u>(19,191)</u>
Fair value of plan assets — ending	<u>\$ 637,316</u>	<u>\$ 552,659</u>
Funded status	<u>\$ (194,944)</u>	<u>\$ (355,728)</u>
Components of net periodic pension cost:		
Service cost	\$ 39,182	\$ 31,907
Interest cost	39,827	37,742
Expected return on plan assets	(44,536)	(41,527)
Prior service benefit recognized	58	38
Recognized actuarial losses	<u>28,489</u>	<u>14,322</u>
Net periodic pension cost	<u>\$ 63,020</u>	<u>\$ 42,482</u>
Other changes in plan assets and benefit obligations not yet recognized in net periodic pension cost:		
Net (gain) loss arising during the period	\$ (146,515)	\$ 120,825
Prior service cost	214	214
Amortization of loss	(28,489)	(14,322)
Amortization of prior service credit	<u>(58)</u>	<u>(38)</u>
Pension-related changes other than net periodic pension cost	<u>\$ (174,848)</u>	<u>\$ 106,679</u>
Total recognized in net periodic pension cost and other pension-related changes	<u>\$ (111,828)</u>	<u>\$ 149,161</u>

The accumulated benefit obligation was \$745,059 and \$792,607 at September 30, 2013 and 2012, respectively.

Carilion's portion of the Plan liability, net of the liability recorded by BMH, was \$190,190 and \$346,855 as of September 30, 2013 and 2012, respectively, and is included in pension and other liabilities in the accompanying consolidated balance sheets. Carilion's portion of net periodic pension cost, net of the cost recorded by BMH, was \$61,564 and \$41,428 and is included in benefits in the accompanying consolidated statements of operations.

During 2013 and 2012, Carilion contributed \$48,956 and \$43,008, respectively, to the Plan. Carilion expects to contribute approximately \$40,000 to \$50,000 to the Plan in fiscal year 2014.

Amounts recognized as changes in unrestricted net assets, but not yet reclassified as components of net periodic pension cost at September 30, 2013, consist of net loss and prior service cost of \$209,517 and \$753, respectively.

The estimated net loss and prior service credit recognized as changes in unrestricted net assets that will be amortized to net periodic pension cost over the next fiscal year are \$14,002 and \$12, respectively.

Significant assumptions used in determining the actuarial present value of the projected benefit obligation of the Plan for the years ended September 30, 2013 and 2012, are as follows:

	2013	2012
Weighted-average discount rate	5.4 %	4.4 %
Expected long-term rate of return on assets	7.7	7.7
Rate of compensation increase	3.0	3.0

The weighted-average discount rates used to determine net periodic pension cost for the years ended September 30, 2013 and 2012, were 4.4% and 5.3%, respectively.

The investment policy for the Plan is structured to maintain a diversified portfolio of equity securities, debt securities, cash equivalents, and alternative investment strategies, including real estate, private equity, fund-of-fund hedge funds, and global trading. The structure is designed to reduce risk and generate absolute returns in various market conditions. The portfolio is rebalanced periodically throughout the year.

Plan assets include alternative investments of \$193,563 and \$174,191 at September 30, 2013 and 2012, respectively (see Note 16).

Carilion's overall expected long-term rate of return on assets is 7.7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The expected long-term rate of return reflects management's estimate of future returns for the target asset allocation and is based primarily on historical returns. The Plan's target allocation for 2013 and plan asset allocation at September 30, 2013 and 2012, is as follows:

Asset Category	Target Allocation 2013	Percentage of Plan Assets at September 30, 2013	Percentage of Plan Assets at September 30, 2012
Equity securities	30 %	32 %	31 %
Hedge funds	10	22	30
Fixed-income securities	30	22	15
Inflation sensitive	15	21	20
Other investments	<u>15</u>	<u>3</u>	<u>4</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

The Plan benefits expected to be paid in fiscal years 2014 to 2018 are \$24,653, \$27,716, \$30,577, \$34,370, and \$38,032, respectively. The aggregate benefits expected to be paid in five years from 2019 to 2023 are \$250,972. The expected benefits are based on the same assumptions used to measure Carilion's benefit obligation at September 30 and include estimated future employee service.

Carilion also maintains three defined contribution retirement plans, which cover substantially all Carilion employees. The plans qualify under Section 403(b) or Section 401(k) of the IRC.

