Franciscan Alliance, Inc. and Affiliates

Consolidated Financial Statements with Supplemental Consolidated Information of the Obligated Group and Designated Group Affiliates
December 31, 2012 and 2011

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December 31, 2012 and 2011

Independent Auditor's Report

Board of Trustees
Franciscan Alliance, Inc.
Mishawaka, Indiana

We have audited the accompanying consolidated financial statements of Franciscan Alliance, Inc. and Affiliates (collectively referred to as the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of the 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.

Auditor's Responsibility
Our responsibility is to express an opinion on the 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 our 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, we consider internal control relevant to the Corporation'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 Corporation'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 Corporation at December 31, 2012 and 2011 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

April 22, 2013

PricewaterhouseCoopers LLP, One North Wacker Drive Chicago, IL,60606
T: (312)298 2000, F: (312) 298 2001, www.pwc.com/us

Franciscan Alliance, Inc. and Affiliates
Consolidated Balance Sheets
December 31, 2012 and 2011
(In thousands)

	2012	2011
Assets		
Current assets		
Cash and cash equivalents	$ 199,564	$ 172,319
Short-term investments	37,159	40,418
Patient accounts receivable, net of allowance for doubtful accounts of $42,917 in 2012 and $47,933 in 2011	336,243	312,539
Inventories of supplies	39,855	36,418
Other current assets	123,365	83,259
Total current assets	736,186	644,953
Board designated and other investments	1,726,697	1,673,904
Property, plant, and equipment, net	1,570,193	1,504,623
Investments in unconsolidated affiliates	21,378	24,012
Goodwill	21,361	18,425
Intangible assets, net of accumulated amortization of $10,554 in 2012 and $7,732 in 2011	19,077	9,940
Other assets	96,314	91,985
Total assets	$ 4,191,206	$ 3,967,842

	2012	2011
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	$ 22,103	$ 17,909
Accounts payable and accrued expenses	228,870	222,514
Accrued payroll and related expenses	110,656	99,128
Estimated third-party payor settlements	34,420	29,074
Total current liabilities	396,049	368,625
Long-term debt, net of current portion	1,116,075	1,119,157
Fair value of interest rate swap contracts	102,208	105,964
Accrued pension liability	426,629	326,527
Estimated insurance liabilities	130,132	136,362
Other liabilities	57,944	37,680
Total liabilities	2,229,037	2,094,315
Net assets		
Unrestricted	1,904,372	1,815,411
Noncontrolling interests in consolidated affiliates	28,376	28,383
Total unrestricted net assets	1,932,748	1,843,794
Temporarily restricted	17,559	17,798
Permanently restricted	11,862	11,935
Total net assets	1,962,169	1,873,527
Total liabilities and net assets	$ 4,191,206	$ 3,967,842

The accompanying notes are an integral part of these consolidated financial statements.

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets
Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Unrestricted revenues, gains, and other support		
Patient service revenue, net of contractual allowances and discounts	$ 2,460,016	$ 2,200,132
Provision for doubtful accounts	(106,994)	(93,140)
Net patient service revenue	2,353,022	2,106,992
Capitation and premium revenue	134,779	108,828
Other operating revenue	126,525	139,112
Equity in earnings of investments in unconsolidated affiliates	5,001	7,608
Net unrealized investment gains (losses)	5,533	(4,132)
Net assets released from restrictions used for operations	2,001	3,068
Total unrestricted revenues, gains and other support	2,626,861	2,361,476
Operating expenses		
Salaries	1,000,612	920,065
Employee benefits	290,012	262,262
Physicians' fees	52,721	48,310
Utilities	43,031	41,473
Repairs and maintenance	41,115	39,503
Drugs and pharmaceuticals	95,961	89,884
Medical supplies	189,503	190,356
Insurance	38,749	35,100
Purchased services	253,927	215,153
Other supplies and expenses	340,145	245,234
Interest	35,133	33,199
Depreciation and amortization	136,171	126,175
Total operating expenses before asset impairment	2,517,080	2,246,714
Operating income before asset impairment	109,781	114,762
Asset impairment	(30,000)	-
Operating income	79,781	114,762
Other income (expense)		
Investment income	82,065	88,709
Net unrealized investment gains (losses) on trading securities	76,311	(62,303)
Net unrealized losses and periodic settlements on interest rate swap contracts	(10,673)	(63,971)
(Loss) gain on sale/disposal of assets	(1,045)	7
Net assets released from restrictions	1,318	2,072
Contributions	431	1,387
Other, net	(5,040)	(3,764)
Total other income (expense), net	143,367	(37,863)
Excess of revenues over expenses	$ 223,148	$ 76,899

The accompanying notes are an integral part of these consolidated financial statements.

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets
Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Unrestricted net assets, controlling interest		
Excess of revenues over expenses	$ 204,073	$ 59,111
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	(116,529)	(94,433)
Other, net	(241)	(3,004)
Net assets released from restrictions used for purchase of property, plant, and equipment	1,658	784
Increase (decrease) in unrestricted net assets, controlling interest	88,961	(37,542)
Unrestricted net assets, noncontrolling interest		
Excess of revenues over expenses	19,075	17,788
Distributions	(19,082)	(16,892)
(Decrease) increase in unrestricted net assets, noncontrolling interest	(7)	896
Temporarily restricted net assets, controlling interest		
Contributions	3,498	6,237
Investment income	366	250
Net assets released from restrictions	(4,977)	(5,924)
Net unrealized investment gains (losses)	100	(147)
Other, net	774	115
(Decrease) increase in temporarily restricted net assets, controlling interest	(239)	531
Permanently restricted net assets, controlling interest		
Contributions	15	-
Investment income	95	71
Net unrealized investment (losses) gains	(64)	252
Other, net	(119)	(111)
(Decrease) increase in permanently restricted net assets, controlling interest	(73)	212
Increase (decrease) in net assets	88,642	(35,903)
Net assets, beginning of the year	1,873,527	1,909,430
Net assets, end of the year	$ 1,962,169	$ 1,873,527

The accompanying notes are an integral part of these consolidated financial statements.

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Cash flows from operating activities		
Increase (decrease) increase in net assets	$ 88,642	$ (35,903)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation of plant, property, and equipment	131,557	122,577
Amortization of bond discounts, deferred financing costs, and other intangible assets	4,614	3,598
Provision for doubtful accounts	106,994	93,140
Loss (gain) on sale/disposal of assets	1,045	(7)
Net investment gains	(163,909)	(22,274)
Asset impairment (see Note 2)	30,000	-
Net unrealized (gains) losses on interest rate swap contracts	(3,756)	49,510
Distributions to noncontrolling interests in consolidated affiliates	19,082	16,892
Distributions from unconsolidated affiliates	8,261	10,981
Equity in earnings of investments in unconsolidated affiliates	(5,001)	(7,608)
Restricted contributions and investment income	(3,974)	(6,558)
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	116,529	94,433
Changes in operating assets and liabilities:		
Patient accounts receivable	(130,699)	(157,212)
Inventories of supplies	(2,488)	1,748
Other assets	(42,943)	(30,835)
Accounts payable and accrued expenses	5,155	9,734
Accrued payroll and related expenses	11,528	13,159
Estimated third-party payor settlements	5,346	(995)
Estimated insurance liabilities	(6,230)	15,357
Accrued pension liability	(16,427)	(21,051)
Other liabilities	20,264	(8,865)
Total adjustments	84,948	175,724
Net cash provided by operating activities	173,590	139,821
Cash flows from investing activities		
Purchases of investments	(8,068,570)	-
Proceeds from sale of investments	8,228,260	-
(Purchases) sales of board designated and other investments in the HSD, net (see Note 2)	(45,315)	66,501
Purchases of property, plant, and equipment	(208,646)	(198,993)
Proceeds from sale of property, plant, and equipment	2,977	1,792
Acquisition of physician practices and other healthcare service organizations	(25,712)	(14,827)
Proceeds from sale of investments in unconsolidated affiliates	-	556
Net cash used by investing activities	(117,006)	(144,971)
Cash flows from financing activities		
Proceeds from issuance of long-term debt (see Note 6)	88,142	-
Refunding of long-term debt (see Note 6)	(82,620)	-
Principal payments on long-term debt	(19,753)	(20,029)
Distributions to noncontrolling interests of consolidated affiliates	(19,082)	(16,892)
Restricted contributions and investment income	3,974	6,558
Net cash used by financing activities	(29,339)	(30,363)
Net increase (decrease) in cash and cash equivalents	27,245	(35,513)
Cash and cash equivalents, beginning of year	172,319	207,832
Cash and cash equivalents, end of year	$ 199,564	$ 172,319

The accompanying notes are an integral part of these consolidated financial statements.

1. Description of Organization and Mission

Organization

Franciscan Alliance, Inc. and Affiliates (collectively referred to as the "Corporation"), under the sponsorship of the Sisters of St. Francis of Perpetual Adoration, Inc., is an Indiana nonprofit, Catholic health care system. The Corporation is dedicated to providing comprehensive health care services, including medical, surgical, behavioral health, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; primary and specialty physician services; as well as physician hospital managed care networks to communities within four geographic regions in Indiana and Illinois (the "Health Centers"). The Corporation also has a number of support related divisions and affiliates including a corporate office, a consolidated information technology services division, various back office/management support organizations, a construction company, a captive insurance company, and nonprofit foundations. In addition, the Corporation has various investments in consolidated and unconsolidated affiliates (see Note 10). The Corporation is incorporated as a not-for-profit corporation under the laws of Indiana and is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the "Code").

Mission

The Corporation's mission statement is as follows:

Continuing Christ's Ministry in Our Franciscan Tradition

Consistent with its mission, the Corporation provides medical care to all patients regardless of their ability to pay. In addition, the Corporation provides services intended to benefit the poor and underserved and to enhance the health status of the communities in which it operates.

The following summary has been prepared in accordance with the Catholic Health Association of the United States' policy document, *Guide for Planning and Reporting Community Benefit,* 2008 edition. The benefits provided are measured at total cost, net of any offsetting revenues, donations, or other funds used to defray cost.

The following amounts reflect the Corporation's quantifiable community benefits for the years ended December 31, 2012 and 2011:

	(Unaudited) 2012	2011
	(in thousands)	
Benefits for the poor and underserved		
Unreimbursed costs of Medicaid and other indigent care programs	$ 96,672	$ 119,144
Cost of charity care provided	83,775	69,465
Other benefits for the poor and underserved		
Subsidized health services	2,953	2,203
Community health improvement services	713	673
Financial and in-kind contributions	584	1,229
Health professions education	-	21
Community building activities	-	2
Community benefit operations	2	7
	4,252	4,135
Total benefits for the poor and underserved	184,699	192,744
Benefits for the broader community		
Subsidized health services	30,954	18,058
Health professions education	14,349	15,373
Community health improvement services	4,380	4,050
Financial and in-kind contributions	2,545	754
Research	937	597
Community building activities	890	988
Community benefit operations	151	107
Total benefits for the broader community	54,206	39,927
Total quantifiable community benefits	238,905	232,671
Unreimbursed costs of Medicare	250,739	192,996
Total quantifiable community benefits including unreimbursed costs of Medicare	$ 489,644	$ 425,667

Total quantifiable community benefits including unreimbursed costs of Medicare were approximately 19% of total operating expenses, before the asset impairment, for both the years ended December 31, 2012 and 2011.

The Corporation also provides a significant amount of uncompensated care to patients which is reported as provision for doubtful accounts in the consolidated statements of operations and changes in net assets and is not reported in the summary of quantifiable community benefits. During the years ended December 31, 2012 and 2011, the Corporation reported approximately $107.0 million and $93.1 million, respectively, as provision for doubtful accounts based on accumulated charges.

Benefits for the poor and underserved include the cost of providing programs and services to persons who are economically poor or are medically indigent and cannot afford to pay for health care services because they have inadequate resources and/or are uninsured or underinsured.

Benefits for the broader community include the costs of providing programs and services aimed at persons and groups for reasons other than poverty. These persons and groups may include needy populations that may not qualify as poor but need special services and support or broader populations who benefit from healthy community initiatives. These programs and services are not intended to be financially self-supporting.

Unreimbursed costs of Medicaid and other indigent care programs represent the cost (determined using a cost to charge ratio) of providing services to beneficiaries of public programs including State Medicaid and indigent care programs in excess of any payments received.

Charity care represents the cost (determined using a cost to charge ratio) of health care services, provided in accordance with the Corporation's charity care policy, for which no or partial reimbursement will be received because of the recipient's inability to pay for those services.

Subsidized health services are net costs for billed services that are subsidized by the Corporation. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would otherwise not be available in sufficient amount. Examples of services include emergency services, free standing community clinics, hospice care, behavioral health services, prenatal services, women's and children's services, palliative care, and parish nurse programs.

Community health improvement services are activities and services for which no patient bill exists. These services are not expected to be financially self-supporting, although some may be supported by outside grants or funding, which is netted against any amounts reported. Some examples include health education, health fairs, free or low cost health screening, immunization services, prescription medication assistance programs, and other various community outreach programs. The Corporation actively collaborates with community groups and agencies to assist those in need in providing such services.

Financial and in kind contributions are made by the Corporation on behalf of the poor and underserved to various community agencies. These amounts include funds used for charitable activities as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and underserved. In kind services include hours donated by staff to the community while on work time, overhead expenses of space donated to community groups, and donations of food, equipment, and supplies.

Health professions education includes the unreimbursed cost of training health professionals such as medical residents, nursing students, technicians, and students in allied health professions.

Community building activities include the costs of programs that improve the physical environment, promote economic development, enhance other community support systems, provide leadership development skills training, and build community coalitions.

Community benefit operations include costs associated with dedicated staff, community health needs and/or asset assessments, and other costs associated with community benefit strategy and operations.

Research includes the unreimbursed cost of clinical and community health research and studies on health care delivery.

Unreimbursed costs of Medicare represent the cost (determined using a cost to charge ratio) of providing services primarily to elderly beneficiaries of the Medicare program in excess of any payments received.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation, and all wholly-owned, majority-owned, and controlled organizations with all significant transactions and accounts between affiliates eliminated in consolidation. Investments in affiliates where the Corporation owns less than or equal to 50% and does not have operational control are recorded under the equity method of accounting unless the Corporation's control or investment percentage is insignificant in which case the Corporation uses the cost method.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Corporation to make assumptions, estimates, and judgments that affect the amounts reported in the consolidated financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The Corporation considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: recognition of net patient service revenue, which includes contractual allowances and a provision for doubtful accounts; recorded values of investments and goodwill; reserves for employee health costs and losses and expenses related to professional and general liabilities; and risks and assumptions for measurement of the pension liabilities. Management relies on historical experience and other assumptions believed to be reasonable in making its judgments and estimates. Actual results could differ materially from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and highly liquid marketable securities including interest bearing securities with maturities which may extend longer than three months. However, adequate liquidity is maintained to satisfy daily cash flow needs. Funds whose use is limited by Board designation or other restrictions are excluded. The carrying amount of cash and cash equivalents approximates fair value because of the short maturities of these instruments.

Inventories of Supplies

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first out method) or market value.

Board Designated, Other Investments, and Investment Income

Board designated investments represents investments set aside by the Corporation primarily for future purposes including capital expenditures, acquisitions, improvements, and amounts held for mission programs. The Corporation's Board of Trustees retains control of these investments and may, at its discretion and in certain circumstances, use them for other purposes. Assets limited as to use include assets under bond indenture and swap agreements, investments maintained for the payment of estimated insurance liabilities, and amounts contributed by donors with stipulated restrictions.

As of April 1, 2012, substantially all of the Corporation's board designated and other investments are invested and managed by professional managers in accordance with agreed-upon investment and socially responsible investing guidelines and are held in custody with a financial institution. Prior to April 1, 2012, approximately 96% of the Corporation's board designated and other investments were invested in a pooled account coordinated through Ascension Health's Health System Depository (the "HSD") under an investment management agreement. The custodian-held assets in the HSD were managed by professional managers who followed agreed-upon investment and socially responsible investing guidelines.

Board designated and other investments are measured at fair value, classified as trading securities, and consist of: cash and cash equivalents; U.S. government, state, municipal, and agency obligations; asset backed securities; corporate and foreign income securities; various types of equity securities and mutual funds; and prior to April 1, 2012, the Corporation's pro-rata share of pooled investments within the HSD. Board designated and other investments also include alternative investments, consisting of investments in hedge funds, prime credit and private equity investments, and real assets, which are generally measured based on their net asset value as a practical expedient for fair value that is further described in Note 4. As of December 31, 2011, the HSD's asset allocation consisted of 38% equities, 29% fixed income, 31% alternative investments, and 2% cash and cash equivalents.

Investment earnings consist of dividends, interest, realized gains and losses and, prior to April 1, 2012, the Corporation's pro-rata net earnings of the HSD. In accordance with industry practice, investment earnings and unrealized gains and losses on assets limited as to use under bond indenture and swap agreements and estimated insurance liability funds are included in other operating revenue in the consolidated statements of operations and changes in net assets. Investment earnings and unrealized gains and losses from all other unrestricted investments and board designated funds are included in other income (expense) in the consolidated statements of operations and changes in net assets. Investment earnings and any associated unrealized gains and losses restricted for specified purposes by donor or legal requirements are recorded as temporarily or permanently restricted in the consolidated statements of operations and changes in net assets.

Board designated and other investments are exposed to various risks, such as interest rate, market, liquidity, performance, and credit risk. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term may affect the amounts reported in the consolidated balance sheets and the consolidated statements of operations and net assets.

Securities Lending Program

The Corporation participates in a securities lending program through its custodian whereby the Corporation lends a portion of its investments to various brokers in exchange for collateral for securities loaned, mostly on a short-term basis. Collateral provided by these brokers consists of cash and is maintained at levels approximating 102-105% of the fair value of the securities on loan, adjusted for any market fluctuations. The Corporation maintains effective control of loaned securities through its custodian during the term of the agreement so that the securities may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. At December 31, 2012, the fair value of collateral for loaned securities provided on behalf of the Corporation was approximately $30.7 million while the fair market value of securities on loan was approximately $30.8 million with the net amount reported in board designated and other investments.