Carilion has a nonqualified deferred compensation plan for certain members of management and physicians to defer a portion of their compensation until retirement. The deferred amounts are invested in accordance with the participant's designation. The deferred compensation liability of \$37,233 and \$33,249, respectively, is included in pension and other liabilities in the September 30, 2013 and 2012, consolidated balance sheets. Carilion has placed certain assets in a rabbi trust to be used to pay benefits to certain deferred compensation plan participants. The carrying amount of the trustee assets was \$37,233 and \$33,249 at September 30, 2013 and 2012, respectively, and is included in assets whose use is limited in the accompanying consolidated balance sheets. Plan assets consist of investments in fixed-income mutual funds, domestic equity mutual funds, and international equity mutual funds (see Note 4).

10. OTHER OPERATING REVENUE

Other operating revenue for the years ended September 30, 2013 and 2012, is summarized as follows:

	2013	2012
Grants to reimburse operating costs	\$ 8,078	\$ 2,364
Rental revenue	4,838	4,593
College revenue	21,777	20,241
Athletic clubs revenue	4,897	4,701
In-kind contributions to Virginia Tech Carilion School of Medicine	1,714	1,813
Laundry services	828	1,153
Management services to equity affiliates	5,171	4,505
Collection services income	5,434	5,735
Cafeteria sales	3,289	3,092
EHR meaningful use revenues	10,885	16,078
Medical supplies and services	18,324	17,230
Medicare Advantage plan premium revenue	22,246	11,550
Medicaid managed care plan premium revenue	50,542	22,958
Other	<u>17,708</u>	<u>17,256</u>
Total	<u>\$ 175,731</u>	<u>\$ 133,269</u>

Other includes revenue from gift shop sales, management services, health care-related equity interests, and various health care services provided on a contract basis.

11. INCOME TAXES

Due to the losses incurred by Carilion's taxable subsidiaries, there was no income tax expense or benefit for the years ended September 30, 2013 and 2012. The primary differences between the expected income tax benefit at the statutory federal rate with the reported income tax benefit for the years ended September 30, 2013 and 2012, were due to the effect of state income taxes and the changes in the balance of the valuation allowance for deferred tax assets. Deferred income taxes at September 30, 2013 and 2012, relate to temporary differences in the asset and liability basis for financial and income tax reporting purposes and were calculated at income tax rates currently in effect. Temporary differences have primarily resulted from differences in the accounting for allowances for accounts and notes receivable, accrued expenses, depreciation, and net operating losses.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax-planning strategies in making this assessment. Based upon the level of historical taxable losses and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that Carilion will not realize the benefits of these deductible differences and loss carryforwards in excess of the amount that can be offset by the reversal of future taxable items. Accordingly, at September 30, 2013 and 2012, the net deferred tax asset has been reduced to zero by a valuation allowance.

At September 30, 2013, CHSI and its subsidiaries had net operating loss carryforwards of approximately \$328,477, which expire on various dates from 2018 to 2033.

12. FUNCTIONAL EXPENSES

Carilion provides various health care services to patients within its geographic location. Expenses related to providing these services for the years ended September 30, 2013 and 2012, are as follows:

	2013	2012
Health care services	\$ 1,164,606	\$ 1,107,858
General and administrative	<u>249,153</u>	<u>202,679</u>
	<u>\$ 1,413,759</u>	<u>\$ 1,310,537</u>

13. CONCENTRATION OF CREDIT RISK

Carilion provides health care services through its inpatient and outpatient care facilities located primarily in southwest Virginia. The facilities grant credit to patients, substantially all of whom are local residents. The facilities generally do not receive collateral or other security in extending credit to patients; however, they routinely obtain assignment of patients' benefits payable under their health insurance programs, plans, or policies. The mix of receivables from patients and third-party payors at September 30, 2013 and 2012, was as follows:

	2013	2012
Medicare	35 %	35 %
Medicaid	13	13
Anthem	13	16
Other third-party payors	20	19
Patients	<u>19</u>	<u>17</u>
	<u>100 %</u>	<u>100 %</u>

14. COMMITMENTS AND CONTINGENCIES

Litigation — Carilion is involved in litigation arising in the ordinary course of business. It is the opinion of management and Carilion's legal counsel that these cases will be resolved without material effect on Carilion's consolidated financial position, results of operations, or cash flows.

Other Industry Risks — 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. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for amounts previously received for patient services. Carilion believes it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material impact on its financial position or results of operations. Compliance with these and other laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

In March 2010, the Patient Protection and Affordability Care Act (the “Act”), a comprehensive health care reform bill, was signed into law. The legislation is complex and will be phased in over several years, with the most significant parts not taking effect until 2014. Carilion is in the process of assessing the potential impact of this reform on its consolidated financial position, results of operations, and cash flows.