Fair Value Measurement

The Corporation's consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets measured at fair value on a recurring basis in the Corporation's consolidated balance sheets include: cash and cash equivalents; short-term investments; U.S. government, state, municipal, and agency obligations; asset backed securities; corporate and foreign income securities; various types of equity securities and mutual funds; hedge funds; private credit and private equity investments; real assets; benefit plan assets; and, prior to April 1, 2012, pooled investments within the HSD. Liabilities measured at fair value on a recurring basis include the Corporation's interest rate swap contracts.

Fair value measurements reflected in the consolidated financial statements conceptually represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Generally accepted accounting principles provide a hierarchy that prioritizes the inputs to fair value measurements based on the extent to which inputs to valuation techniques are observable in the marketplace. The hierarchy assigns a higher priority to observable inputs that reflect the Corporation's assumptions about how market participants would value an asset or liability based on the best information available. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs.

The three levels of the hierarchy of inputs used to measure fair value are described briefly as follows:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 Unobservable inputs for the asset or liability, used in situations in which little or no market activity exists for the asset or liability at the measurement date.

The categorization of fair value measurements by hierarchy level is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability.

The Corporation applies the guidance in Accounting Standards Codification 820-10-15-4, *Fair Value Measurements of Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*. Under the guidance, the Corporation is permitted, as a practical expedient, to estimate the fair value of certain portfolio investments on the basis of the net asset value per share. In the normal course of business, the Corporation holds certain investments that qualify for the usage of the practical expedient. Fair value measurements of certain investment assets for which the measurement was based on net asset value ("NAV") or its equivalent as provided by an external manager are categorized within Level 2 or 3.

In the event that changes in the inputs used in the fair value measurements of an asset or liability results in a transfer of the fair value measurement to a different categorization (e.g., from Level 3 to Level 2), such transfers between fair value categories are recognized at the end of the reporting period.

Property, Plant, and Equipment
Property, plant, and equipment (including internal-use software) are recorded at cost if purchased or at fair value at the date of donation, if donated. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Routine maintenance, repairs, and minor equipment replacement costs are charged to expense when incurred. Cost incurred in the development and installation of internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post implementation stage. Upon sale or retirement of property, plant, and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets. Interest costs incurred during the period of construction or development of capital assets are capitalized as a component of the cost of acquiring those assets. Depreciation is provided over the estimated useful lives of the assets utilizing the straight-line method. Assets under capital lease obligations are amortized utilizing the straight-line method over the shorter of the lease term or estimated useful life of the asset. Amounts capitalized for internal-use software are amortized over the useful life of the developed asset following project completion.

A conditional asset retirement obligation is recorded for any legal obligation associated with the retirement of long-lived assets resulting from the acquisition, construction, development, and/or normal use of the underlying assets. The associated asset retirement costs are capitalized as part of the carrying amount of the underlying asset and depreciated over the asset's estimated useful life. The liability is accreted through charges to operating expense. If the conditional asset retirement obligation is settled for other than the carrying amount of the liability, a gain or loss on sale/disposal of assets is recognized. As of December 31, 2012 and 2011, conditional asset retirement obligations of approximately $18.7 million and $18.9 million, respectively, are included within other liabilities in the consolidated balance sheets.

Goodwill and Intangible Assets
Goodwill represents the excess of costs over the fair value of assets of businesses acquired. Goodwill is tested for impairment on an annual basis or when an event or change in circumstances indicates the value of a reporting unit, which for the Corporation is the individual Health Centers within its four regions, may have changed. There is a two-step process for determining goodwill impairment. Step one compares the carrying value of each reporting unit with its fair value. Step two compares the implied fair value of the reporting unit's goodwill with the carrying value of the reporting unit's goodwill. If the carrying value of goodwill is impaired, the Corporation reduces the carrying amount to fair value. Estimates of fair value are based on appraisals, internal estimates of future net cash flows on a discounted basis, as well as other generally accepted valuation methodologies.

Intangible assets primarily consist of covenants not to compete which are amortized on a straight-line basis over periods ranging from 2 to 5 years.

Asset Impairment
The Corporation periodically evaluates the carrying value of its other long-lived assets for impairment whenever events or business conditions indicate the carrying value of such assets may not be fully recoverable. Initial assessments of recoverability are based upon estimates of undiscounted future net cash flows associated with an asset or group of assets. When an impairment is indicated, the carrying amount of these long-lived assets is reduced to fair value, based on future discounted net cash flows or other estimates of fair value.

During the year ended December 31, 2012, the Corporation recognized an impairment of buildings, building equipment, and departmental equipment of $30.0 million at two of its Health Centers due to declines in operating performance.

Deferred Financing Costs
Deferred financing costs incurred with the Hospital and Health System Revenue Bonds and Refunding Bonds are amortized using the bonds outstanding method. Costs associated with securing the direct pay letters of credit to support its variable rate demand bonds are amortized over the term of the associated liquidity facility. Deferred financing costs are included in other assets in the consolidated balance sheets.

Estimated Insurance Liabilities
The provision for estimated insurance liabilities includes actuarial estimates of the ultimate costs for both reported claims and claims incurred but not reported for professional liability, general liability, long-term disability insurance, excess workers' compensation, and amounts self-insured for allocated loss adjustment expenses.

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

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the consolidated financial statements.

During 2012 and 2011, net assets of $4,977,000 and $5,924,000, respectively, were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes or by the passage of time.

Performance Indicator
The performance indicator is excess of revenues over expenses, which includes all changes in unrestricted net assets except for the change in pension and postretirement benefits other than net periodic pension costs which is included in accrued pension liability; contributions and distributions to noncontrolling interests in consolidated affiliates; and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Operating and Nonoperating Activities

The Corporation's primary mission is to meet the health care needs in the communities it is privileged to operate through a broad range of general and specialized health care services, including medical, surgical, behavioral health, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; primary and specialty physician services; as well as physician hospital managed care networks. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to the Corporation's primary mission are considered to be nonoperating activities.

Patient Accounts Receivable, Estimated Third-Party Payor Settlements, and Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments at amounts different from its established rates. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered net of the provision for doubtful accounts and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors and amounts received under various state Medicaid Hospital Assessment and Disproportionate Share Programs. Revenue under certain third-party payor agreements is subject to audit, retroactive adjustments, and significant regulatory actions. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as additional information becomes available and as final settlements are determined.

Allowance for Doubtful Accounts

The collection of outstanding patient accounts receivable from government, managed care, and other third party payors and patients is the Corporation's primary source of cash. The Corporation's main collection risk relates to uninsured patient accounts and to patient accounts for which the third party payor has paid amounts in accordance with the applicable agreement, however the patient's responsibility, usually in the form of deductibles, copayments, and coinsurance payments, remain outstanding ("self-pay accounts"). The Corporation's patient accounts receivable is reduced by an allowance for amounts, primarily self-pay accounts, which could become uncollectible in the future. Throughout the year, the Corporation estimates this allowance based on the aging of its patient accounts receivable, historical collection experience, and other relevant factors. These factors include changes in the economy and unemployment rates, which has an impact on the number of uninsured and underinsured patients, as well as trends in health care coverage, such as the increased burden of deductibles, copayments, and coinsurance payments to be made by patients with insurance. After satisfaction of amounts due from insurance and reasonable efforts to collect from the patient have been exhausted, the Corporation follows established procedures for placing certain past due patient balances with collection agencies, subject to the terms and certain restrictions on collection efforts as determined by the Corporation. Uncollectible patient accounts receivable are written off against the allowance for doubtful accounts with any subsequent recoveries being recorded against the provision for doubtful accounts.

Charity Care
As an integral part of its mission, the Corporation provides care to patients who meet certain criteria under its charity care and uninsured patient discount policy without charge or at amounts less than its established rates. The cost of charity care is determined based on each Health Center's total cost as a percentage of total charges and that ratio is applied to the charges incurred by patients qualifying for charity care under the Corporation's policy and is not included in net patient service revenue in the consolidated statements of operations and changes in net assets. The estimated cost of charity care provided approximated $83.8 million and $69.5 million for the years ending December 31, 2012 and 2011, respectively. For both the years ending December 31, 2012 and 2011, no gifts or grants were received to offset or subsidize charity care services provided. The Corporation maintains records to identify and monitor the level of charity it provides.

Capitation and Premium Revenue
The Corporation has certain Health Centers that arrange for the delivery of health care services to enrollees through various contracts with providers and common provider entities. Enrollee contracts are negotiated on an annual basis. Premiums are due monthly and are recognized as revenue during the period in which the Corporation is obligated to provide services to enrollees.

Certain of the Corporation's Health Centers have entered into capitation agreements whereby they accept the risk for the provision of certain health care services to health plan members. Under these agreements, the Corporation's Health Centers are financially responsible for services provided to health plan members by other health care providers. Capitation revenue is recognized during the period for which the Health Centers are obligated to provide services to health plan enrollees under capitation contracts.

Reserves for incurred but not reported claims have been established to cover the unpaid costs of health care services under capitation and premium arrangements. Capitation and premium arrangement reserves are classified within accounts payable and accrued expenses in the consolidated balance sheets. The liability is estimated based on actuarial studies, historical reporting, and payment trends. Actual claims experience will differ from estimated liabilities due to variances in estimated and actual utilization of health care services, charge amounts, and other factors. As settlements are made and estimates revised, any differences are reflected in current operations. The Corporation limits a portion of its liabilities through stop-loss reinsurance.

During 2011, the Corporation formed Franciscan Alliance Accountable Care Organization, LLC along with various accountable care affiliates (collectively referred to as "Franciscan ACO"). Franciscan ACO is an organization formed to manage and coordinate a full continuum of patient care services to covered individuals on a capitated, shared savings, risk or partial risk basis under contracts with the Centers for Medicare and Medicaid Services ("CMS") and commercial payors. In December 2011, Franciscan ACO was selected as a participant in the Medicare Pioneer Accountable Care Organization initiative ("Pioneer ACO") for a three year period effective January 1, 2012. In July 2012 and January 2013, Franciscan ACO was selected as a participant in two Medicare Shared Savings Program initiatives ("MSSP"). The Pioneer ACO and the MSSP initiatives are new programs sponsored by CMS to provide Medicare beneficiaries with high-quality coordinated care at a lower cost. Under the first year of the Pioneer ACO agreement, the Corporation does not have any downside risk attributable to its performance. The MSSP initiatives that the Corporation selected do not have any downside risk for any performance year.

Electronic Health Record Incentive Payments
Starting in 2011, Medicare and state Medicaid programs are providing an incentive payment to eligible hospitals and professionals if meaningful use certified electronic health care ("EHR") technology is adopted and utilized. The Corporation recognizes income related to these incentive payments using a grant accounting model that is based upon when the Corporation has reasonable assurance that it will comply with any designated conditions set forth by Medicare and Medicaid and that the dollars will be received. For the years ended December 31, 2012 and 2011, approximately $19.8 million and $10.7 million, respectively, of EHR incentive income was recognized and is included in other operating revenue in the consolidated statements of operations and changes in net assets. The Corporation's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were initially calculated. The Corporation has incurred and will continue to incur both capital expenditures and operating expenses in order to implement certified EHR technology and to meet meaningful use requirements. The timing of expense recognition to implement the Corporation's certified EHR technology may not correlate with the receipt of incentive payments and recognition of EHR incentive revenue.

Income Taxes
The Corporation has established its status as an organization exempt from income taxes under Code Section 501(c)(3) and the laws of the states in which it operates. Certain divisions and affiliates are subject to federal and state income taxes; however, such amounts are not material to the consolidated financial statements.

Derivative Financial Instruments
Derivative financial instruments consist of interest rate swap contracts that are measured at fair value. The Corporation accounts for any changes in the fair value of derivative financial instruments in other income (expense) in the consolidated statements of operations and changes in net assets. The Corporation has reflected the fair value of its interest rate swap contracts as a long-term liability on the consolidated balance sheets (see Note 7).

Consolidated Statements of Cash Flows
Supplemental disclosure of cash flow information and noncash investing and financing activities are summarized as follows:

Cash paid during the year for interest, net of amounts capitalized, amounted to $38,665,000 and $40,844,000 for the years ended December 31, 2012 and 2011, respectively.

Cash paid (received) for income taxes approximated $386,000 and ($232,000) for the years ended December 31, 2012 and 2011, respectively.

Included in accounts payable and accrued expenses and other liabilities at December 31, 2012 and 2011 are approximately $20,926,000 and $24,093,000, respectively, of costs related to construction in progress and for the acquisition of property, plant, and equipment (including internal-use software).

Reclassifications
Certain reclassifications were made to prior year balances to conform to current year presentation. Distributions from unconsolidated affiliates have been reclassified from cash flows from investing activities to cash flows from operating activities on the consolidated statements of cash flows.

3. Net Patient Service Revenue, Patient Accounts Receivable, and Concentration of Credit Risk

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

Medicare – Acute inpatient and outpatient services rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediaries.

Medicaid – Reimbursement for services rendered to Medicaid program beneficiaries includes prospectively determined rates per discharge, per diem payments, discounts from established charges, fee schedules, and cost reimbursement methodologies with certain limitations. Cost reimbursable items are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediaries.

Certain of the Corporation's Health Centers qualify as State of Indiana Medicaid Acute Disproportionate Share and Medicaid Safety Net Hospitals ("DSH"). These Health Centers qualified as DSH providers under Indiana law (HEA 1095, Public Law 27-1992), and, as such, are eligible to receive DSH payments linked to the State's fiscal year, which differs from the Corporation's fiscal year. The amount of these additional DSH funds is dependent on regulatory approval by agencies of the federal and state governments, and is determined by the level, extent, and cost of uncompensated care (as defined) and various other factors. The Corporation records such amounts as revenue when payments are received or based upon data from the State of Indiana that payments are determinable and probable of receipt. For the years ended December 31, 2012 and 2011, the Corporation recognized unrestricted revenue of approximately $19.7 million and $35.7 million, respectively, related to the DSH program in the consolidated statements of operations and changes in net assets.

During 2012, the State of Indiana established a Hospital Assessment Fee Program ("HAF") which was retroactive to July 1, 2011, that increased reimbursements made under the State's fee for service and managed Medicaid programs. For the year ended December 31, 2012, the Corporation's Indiana Health Centers were assessed a fee under the HAF program of approximately $84.1 million (approximately $27.1 million related to the year ended December 31, 2011), which is included as a component of other supplies and expenses in the accompanying consolidated statements of operations and changes in net assets and the Corporation's Indiana Health Centers recognized approximately $135.2 million (approximately $43.4 million related to the year ended December 31, 2011) in supplemental Medicaid reimbursement, which is a component of net patient service revenue in the consolidated statements of operations and changes in net assets.

The Corporation's Illinois Health Centers are obligated under Illinois Public Act 95-859 to participate in the State of Illinois' Hospital Assessment Program. For the years ended December 31, 2012 and 2011, the Corporation recognized $17.4 million and $17.7 million of unrestricted revenue and $10.3 million and $7.4 million, respectively, of other expense related to the Illinois Hospital Assessment Program.

Other – Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the established charges for services and estimated total payments to be received from third-party payors.

A summary of gross patient service revenue, by payor, for the periods ended December 31, 2012 and 2011, is as follows:

	2012	**2011**
Medicare	38 %	38 %
Medicare managed care	5 %	4 %
Medicaid	8 %	9 %
Medicaid managed care	5 %	4 %
Other third-party payors	38 %	40 %
Self-pay	5 %	4 %
Other	1 %	1 %
	100 %	100 %

The Corporation grants credit without collateral to its patients, most of who are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31, 2012 and 2011, is as follows:

	2012	**2011**
Medicare and Medicare managed care	23 %	24 %
Medicaid and Medicaid managed care	18 %	19 %
Other third-party payors	45 %	43 %
Self-pay and Other	14 %	14 %
	100 %	100 %

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action including fines, penalties, and/or exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates may change in the near term. Net patient service revenue increased by approximately $10.1 million and by $3.0 million for the years ended December 31, 2012 and 2011, respectively, due to changes in estimates related to prior-year settlements with third party payors. In addition, for the year ended December 31, 2012, net patient service revenue includes approximately $19.1 million related to Medicare's settlement of the Rural Floor Budget Neutrality Adjustment Appeal that related to fiscal years 2007-2011.

4. Board Designated and Other Investments

Board designated investments represents investments set aside by policy of the Corporation primarily for future purposes including capital expenditures, acquisitions, and improvements as well as amounts held for mission programs. Assets limited as to use include assets under bond indenture and swap agreements, investments maintained for the payment of estimated insurance liabilities, and amounts contributed by donors with stipulated restrictions.

The composition of board designated and other investments, at December 31, 2012 and 2011, is as follows:

	2012	2011
	(in thousands)	
Board designated investments		
Funded depreciation and other Board projects	$ 1,543,442	$ 1,509,215
Other designated investments	3,190	2,876
	1,546,632	1,512,091
Assets limited as to use		
Estimated insurance liability funds	152,680	137,945
Assets under bond indenture and swap agreements	40,970	40,540
Other restricted investments	23,574	23,746
	217,224	202,231
Board designated and other investments	1,763,856	1,714,322
Less short-term investments	37,159	40,418
Board designated and other investments, classified as noncurrent	$ 1,726,697	$ 1,673,904

Board designated and other investments at December 31, 2012 and 2011, consist of the following:

	2012	2011
	(in thousands)	
Cash and cash equivalents	$ 83,537	$ 41,870
U.S. government, state, municipal, and agency obligations	231,938	9,751
Other fixed income securities	180,998	11,132
Pooled funds	-	1,637,653
Equity securities	350,398	-
Asset-backed securities	128,414	-
Index funds, exchange traded funds and mutual funds	316,183	13,916
Unregistered mutual funds	56,257	-
Real estate investment trusts	3,746	-
Hedge funds	247,699	-
Private credit	23,664	-
Private equity	79,238	-
Real assets	61,784	-
	$ 1,763,856	$ 1,714,322