Lease Commitments — Certain Carilion entities are parties to operating leases for various property and medical and other equipment. Lease expense was approximately \$6,303 and \$7,624 for the years ended September 30, 2013 and 2012, respectively, and is included in supplies and other expenses in the accompanying consolidated statements of operations.

A schedule of future minimum lease payments under operating leases at September 30, 2013, is as follows:

Years Ending September 30	Amount
2014	\$ 2,997
2015	1,508
2016	742
2017	552
2018	233
Thereafter	<u>627</u>
Total	<u><u>\$ 6,659</u></u>

Virginia Tech Carilion School of Medicine and Research Institute — Carilion and Virginia Polytechnic Institute and State University (“Virginia Tech”) have entered into a memorandum of understanding (MOU) agreement to establish and fund a portion of the costs related to a medical school (the “Virginia Tech Carilion School of Medicine” or the “Medical School”) and a research institute (the “Virginia Tech Carilion Research Institute” or the “Research Institute”) in order to address long-term regional health care needs and advance medical research in southwest Virginia. The Medical School admitted its first class of students in August 2010. The Research Institute opened in September 2010. The Medical School is a nonstock, nonprofit corporation. The Research Institute is constituted as a center of Virginia Tech. The facility housing the Medical School and Research Institute is owned by Virginia Tech and is located adjacent to CMC’s campus in Roanoke, Virginia. Carilion initially leased the underlying land to the Virginia Tech Foundation (the “Foundation”). Carilion sold the leased land to the Foundation during 2013 for \$1,648 and donated the proceeds from the sale to the Medical School. The land sale, contribution expense, and related selling expenses of the land are included in the other nonoperating loss in the accompanying consolidated statement of operations.

Under the MOU agreement, Carilion agreed to contribute up to \$35,000 to fund start-up costs for the Medical School and up to \$2,000 annually (subject to adjustment based on the Consumer Price Index) to fund operating deficits of the Medical School. In addition, Carilion agreed to facilitate funding for excess annual operating deficits in the form of nonrecourse loans to the Medical School, not to exceed \$1,000 annually, made directly by Carilion or a loan arranged through a financial institution and guaranteed by Carilion. Carilion would have no claim to repayment of such loans except to the extent that there are future operating surpluses generated by the Medical School. Carilion has agreed that such surpluses shall first be used to accumulate cash reserves by the Medical School up to the amount of \$5,000 prior to loan repayment. Under the terms of the MOU, Carilion’s commitments to fund start-up costs and operating deficits are unconditional through June 30, 2014, at which time the MOU will

terminate if the Medical School has not received accreditation. The amended MOU provides for termination prior to June 30, 2014, if certain other events or circumstances occur that are not solely under Carilion's control.

As of September 30, 2013, Carilion has provided cumulative start-up cost and operating deficit funding to the Medical School of \$19,166 and \$5,025, respectively. At September 30, 2013, Carilion has recognized other current liabilities of \$2,534 and \$1,575 for the unconditional portion of start-up and operating deficit funding, respectively, expected to be paid prior to June 30, 2014. The remaining unrecognized portion of Carilion's conditional commitment to fund start-up costs after June 30, 2014, was \$13,300 as of September 30, 2013.

15. SELF-INSURANCE LIABILITIES

Employee Health — Carilion offers subsidized health and dental insurance to its employees through a self-insured plan. The related liabilities are not material to Carilion's consolidated financial statements.

Workers' Compensation — Carilion is self-insured for workers' compensation liability up to the first \$500 per accident and has excess coverage up to applicable statutory limits on a claims-made basis. The related liabilities are not material to Carilion's consolidated financial statements.

Medical Malpractice — Carilion is self-insured for medical malpractice losses through its wholly owned subsidiary BRIC. BRIC is licensed as a captive insurance company by the Vermont Commissioner of Banking, Insurance, Securities, and Health Care Administration, pursuant to the provisions of the Vermont Statutes Annotated, and provides first-dollar coverage on a claims-made basis, with limits of \$52,100 per loss or medical incident and \$66,000 in the annual aggregate for professional and general liabilities. Through various independent carriers, BRIC carries reinsurance coverage of up to \$50,000 per each loss or medical incident and in the annual aggregate, excess of a limit up to \$2,100 per loss or medical incident and \$16,000 in the annual aggregate.