The following tables present the fair value hierarchy of the valuation techniques utilized to determine the fair value of the Corporation's board designated and other investments as of December 31, 2012 and 2011:

	Balance as of December 31, 2012	Level 1 (in thousands)	Level 2	Level 3
Investments				
Cash and cash equivalents	$ 83,537	$ 83,537	$ -	$ -
U.S. government, state, municipal, and agency obligations	231,938	162,654	68,001	1,283
Other fixed income securities	180,998	-	177,780	3,218
Equity securities	350,398	350,398	-	-
Asset-backed securities	128,414	-	128,124	290
Index funds, exchange traded funds and mutual funds	316,183	316,183	-	-
Unregistered mutual funds	56,257	-	56,257	-
Real estate investment trusts	3,746	3,746	-	-
Hedge funds	247,699	-	-	247,699
Private credit	23,664	-	-	23,664
Private equity	79,238	-	-	79,238
Real assets	61,784	-	-	61,784
	$ 1,763,856	$ 916,518	$ 430,162	$ 417,176

	Balance as of December 31, 2011	Level 1 (in thousands)	Level 2	Level 3
Investments				
Cash and cash equivalents	$ 41,870	$ 41,870	$ -	$ -
U.S. government, state, municipal, and agency obligations	9,751	4,048	5,703	-
Other fixed income securities	11,132	-	11,132	-
Pooled funds	1,637,653	-	1,637,653	-
Index funds, exchange traded funds and mutual funds	13,916	13,916	-	-
	$ 1,714,322	$ 59,834	$ 1,654,488	$ -

Certain investments categorized within Level 2 are not traded in active markets but are measured using pricing sources such as broker quotes, or using models with externally verifiable inputs, such as relevant interest or exchange rates.

Changes in Level 3 hierarchy assets measured at fair value for the Corporation's board designated and other investments at December 31, 2012 are as follows:

	Initial Contribution at Fair Value	Net Unrealized Gain (Loss)	Net Realized Gain (Loss) (in thousands)	Purchases	Sales	Ending Balance
U.S. government, state, municipal, and agency obligations	$ 1,249	$ 34	$ -	$ -	$ -	$ 1,283
Other fixed income securities	-	66	70	12,413	(9,331)	3,218
Asset-backed securities	384	(1)	7	-	(100)	290
Hedge funds	233,701	10	5,836	54,000	(45,848)	247,699
Private credit	20,083	1,763	(131)	6,293	(4,344)	23,664
Private equity	70,327	4,589	272	12,486	(8,436)	79,238
Real assets	52,007	1,414	95	17,911	(9,643)	61,784
	$ 377,751	$ 7,875	$ 6,149	$ 103,103	$ (77,702)	$ 417,176

There were no significant transfers to or from Levels 1 and 2 during the years ended December 31, 2012 and 2011.

The following table summarizes the Corporation's investment in entities that calculate net asset value per share (or its equivalent):

	Fair Value	Unfunded Commitments (in thousands)	Redemption Frequency	Redemption Notice Period
Hedge Funds	$ 247,699	$ -	Monthly, quarterly, annually	5 - 180 days
Private Credit	23,644	12,466	Not currently redeemable	
Private Equity	79,238	45,310	Not currently redeemable	
Real Assets	61,784	46,469	Not currently redeemable	
Unregistered mutual funds	56,257	-	Monthly	1 day
	$ 468,622	$ 104,245		

Hedge funds include absolute return and directional hedge funds. Absolute return hedge funds pursue multiple strategies to diversify risks and reduce volatility while directional hedge funds utilize market movement, trends, and inconsistencies when selecting securities across a variety of markets. Directional hedge funds are usually less exposed to the overall market and are likely to include long equity positions hedged with short positions to cancel out short-term uncertainty. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

Private credit includes investments that are secured by high quality assets or backed by a senior claim on stable cash flows. Investments in this asset class will be made opportunistically during periods of broad market or security specific distress. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 10 years. However, the individual investments that will be sold have not yet been determined.

Private equity includes funds that invest globally using strategies that include leveraged buyouts, venture capital, growth capital, distressed investments, and mezzanine capital. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 10 years. However, the individual investments that will be sold have not yet been determined.

Real asset includes energy and energy-related investments and private real estate funds that invest in both U.S. and international commercial real estate. Energy and energy-related investments exposure mainly relate to oil and gas properties which include exploration, production, processing, servicing, or transportation of oil, natural gas, and other hydrocarbon fuels. Private real estate investment strategies include core, value-add, and opportunistic real estate which typically seek to earn a return over inflation. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 2 to 14 years. However, the individual investments that will be sold have not yet been determined.

Unregistered mutual funds include funds that primarily invest in domestic and international short-term government, investment grade, high yield, and mortgage-related fixed income securities. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

Investment returns including net unrealized gains (losses) included in the consolidated statements of operations and changes in net assets for the years ended December 31, 2012 and 2011, are as follows:

	2012	2011
	(in thousands)	
Unrestricted revenues, gains and other support		
Investment income	$ 9,807	$ 7,788
Net unrealized investment gains (losses)	5,533	(4,132)
	15,340	3,656
Other income (expense)		
Investment income	82,065	88,709
Net unrealized investment gains (losses) on trading securities	76,311	(62,303)
	158,376	26,406
Temporarily restricted net assets, controlling interest		
Investment income	366	250
Net unrealized investment gains (losses)	100	(147)
	466	103
Permanently restricted net assets, controlling interest		
Investment income	95	71
Net unrealized investment (losses) gains	(64)	252
	31	323
	$ 174,213	$ 30,488

5. Property, Plant, and Equipment

A summary of property, plant, and equipment at December 31, 2012 and 2011, is as follows:

	2012	2011
	(in thousands)	
Land and land improvements	$ 120,577	$ 115,109
Buildings and building equipment	1,326,847	1,242,346
Departmental equipment	1,328,500	1,128,588
Construction in progress	72,765	337,016
	2,848,689	2,823,059
Less accumulated depreciation	1,278,496	1,318,436
	$ 1,570,193	$ 1,504,623

As of December 31, 2012, approximately $3.6 million of construction commitments and commitments to purchase software were outstanding. Costs of these capital items are expected to be financed by using the Corporation's board designated funded depreciation investments, future operations of the Corporation, and contributions. The decrease in construction in progress is due to the completion and capitalization of several major building projects during 2012.

Certain leases for facilities and medical equipment are accounted for as capital leases. These leases expire in various years through 2024 and are included in property, plant, and equipment on the consolidated balance sheets. The amortization of assets under capital leases is included in depreciation and amortization expense in the consolidated statements of operations and changes in net assets.

6. Long-Term Debt

Long-term debt at December 31, 2012 and 2011, consists of the following:

	Year of Final Maturity	Interest Rate Range over Life of Bonds		2012	2011
				(in thousands)	
Tax Exempt Hospital and Health System Revenue and Refunding Bonds					
Fixed rate term and serial bonds					
Series 2009	2039	2.50% - 5.375%		$ 218,105	$ 220,480
Series 2008C	2032	5.00% - 5.50%		278,995	284,830
Series 2006E, insured	2041	5.125% - 5.25%		84,675	84,675
Series 2001	-	4.75% - 5.35%		-	7,620
Series 1999, insured	-	5.25%		-	4,065
Less: bond discounts and premiums, net				(3,653)	(3,948)
Total fixed rate term and serial bonds				$ 578,122	$ 597,722
		Interest Rate Range 2012	**Interest Rate Range 2011**		
Variable rate direct placement bonds					
Series 2012A	2048	1.00% - 1.02%	-	$ 75,000	$ -
Series 2012B	2015	0.85% - 0.87%	-	5,855	-
Total variable rate direct placement bonds				$ 80,855	$ -
Variable rate demand bonds, subject to seven-day put provision supported by direct pay bank letters of credit					
Series 2008A	2041	0.03% - 0.27%	0.02% - 0.32%	$ 81,175	$ 81,175
Series 2008B	2041	0.04% - 0.24%	0.02% - 0.32%	81,070	81,170
Series 2008D	2048	0.04% - 0.29%	0.03% - 0.38%	-	75,000
Series 2008E	2048	0.04% - 0.29%	0.03% - 0.38%	50,000	50,000
Series 2008F	2048	0.04% - 0.24%	0.03% - 0.32%	45,200	45,200
Series 2008G	2048	0.04% - 0.24%	0.03% - 0.32%	45,250	45,250
Series 2008H	2048	0.05% - 0.24%	0.03% - 0.32%	63,895	63,895
Series 2008I	2037	0.03% - 0.25%	0.03% - 0.29%	40,495	40,595
Series 2008J	2037	0.04% - 0.24%	0.03% - 0.29%	40,500	40,600
Total variable rate demand bonds				$ 447,585	$ 522,885
Other debt					
Capital lease obligations (excluding imputed interest of $5,498 and $4,626 at December 31, 2012 and 2011, respectively)				$ 21,696	$ 12,067
Other				9,920	4,392
Total other debt				$ 31,616	$ 16,459
Total long-term debt				$1,138,178	$1,137,066
Less current portion of long-term debt				(22,103)	(17,909)
Long-term debt, net of current portion				$1,116,075	$1,119,157

Scheduled principal payments on long-term debt are as follows:

Years ending December 31	Fixed and Variable Rate Bonds	Capital Lease Obligations	Other	Total
		(in thousands)		
2013	$ 15,040	$ 4,771	$ 2,292	$ 22,103
2014	15,780	3,426	2,130	21,336
2015	16,585	3,318	2,217	22,120
2016	17,370	3,181	2,188	22,739
2017	18,165	2,320	1,093	21,578
Thereafter	1,019,969	4,680	-	1,024,649

Total interest costs incurred on the long-term debt less capitalized interest are as follows:

	2012	2011
	(in thousands)	
Interest costs incurred	$ 38,302	$ 40,711
Less capitalized interest	3,169	7,512
Interest expense included in operating income	$ 35,133	$ 33,199

The fair value of the Corporation's long-term debt at December 31, 2012 and 2011 approximates $1,128,000,000 and $1,181,000,000, respectively. The fair values of the Corporation's underlying tax exempt Hospital and Health System Revenue Bonds and Refunding Bonds are based on current traded values for similar types of borrowings which are considered Level 2 inputs as described in Note 2.

Obligated Group and Designated Group Affiliates and Other Requirements - The Corporation has long-term debt outstanding under a Master Trust Indenture dated November 1, 1997, as amended and supplemented ("AMTI"). The AMTI permits the Corporation to issue obligations to finance certain activities. Obligations issued under the AMTI are general, direct obligations of the Corporation and any future members of the Franciscan Alliance, Inc. Obligated Group ("Obligated Group"). All members of the Obligated Group are jointly and severally liable with respect to the payment of each obligation issued under the AMTI. In addition, the AMTI provides that certain affiliates of the Corporation may be designated as Designated Group Affiliates from time to time and the Corporation covenants to cause each of its Designated Group Affiliates to pay, loan, or otherwise transfer to the Obligated Group such amounts necessary to pay the obligations issued under the AMTI. The Designated Group Affiliates are not members of the Obligated Group and are not directly liable for payments on the obligations. The Corporation has granted a security interest in its unrestricted receivables, among others, for the benefit of the owners of the obligations. The AMTI includes covenants which require the Corporation to maintain a minimum debt service coverage ratio of 1.10 and limit the Corporation's ability to encumber certain of its assets. In determining whether the Corporation has satisfied such covenants, the AMTI requires the Corporation to include the Obligated Group and Designated Group Affiliates together in calculating the related ratios and in testing for compliance even though the Designated Group Affiliates are not directly obligated on the long-term debt issued under the AMTI. As of December 31, 2012 and 2011, the Corporation was in compliance with the terms of the AMTI and there were no other Obligated Group members nor any Designated Group Affiliates.

Refunding of Long-Term Debt – In April 2012, the Corporation issued at par $82.62 million of Series 2012A and 2012B variable rate direct placement bonds. Proceeds were used to refund the Series 2008D variable rate demand bonds that were previously supported by a direct pay letter of credit and legally defeased the Series 2001 fixed rate bonds. The transaction resulted in a loss on refunding of long-term debt of approximately $0.2 million, which is reflected in other income (expense) in the consolidated statements of operations and change in net assets.

Variable Rate Demand Bonds– As of December 31, 2012, the Corporation has separate direct pay letters of credit totaling $447.6 million to fully support its Series 2008A, Series 2008B, and Series 2008E through Series 2008J variable rate demand bonds. These liquidity facilities are available to the Corporation should the holders of the obligations present such obligations for redemption and the obligations are not remarketed. Additionally, these facilities (if utilized) generally have repayment terms for bonds held by the letter of credit banks that amortize ratably over 3 to 5 years, depending on the facility used. Termination dates for the various liquidity facility agreements have expiration dates extending from October 2014 through April 2017. Since the liquidity facilities expire beyond one year from the Corporation's balance sheet date and the Corporation has the intent to continually renew these liquidity facilities, the variable rate demand bonds are classified as long-term debt and are disclosed in accordance with the stated maturities.

7. Other Liabilities and Commitments

Interest Rate Swap Contracts – The Corporation utilizes interest rate swaps to manage interest rate risk associated with its variable rate bonds. Cash payments on the interest rate swap contracts totaled $14.4 million and $14.5 million for the years ended December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the interest rate swap contracts were in a liability position with a fair value of approximately $102.2 million and $106.0 million, respectively. The fair value of the Corporation's interest rate swap contracts are based on observable inputs, such as interest rates and credit risk spreads, that fall within Level 2 of the hierarchy of fair value inputs as described in Note 2. Certain of the Corporation's interest rate swap agreements include collateral funding requirements based on the market value of these contracts. At December 31, 2012 and 2011, the Corporation had posted $41.0 million and $40.5 million, respectively, to satisfy its collateral funding obligations on these contracts which are included in assets under bond indenture and swap agreements within board designated and other investments on the consolidated balance sheets.

Operating Leases – The Corporation leases various facilities, equipment, and software. Total rental expense under operating leases approximated $39.8 million and $38.1 million for the years ended December 31, 2012 and 2011, respectively. Future minimum lease payments under operating leases as of December 31, 2012 that have initial or remaining lease terms in excess of one year are as follows:

	(in thousands)
Years ending December 31	
2013	$ 36,730
2014	34,361
2015	34,357
2016	33,226
2017	32,443
Thereafter	52,091
	$ 223,208

8. Pension and Other Benefit Plans

Noncontributory Defined Benefit Pension Plans - The Corporation has qualified, noncontributory defined benefit pension plans covering all eligible employees of certain of the Corporation's entities. The plans provide defined benefits based on years of service and final average salary. Certain nonqualified, supplemental plan arrangements also provide retirement benefits to specified groups of participants. Because the pension plans have church plan status as defined in the Employee Retirement Income Security Act of 1974 ("ERISA"), funding in accordance with ERISA is not required. The Corporation's funding policy for the qualified plans, which is reviewed annually and may be adjusted as needed, is to fund the normal service cost based on the accumulated benefit obligation for the plan's year and amortize any under or over funding over a ten year period.

The Corporation's measurement date for all pension calculations is December 31.

The change in projected benefit obligation, change in plan assets, and funded status of the Corporation's pension plans as of December 31, 2012 and 2011, are as follows:

	2012	2011
	(in thousands)	
Change in benefit obligation		
Benefit obligation, beginning of year	$ 1,164,705	$ 956,720
Service cost	45,732	37,796
Interest cost	57,896	55,215
Plan amendment	2,766	-
Actuarial loss	159,643	139,706
Benefits paid	(27,584)	(24,732)
Benefit obligation, end of year	1,403,158	1,164,705
Change in plan assets		
Fair value of plan assets, beginning of year	838,463	703,544
Actual gain on plan assets	85,365	79,791
Employer contributions	78,773	79,860
Benefits paid	(27,584)	(24,732)
Fair value of plan assets, end of year	975,017	838,463
Funded status	$ (428,141)	$ (326,242)
Amounts recognized in the consolidated balance sheets		
Noncurrent assets	$ -	$ 464
Current liabilities	(1,512)	(179)
Noncurrent liabilities	(426,629)	(326,527)
Total amount recognized	$ (428,141)	$ (326,242)

The amounts in unrestricted net assets, including amounts arising during the year and amounts reclassified into net periodic benefit cost, are as follows:

	Net Gain (Loss)	Prior Service Cost	Total
		(in thousands)	
December 31, 2010	$ (226,621)	$ (2,879)	$ (229,500)
Amounts reclassified into net periodic benefit cost	15,648	2,018	17,666
Amounts arising during the year	(112,099)	-	(112,099)
December 31, 2011	$ (323,072)	$ (861)	$ (323,933)

	Net Gain (Loss)	Prior Service Cost	Total
		(in thousands)	
December 31, 2011	$ (323,072)	$ (861)	$ (323,933)
Amounts reclassified into net periodic benefit cost	22,959	(1,602)	21,357
Amounts arising during the year	(137,886)	-	(137,886)
December 31, 2012	$ (437,999)	$ (2,463)	$ (440,462)

The following are estimated amounts to be amortized from unrestricted net assets into net periodic pension cost in the next fiscal year:

	(in thousands)
Unrecognized prior service cost	$ (485)
Unrecognized loss	(32,153)
Total amount expected to be amortized from unrestricted net assets in 2013	$ (32,638)

The accumulated benefit obligation ("ABO") at December 31, 2012 and 2011 was $1,235,880,000 and $1,027,114,000, respectively. The following information is provided for plans with an ABO in excess of plan assets at December 31, 2012 and 2011:

	2012	2011
	(in thousands)	
Projected benefit obligation	$ 1,403,158	$ 1,150,358
ABO	1,235,880	1,012,766
Fair value of plan assets	975,017	823,652

Components of net periodic pension cost for the years ended December 31, 2012 and 2011, are as follows:

	2012	2011
	(in thousands)	
Service cost	$ 45,732	$ 37,796
Interest cost	57,896	55,215
Expected return on plan assets	(64,046)	(52,184)
Amortization of prior service cost	1,602	2,018
Amortization of net loss	22,959	15,648
Net periodic pension cost	$ 64,143	$ 58,493

The following weighted-average assumptions were used to determine the Corporation's benefit obligations and net periodic pension cost for the years ended December 31:

	2012	2011
Benefit obligation		
Discount rate	4.25 %	5.00 %
Rate of compensation increase	4.50 %	4.50 %
Net periodic pension cost		
Discount rate	5.00 %	5.75 %
Expected rate of return on plan assets	7.31 %	7.38 %
Rate of compensation increase	4.50 %	4.50 %

In developing the expected rate of return on plan assets assumption, the Corporation considered the historical returns and the expectation for future returns on each asset class, as well as the target asset allocation of the pension investment portfolio. The rate of return on plan assets assumption also considers investment and administrative expenses.