Policies on a claims-made basis must be renewed or replaced with equivalent insurance, if claims incurred during their term, but asserted after their expiration, are to be insured. Carilion has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of claims that have been incurred but not reported. The liability for medical malpractice losses, discounted at 4%, was \$34,293 and \$28,514 as of September 30, 2013 and 2012, respectively, and is included in other current liabilities in the accompanying consolidated balance sheets. In the opinion of management, adequate liabilities for medical malpractice claims have been established.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with U.S. GAAP, certain assets and liabilities are required to be measured at fair value on a recurring basis. For Carilion, the assets and liabilities that are adjusted at fair value on a recurring basis are investments, assets whose use is limited, and interest rate swap agreements.

U.S. GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Additionally, the inputs used to measure fair value are prioritized based on a three-level hierarchy. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 — Valuations based on unadjusted quoted prices for identical instruments in active markets that are available as of the measurement date

Level 2 — Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly

Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement

Transfers between Levels — The availability of market observable data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or valuation methodologies may require the transfer of financial instruments from one fair value hierarchy level to another. In such instances, the transfer would be reported at the beginning of the reporting period. Carilion evaluates the significance of transfers based on the nature of the financial instrument and the size of the transfer. There were no transfers of investments between levels for the years ending September 30, 2013 and 2012.

Investments and Assets Whose Use Is Limited — Valuations classified as Level 1 include short-term money market investments, common stocks, and publicly traded mutual funds for which unadjusted quoted market prices for identical securities are available as of the measurement date. Valuations classified as Level 2 include short-term investments, such as certain money market funds, certificates of deposit, and U.S. government agency securities, for which fair values are determined based on observable inputs. Carilion did not have any investments measured using Level 2 inputs as of September 30, 2013 and 2012. Valuations classified as Level 3 include alternative investments, for which fair values are determined based on inputs that are unobservable and significant to the overall fair value measurement (see Note 1).

The fair value hierarchy classification of assets in the system-wide investment pool and assets whose use is limited at September 30, 2013, is summarized in the table below:

	Fair Value Measurement at September 30, 2013			
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 3,834	\$ 3,834	\$ -	\$ -
Mutual funds	437,218	437,218		
Domestic equity securities	78,966	78,966		
Alternative investments (Note 1)	322,725			322,725
Assets whose use is limited:				
Short-term money market and treasury investments	16,744	16,744		
Debt and equity mutual funds	59,741	59,741		
Assets on deposit with regulatory authorities	<u>2,000</u>	<u>2,000</u>		
Total	<u>\$921,228</u>	<u>\$598,503</u>	<u>\$ -</u>	<u>\$322,725</u>

The fair value hierarchy classification of assets in the system-wide investment pool and assets whose use is limited at September 30, 2012, is summarized in the table below:

	Fair Value Measurement at September 30, 2012			
	September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 63,008	\$ 63,008	\$ -	\$ -
Mutual funds	317,627	317,627		
Domestic equity securities	60,135	60,135		
Alternative investments (Note 1)	273,957			273,957
Assets whose use is limited	88,682	88,682		
Assets on deposit with regulatory authorities	<u>2,000</u>	<u>2,000</u>		
Total	<u>\$805,409</u>	<u>\$531,452</u>	<u>\$ -</u>	<u>\$273,957</u>

The table below discloses the redemption frequency and redemption notice period for each applicable investment class as of September 30, 2013 and 2012, for which fair value is measured using the reported NAV per share of the investment. Such investments are classified within Level 3 of the fair value hierarchy because they cannot be redeemed by Carilion at the reported NAV as of the measurement date but, rather, are subject to the redemption frequency and notice periods described in the table below:

	2013	2012	Redemption Frequency	Redemption Notice Period
Core hedge funds	\$ 41,429	\$ 37,019	Quarterly	60–91 days
Core hedge funds	88,706	69,603	Annually	105 days
Low volatility hedge funds	9,381	11,707	Scheduled liquidation	N/A
Private equity funds	35,771	29,889	N/A	N/A
Real estate funds	95,395	85,138	Quarterly	45–90 days
Inflation sensitive funds	28,794	22,410	Monthly	10 days
Macro trading funds	<u>23,249</u>	<u>18,191</u>	Monthly/Quarterly	10–90 days
Total	<u>\$ 322,725</u>	<u>\$ 273,957</u>		

Pension Plan Assets — The fair value hierarchy classification of pension plan assets at September 30, 2013 and 2012, is summarized in the tables below:

Fair Value Measurement at September 30, 2013				
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 17,551	\$ 17,551	\$ -	\$ -
Common stocks	72,798	72,798		
Mutual funds:				
Fixed income	160,273	160,273		
Global equity	134,647	134,647		
Multi-strategy	58,484	58,484		
Alternative investments (Note 1):				
Private equity securities	15,999			15,999
Core hedge funds	76,123			76,123
Low volatility hedge funds	5,653			5,653
Real estate funds	58,029			58,029
Inflation sensitive funds	16,487			16,487
Macro trading funds	<u>21,272</u>	<u> </u>	<u> </u>	<u>21,272</u>
Total	<u>\$637,316</u>	<u>\$443,753</u>	<u>\$ -</u>	<u>\$193,563</u>

Fair Value Measurement at September 30, 2012				
	September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short-term money market investments	\$ 33,249	\$ 33,249	\$ -	\$ -
Common stocks	53,895	53,895		
Mutual funds:				
Fixed income	128,416	128,416		
Global equity	111,914	111,914		
Multi-strategy	50,994	50,994		
Alternative investments (Note 1):				
Private equity securities	14,986			14,986
Core hedge funds	68,436			68,436
Low volatility hedge funds	7,490			7,490
Real estate funds	50,727			50,727
Inflation sensitive funds	15,973			15,973
Macro trading funds	<u>16,579</u>	<u> </u>	<u> </u>	<u>16,579</u>
Total	<u>\$552,659</u>	<u>\$378,468</u>	<u>\$ -</u>	<u>\$174,191</u>

A reconciliation of changes in beginning and ending balances for investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended September 30, 2013 and 2012, is as follows:

	Fair Value Measurements Using Significant Unobservable Inputs Level 3						
	Private Equity Securities (a)	Core Hedge Funds (b)	Low Volatility Hedge Funds (c)	Real Estate (d)	Inflation Sensitive (e)	Macro Trading (f)	Total
Ending balance — September 30, 2011	\$34,829	\$ 94,597	\$13,734	\$77,409	\$29,182	\$ 29,118	\$278,869
Total gains	825	6,374	670	8,102	2,843	1,727	20,541
Purchases	376	29,500					29,876
Sales	(6,141)	(23,849)	(2,697)	(373)	(9,615)	(12,654)	(55,329)
Ending balance — September 30, 2012	29,889	106,622	11,707	85,138	22,410	18,191	273,957
Total gains (losses)	6,580	11,513	698	10,257	(2,116)	5,058	31,990
Purchases	4,464	12,000			8,500		24,964
Sales	(5,162)		(3,024)				(8,186)
Ending balance — September 30, 2013	<u>\$35,771</u>	<u>\$130,135</u>	<u>\$ 9,381</u>	<u>\$95,395</u>	<u>\$28,794</u>	<u>\$ 23,249</u>	<u>\$322,725</u>

A reconciliation of changes in beginning and ending balances for Plan investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended September 30, 2013 and 2012, is as follows:

	Fair Value Measurements Using Significant Unobservable Inputs Level 3						
	Private Equity Securities (a)	Core Hedge Funds (b)	Low Volatility Hedge Funds (c)	Real Estate (d)	Inflation Sensitive (e)	Macro Trading (f)	Total
Ending balance — September 30, 2011	\$12,904	\$ 72,100	\$ 8,891	\$51,535	\$ 23,527	\$19,972	\$188,929
Total gains	6,624	4,053	619	6,746	2,626	2,114	22,782
Purchases	102	9,000					9,102
Sales	(4,644)	(16,717)	(2,020)	(7,554)	(10,180)	(5,507)	(46,622)
Ending balance — September 30, 2012	14,986	68,436	7,490	50,727	15,973	16,579	174,191
Total gains (losses)	209	7,876	18	7,302	(1,486)	4,693	18,612
Purchases	3,633				2,000		5,633
Sales	(2,829)	(189)	(1,855)				(4,873)
Ending balance — September 30, 2013	<u>\$15,999</u>	<u>\$ 76,123</u>	<u>\$ 5,653</u>	<u>\$58,029</u>	<u>\$ 16,487</u>	<u>\$21,272</u>	<u>\$193,563</u>

- a) This class includes several private equity funds and cannot be directly redeemed. Instead, the nature of the investments in this category class is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is estimated that the underlying assets of the fund would be liquidated over five to eight years.
- b) This class includes investments in fund-of-fund hedge funds that invest both long and short primarily in domestic common stocks. The funds' strategy is to maintain a low correlation to the market and low volatility.
- c) This class includes investments in fund-of-fund hedge funds that seek to achieve long-term, nonmarket directional returns with low relative volatility by utilizing a variety of defensive hedge fund strategies.
- d) This class includes a real estate investment trust and a fund made up of participating mortgages.
- e) This class invests primarily in liquid asset categories that offer negative correlation in a rising-inflation environment.
- f) This class invests in a global macro hedge fund strategy that combines both systematic and discretionary trading in global asset classes and financial markets and also invests in the leveraged bank loan market.