The discount rate assumption reflects the yield of a portfolio of high quality bonds matched against the timing and amount of projected future benefit payments as of the measurement date.

The Corporation's pension investment policy reflects the long-term nature of the pension plans' funding obligations. Assets are invested to achieve a rate of return consistent with policy allocation targets, which significantly contributes to meeting the current and future obligations of the plans and helps to ensure solvency of the plans over time. It is expected that this objective can be achieved through a well-diversified asset portfolio and an emphasis on long-term capital appreciation as a primary source of return. The plans utilize a multi-manager structure of complementary investment styles and classes. Manager performance is judged over an investment market cycle which is generally 3 to 5 years.

Plan assets are exposed to risk and fluctuations in market value from year to year. To minimize risk, each manager is required to maintain adequate portfolio diversification to insulate the plan assets from substantial loss in any single security or market sector. Asset allocation is reviewed monthly for deviations in the allowable range and is rebalanced as necessary. The asset allocation for the Corporation's pension plans as of December 31, 2012 and 2011 and the target allocation of the pension plans, by asset category, are as follows:

Asset class	Target Allocation	Percentage of Plan Assets 2012	Percentage of Plan Assets 2011
Domestic large capitalization securities	26 %	26 %	24 %
Domestic mid capitalization securities	3	4	4
Domestic small capitalization securities	9	8	8
International equity securities	19	18	16
Fixed income securities	36	39	44
Hedge funds	7	5	4
	100 %	100 %	100 %

Cash Flows

During 2013, the Corporation anticipates making contributions of approximately $29.1 million to fund the normal service cost in accordance with its standard funding policy and an additional $50 million to fund the second year of a four year, $200 million total supplemental pension funding commitment approved by the Corporation's Board.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	(in thousands)
2013	$ 41,845
2014	39,280
2015	46,666
2016	50,410
2017	51,504
Years 2018-2022	354,865

Defined Contribution Benefits - The Corporation sponsors various defined contribution benefit plans covering eligible employees. These employees may contribute a portion of their pre-tax and/or after-tax compensation to the plans, in accordance with specified guidelines. In addition to any discretionary contributions, these plans provide for established contribution percentages or a percentage match of employee contributions up to certain limits. Contribution expense for the years ended December 31, 2012 and 2011 aggregated $14.3 million and $14.0 million, respectively.

The following tables summarize the Corporation's pension and other benefit plans' assets, measured at fair value as of December 31, 2012 and 2011, respectively.

Asset category	**Balance as of December 31, 2012**	**Level 1**	**Level 2**	**Level 3**
		(in thousands)		
Cash and cash equivalents	$ 64,917	$ 64,917	$ -	$ -
U.S. government, state, municipal, and agency obligations	328,793	328,793	-	-
Other fixed income securities	33,958	-	33,958	-
Equity securities	422,878	422,878	-	-
Asset-backed securities	2,122	-	2,122	-
Registered and unregistered mutual funds	74,484	318	74,166	-
Real estate investment trusts	6,044	6,044	-	-
Hedge funds	41,821	-	-	41,821
Total	$ 975,017	$ 822,950	$ 110,246	$ 41,821

Asset category	**Balance as of December 31, 2011**	**Level 1**	**Level 2**	**Level 3**
		(in thousands)		
Cash and cash equivalents	$ 69,309	$ 69,309	$ -	$ -
U.S. government, state, municipal, and agency obligations	304,955	304,955	-	-
Other fixed income securities	29,302	-	29,302	-
Equity securities	333,769	333,769	-	-
Asset-backed securities	3,079	-	3,079	-
Registered and unregistered mutual funds	64,299	335	63,964	-
Real estate investment trusts	5,003	5,003	-	-
Hedge funds	28,747	-	-	28,747
Total	$ 838,463	$ 713,371	$ 96,345	$ 28,747

There were no significant transfers to or from Levels 1 and 2 during the years ended December 31, 2012 and 2011.

Changes in Level 3 hierarchy assets measured at fair value for the Corporation's pension and other benefit plans are as follows:

	(in thousands)
Beginning balance, December 31, 2010	$ 30,547
Net unrealized investment gains	-
Investment losses	-
Purchases of investments	1,157
Sales of investments	(2,957)
Ending balance, December 31, 2011	28,747
Beginning balance, December 31, 2011	28,747
Net unrealized investment gains	415
Investment losses	(10)
Purchases of investments	40,997
Sales of investments	(28,328)
Ending balance, December 31, 2012	$ 41,821

9. Estimated Insurance Liabilities

Hills Insurance Company, Inc. ("Hills Inc."), the wholly owned captive insurance subsidiary of the Corporation, provides certain professional and general liability coverage for the Health Centers and other corporate entities. The Corporation, through Hills Inc., has limited its liability by purchasing reinsurance and excess insurance coverage from several commercial insurance companies. In the unlikely event that any or all of the insurance or reinsurance companies might be unable to meet their obligations under the existing agreements, the Corporation, through Hills Inc., would be liable for such defaulted amounts. In addition, the Corporation is self-insured for its employee health, long-term disability, and workers' compensation employee benefit programs.

The estimated insurance liabilities provide for reported losses and for losses incurred but not reported based on projections by independent actuaries using information provided by the Corporation's management. The estimated insurance liabilities, which consist of professional liability, general liability, long-term disability insurance, workers' compensation, and amounts self-insured for allocated loss adjustment expenses, approximated $130.1 million and $136.4 million on an undiscounted basis at December 31, 2012 and 2011, respectively.

Claims arising from provisions of health care and other operating activities have been asserted against the Corporation by various claimants. These claims are in various stages of processing and some may ultimately be brought to trial. Counsel is unable to conclude as to the ultimate outcome of the actions. There are known incidents occurring through December 31, 2012 that may result in the assertion of additional claims and other claims may be asserted arising from services provided to patients in the past. While it is possible that settlement of asserted claims and claims which may be asserted in the future could result in liabilities in excess of amounts provided by the Corporation, management believes that the excess liability, if any, would not materially affect the consolidated financial position of the Corporation at December 31, 2012.

10. Noncontrolling Interests in Consolidated Affiliates and Investments in Unconsolidated Affiliates

The Corporation is involved in several joint ventures whose operations have been included in the consolidated financial statements.

Noncontrolling Interests in Consolidated Affiliates

The Corporation's consolidated financial statements include all assets, liabilities, revenues, and expenses of less than 100% owned entities that it controls. Accordingly, the Corporation has recorded noncontrolling interests in the earnings and equities of such entities in its consolidated financial statements.

The significant consolidated affiliates that the Corporation had jointly owned, along with a number of physicians who are unrelated to the Corporation, include Franciscan Physicians Hospital, LLC ("FPH") and Franciscan Physicians Real Property, LLC ("FPRP"). FPH is an Indiana limited liability company that leases and operates a 63-bed acute care hospital in Northwest Indiana. FPRP is an Indiana limited liability company that owns and leases all the real property inclusive of land, improvements, and buildings to FPH. In April 2011, all external physician ownership in FPH was fully redeemed making the Corporation the sole owner of FPH. At both December 31, 2012 and 2011, the Corporation's ownership in FPRP was 90%, with the Corporation having majority board membership and reserve powers.

The Corporation's other consolidated affiliates reflected in its consolidated financial statements include various health service related entities that support the Corporation's mission.

Investments in Unconsolidated Affiliates

The Corporation has investments in entities that are recorded under the cost or equity method of accounting. At December 31, 2012, the Corporation maintained investments in unconsolidated affiliates that support the Corporation's mission having noncontrolling ownership interests ranging from 8% to 50%.

At December 31, 2012 and 2011, the Corporation had a 33%, economic interest in Alverno Clinical Laboratories, LLC ("ACL, LLC"), an Indiana limited liability company created to direct, operate, maintain, and manage a centralized clinical laboratory in Hammond, Indiana supporting the Corporation and Presence Health ("Presence"). The Corporation is also an owner of Alverno Provena Hospital Laboratories, LLC ("APHL"), a nonprofit cooperative corporation created to direct, operate, maintain, and manage the on-site laboratories of the Corporation's and Presence's health centers. Governance of ACL, LLC and APHL (collectively referred to as the "Laboratories") is shared between the health system members. The Corporation accounts for its investment in ACL, LLC under the equity method which approximated $4.1 million and $4.0 million at December 31, 2012 and 2011, respectively. The Corporation's capital account in APHL approximates $50,000 at both December 31, 2012 and 2011.

The Corporation's share of the equity in earnings of investments in unconsolidated affiliates accounted for on the equity method is approximately $5.0 million and $7.6 million for the years ended December 31, 2012 and 2011, respectively, which is included in total unrestricted revenues, gains, and other support in the consolidated statements of operations and changes in net assets.

The unaudited summarized financial position and results of operations for the entities accounted for under the equity method as of and for the periods ended December 31 is as follows:

	2012	2011
	(in thousands)	
Total assets	$ 127,161	$ 116,797
Total liabilities	71,516	54,824
Net assets	55,645	61,973
Total unrestricted revenues, gains, and other support	664,353	597,537
Excess of revenues over expenses	9,660	20,070

11. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31, 2012 and 2011:

	2012	2011
	(in thousands)	
Capital expenditures	$ 4,216	$ 5,745
Medical education programs	4,785	4,557
Health care programs	5,627	5,161
Other restrictions	2,931	2,335
	$ 17,559	$ 17,798

Capital expenditures relate to assets held by the Corporation, its Health Centers, and associated foundations which are restricted by donors or grantors to be used specifically for equipment, capital projects, or other capital needs.

Medical education programs relate to assets held by the Corporation, its Health Centers, and associated foundations which are restricted by donors or grantors to be used in specific education programs or for staff education.

Health care programs relate mainly to assets held by the Corporation’s Health Centers and associated foundations which are restricted by donors or grantors to be used in specific health care programs for medical and patient services.

Other restrictions relate to assets held by foundations which are restricted by donors or grantors to be used for programs such as spiritual care, mission related activities, or employee emergencies.

Permanently restricted net assets of approximately $11.9 million at both December 31, 2012 and 2011, are restricted to investments to be held in perpetuity with the income expendable to support the Corporation’s mission.

12. Related Party Transactions

The Corporation's Health Centers incurred clinical laboratory charges from the Laboratories of approximately $60.5 million and $59.4 million for the years ended December 31, 2012 and 2011, respectively, which is included in purchased services in the consolidated statements of operations and changes in net assets. The Corporation provides information technology services, central procurement and disbursement services, and rents the core lab facilities to the Laboratories for which the Corporation has recorded approximately $2.3 million and $1.8 million for the years ended December 31, 2012 and 2011, respectively, as other operating revenue on the consolidated statements of operations and changes in net assets.

13. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended December 31, 2012 and 2011, are as follows:

	2012	2011
	(in thousands)	
Health care services	$ 2,042,280	$ 1,844,850
General, administrative, and other nonhealth care services	474,800	401,864
Total operating expenses before asset impairment	$ 2,517,080	$ 2,246,714

14. Subsequent Events

Management has evaluated events and transactions through April 22, 2013, the date the consolidated financial statements were issued, noting no subsequent events requiring recording or disclosure

Independent Auditor's Report on Accompanying Supplemental Consolidated Information of the Obligated Group and Designated Group Affiliates

Board of Trustees
Franciscan Alliance, Inc.
Mishawaka, Indiana

The report on our audits of the consolidated financial statements of Franciscan Alliance, Inc. and Affiliates (collectively referred to as the “Corporation”) as of December 31, 2012 and 2011 and for the years then ended appears on page 1 of this document. Those audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental consolidated information of the Obligated Group and Designated Group Affiliates (collectively referred to as the “Obligated Group financial statements”) is presented for purposes of complying with Article IV of the Master Trust Indenture dated November 1, 1997 as amended and supplemented by various supplemental indentures between the Corporation and The Bank of New York, and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and changes in net assets of the Obligated Group financial statements. The Obligated Group financial statements are the responsibility of management and were derived from, and relate to, the underlying accounting and other records used to prepare the financial statements. However, the Obligated Group financial statements have been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, except for not consolidating various wholly owned subsidiaries of the Corporation which are not Designated Group Affiliates, that are accounted for under the equity method which is not in compliance with generally accepted accounting principles, are fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

PricewaterhouseCoopers LLP

April 22, 2013

Franciscan Alliance, Inc. and Affiliates
Consolidated Balance Sheets - Obligated Group and Designated Group Affiliates
December 31, 2012 and 2011
(In thousands)

	2012	2011
Assets		
Current assets		
Cash and cash equivalents	$ 160,283	$ 135,624
Short-term investments	11,987	16,429
Patient accounts receivable, net of allowance for doubtful accounts of $33,548 in 2012 and $46,914 in 2011	308,141	296,994
Inventories of supplies	37,303	34,494
Other current assets	116,855	64,748
Total current assets	634,569	548,289
Board designated and other investments	1,558,720	1,535,958
Property, plant, and equipment, net	1,514,753	1,459,400
Investments in unconsolidated affiliates	105,744	95,291
Goodwill	14,465	11,529
Intangible assets, net of accumulated amortization of $10,421 in 2012 and $7,732 in 2011	19,036	9,940
Other assets	108,760	61,827
Total assets	$ 3,956,047	$ 3,722,234

	2012	2011
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	$ 21,466	$ 17,362
Accounts payable and accrued expenses	183,479	182,763
Accrued payroll and related expenses	99,246	92,230
Estimated third-party payor settlements	34,326	29,051
Total current liabilities	338,517	321,406
Long-term debt, net of current portion	1,114,225	1,116,558
Fair value of interest rate swap contracts	102,208	105,964
Accrued pension liability	425,081	325,466
Estimated insurance liabilities	11,490	11,717
Other liabilities	57,888	37,617
Total liabilities	2,049,409	1,918,728
Net assets		
Unrestricted	1,872,250	1,753,815
Noncontrolling interests in consolidated affiliates	25,918	25,612
Total unrestricted net assets	1,898,168	1,779,427
Temporarily restricted	1,156	13,103
Permanently restricted	7,314	10,976
Total net assets	1,906,638	1,803,506
Total liabilities and net assets	$ 3,956,047	$ 3,722,234

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets - Obligated Group and Designated Group Affiliates
Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Unrestricted revenues, gains, and other support		
Patient service revenue, net of contractual allowances and discounts	$ 2,339,401	$ 2,134,900
Provision for doubtful accounts	(102,185)	(91,416)
Net patient service revenue	2,237,216	2,043,484
Capitation and premium revenue	66,341	78,345
Other operating revenue	90,977	95,302
Equity in earnings of investments in unconsolidated affiliates	12,205	18,065
Net unrealized investment gains (losses)	5,533	(4,132)
Net assets released from restrictions used for operations	2,001	3,068
Total unrestricted revenues, gains and other support	2,414,273	2,234,132
Operating expenses		
Salaries	910,962	877,281
Employee benefits	269,100	250,764
Physicians' fees	49,993	46,475
Utilities	40,495	40,211
Repairs and maintenance	38,871	38,405
Drugs and pharmaceuticals	84,367	85,032
Medical supplies	182,356	184,629
Insurance	30,519	32,494
Purchased services	236,003	204,570
Other supplies and expenses	290,475	205,337
Interest	35,038	32,798
Depreciation and amortization	128,970	123,528
Total operating expenses before asset impairment	2,297,149	2,121,524
Operating income before asset impairment	117,124	112,608
Asset impairment	(30,000)	-
Operating income	87,124	112,608
Other income (expense)		
Investment income	81,562	87,975
Net unrealized investment gains (losses) on trading securities	76,017	(61,961)
Net unrealized losses and periodic settlements on interest rate swap contracts	(10,673)	(63,971)
Loss on sale/disposal of assets	(1,030)	(1,058)
Contributions	272	278
Other, net	(2,132)	(1,323)
Total other income (loss), net	144,016	(40,060)
Excess of revenues over expenses	$ 231,140	$ 72,548

Franciscan Alliance, Inc. and Affiliates
Consolidated Statements of Operations and Changes in Net Assets - Obligated Group and Designated Group Affiliates
Years Ended December 31, 2012 and 2011
(In thousands)

	2012	2011
Unrestricted net assets		
Excess of revenues over expenses	$ 231,140	$ 72,548
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	(116,287)	(94,681)
Distributions to noncontrolling interests of consolidated affiliates	(19,082)	(16,894)
Equity transfers to affiliates, net	1,414	(49,587)
Transfer to non-obligated group member	19,238	-
Other, net	660	(1,873)
Net assets released from restrictions used for purchase of property, plant, and equipment	1,658	784
Increase (decrease) in unrestricted net assets	118,741	(89,703)
Temporarily restricted net assets		
Contributions	2,748	4,117
Investment income	366	250
Net assets released from restrictions	(3,659)	(3,852)
Net unrealized investment gains (losses)	101	(147)
Transfer of temporarily restricted funds to non-obligated group member (Franciscan Alliance Foundation)	(11,708)	-
Other, net	205	76
(Decrease) increase in temporarily restricted net assets	(11,947)	444
Permanently restricted net assets		
Contributions	15	-
Investment income	30	71
Net unrealized investment (losses) gains	(64)	252
Other, net	(3,643)	(111)
(Decrease) increase in permanently restricted net assets	(3,662)	212
Increase (decrease) in net assets	103,132	(89,047)
Net assets, beginning of the year	1,803,506	1,892,553
Net assets, end of the year	$ 1,906,638	$ 1,803,506