Interest Rate Swap Agreements — The fair values of Carilion's interest rate swap agreements are determined using a standard valuation model based on observable inputs, including interest rate indices, and unobservable inputs, including extrapolations of observable inputs over the unobservable portion of the duration of the instrument. Interest rate swap agreements are classified as Level 3 fair value measurements because the unobservable inputs are significant to the overall fair value measurement.

Long-Term Debt — Fair values of Carilion's long-term debt are estimated using standard valuation models and/or quoted market prices for its bonds available close to the measurement date and were \$611,443 and \$638,910 as of September 30, 2013 and 2012, respectively (Level 2).

Other Assets and Liabilities — The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accrued expenses and other liabilities approximate fair value because of the short maturity of these instruments.

Nonrecurring Fair Value Measurements — In addition to assets and liabilities that are recorded at fair value on a recurring basis, Carilion records assets and liabilities at fair value on a nonrecurring basis as required by U.S. GAAP. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges. There were no material nonrecurring fair value measurements as of or during the years ended September 30, 2013 and 2012.

17. RELATED-PARTY TRANSACTIONS

Expenses for lab services provided by LGH were \$39,447 and \$36,171 for the years ended September 30, 2013 and 2012, and are included in supplies and other expenses in the accompanying consolidated statements of operations.

Revenues for services provided to BMH were \$5,401 and \$4,722 for the years ended September 30, 2013 and 2012, respectively, and are included in other operating revenue in the accompanying consolidated statements of operations.

18. ENDOWMENT FUNDS

Carilion's permanently restricted net assets consist primarily of one endowment fund. The income derived from the endowment fund is required by donor stipulations to be used for neonatal and pediatric care. Management has determined that assets whose use is limited that have been designated by the board for future capital improvements are not endowments because such assets are not required to be maintained permanently or for a specified term.

Management has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, Carilion classifies as permanently restricted net assets at the original value of gifts donated to the permanent endowment. The remaining portion of the donor-restricted endowment funds that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Carilion consistent with the donor's wishes. Losses on the investments of donor-restricted endowment funds are recorded as a reduction of temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining losses reduce unrestricted net assets and are excluded from the excess (deficit) of unrestricted revenues and gains over expenses.

In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: the duration and preservation of the fund, the purposes of the donor-restricted endowment fund, general economic conditions, the possible effect of inflation and deflation, the expected total return from income, and the appreciation of investments and other resources of Carilion.

Endowment net assets are held in the systemwide investment pool (see Note 4) and are subject to Carilion's investment policies. The endowment net asset composition at September 30, 2013 and 2012, is composed of the following:

	2013	2012
Endowment net asset composition:		
Temporarily restricted	\$ 2,723	\$ 1,778
Permanently restricted	<u>11,876</u>	<u>11,876</u>
Total	<u>\$ 14,599</u>	<u>\$ 13,654</u>

Changes in endowment assets for the year ended September 30, 2013, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets — beginning of year	\$ -	\$ 1,778	\$ 11,876	\$ 13,654
Investment income		1,429		1,429
Net assets transferred to Jefferson College of Health Sciences Education Foundation				
Appropriations of endowment assets for expenditure	<u>—</u>	<u>(484)</u>	<u>—</u>	<u>(484)</u>
Endowment net assets — end of year	<u>\$ -</u>	<u>\$ 2,723</u>	<u>\$ 11,876</u>	<u>\$ 14,599</u>

Changes in endowment assets for the year ended September 30, 2012, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets — beginning of year	\$ -	\$ 1,077	\$ 11,885	\$ 12,962
Investment income		1,074		1,074
Net assets transferred to Jefferson College of Health Sciences Education Foundation			(9)	(9)
Appropriations of endowment assets for expenditure	<u>—</u>	<u>(373)</u>	<u>—</u>	<u>(373)</u>
Endowment net assets — end of year	<u>\$ -</u>	<u>\$ 1,778</u>	<u>\$ 11,876</u>	<u>\$ 13,654</u>

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