

Trinity Health

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

TRINITY HEALTH

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Trinity Health
Livonia, Michigan

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

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 Trinity Health and subsidiaries as of June 30, 2013 and 2012, 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.

Emphasis-of-Matter

As discussed in Note 2 to the consolidated financial statements, the Corporation adopted the presentation and disclosure requirements of Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, and changed its presentation of the provision for bad debts in the consolidated statements of operations and changes in net assets. Our opinion is not modified with respect to this matter.

Deloitte + Touche LLP

September 25, 2013

TRINITY HEALTH

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2013 AND 2012

(In thousands)

| | 2013 | 2012 |
|--|----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 709,683 | \$ 708,889 |
| Investments | 2,088,973 | 1,883,325 |
| Security lending collateral | 114,865 | 130,702 |
| Assets limited or restricted as to use — current portion | 27,112 | 27,420 |
| Patient accounts receivable — net of allowance for doubtful accounts of \$268.1 million and \$217.5 million in 2013 and 2012, respectively | 942,880 | 965,573 |
| Estimated receivables from third-party payors | 155,534 | 140,614 |
| Other receivables | 137,579 | 140,718 |
| Inventories | 137,780 | 133,634 |
| Prepaid expenses and other current assets | 103,530 | 159,674 |
| Total current assets | <u>4,417,936</u> | <u>4,290,549</u> |
| ASSETS LIMITED OR RESTRICTED AS TO USE — Noncurrent portion: | | |
| Held by trustees under bond indenture agreements | - | 51,114 |
| Self-insurance, benefit plans and other | 388,758 | 419,685 |
| By Board | 2,475,659 | 2,153,574 |
| By donors | 141,647 | 129,628 |
| Total assets limited or restricted as to use — noncurrent portion | 3,006,064 | 2,754,001 |
| PROPERTY AND EQUIPMENT — Net | 4,548,908 | 4,221,827 |
| INVESTMENTS IN UNCONSOLIDATED AFFILIATES | 127,899 | 126,678 |
| GOODWILL | 118,542 | 107,704 |
| INTANGIBLE ASSETS — Net of accumulated amortization of \$20.4 million and \$17.1 million in 2013 and 2012, respectively | 65,409 | 64,475 |
| OTHER ASSETS | <u>164,735</u> | <u>110,681</u> |
| TOTAL ASSETS | <u>\$ 12,449,493</u> | <u>\$ 11,675,915</u> |

| | 2013 | 2012 |
|---|-----------------------------|-----------------------------|
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES: | | |
| Commercial paper | \$ 368,923 | \$ 134,989 |
| Short-term borrowings | 867,130 | 892,865 |
| Current portion of long-term debt | 30,862 | 32,362 |
| Accounts payable | 419,050 | 351,931 |
| Accrued expenses | 130,383 | 138,114 |
| Salaries, wages and related liabilities | 439,214 | 421,448 |
| Current portion of self-insurance reserves | 92,300 | 121,045 |
| Payable under security lending agreements | 114,865 | 130,702 |
| Estimated payables to third-party payors | <u>285,419</u> | <u>269,377</u> |
| Total current liabilities | 2,748,146 | 2,492,833 |
| LONG-TERM DEBT — Net of current portion | 2,299,594 | 2,302,236 |
| SELF-INSURANCE RESERVES — Net of current portion | 507,845 | 513,602 |
| ACCRUED PENSION AND RETIREE HEALTH COSTS | 686,946 | 1,057,566 |
| OTHER LONG-TERM LIABILITIES | <u>403,928</u> | <u>440,668</u> |
| Total liabilities | <u>6,646,459</u> | <u>6,806,905</u> |
| NET ASSETS: | | |
| Unrestricted net assets | 5,627,077 | 4,707,202 |
| Noncontrolling ownership interest in subsidiaries | <u>19,758</u> | <u>18,160</u> |
| Total unrestricted net assets | 5,646,835 | 4,725,362 |
| Temporarily restricted net assets | 113,438 | 102,978 |
| Permanently restricted net assets | <u>42,761</u> | <u>40,670</u> |
| Total net assets | <u>5,803,034</u> | <u>4,869,010</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u><u>\$ 12,449,493</u></u> | <u><u>\$ 11,675,915</u></u> |

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

TRINITY HEALTH

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2013 AND 2012

(In thousands)

| | 2013 | 2012 |
|---|-------------------|-------------------|
| UNRESTRICTED REVENUE: | | |
| Patient service revenue — net of contractual and other allowances | \$8,288,991 | \$7,849,161 |
| Provision for bad debts | <u>480,302</u> | <u>431,457</u> |
| Net patient service revenue less provision for bad debts | 7,808,689 | 7,417,704 |
| Capitation and premium revenue | 467,093 | 422,493 |
| Net assets released from restrictions | 13,566 | 12,120 |
| Other revenue | <u>689,037</u> | <u>617,136</u> |
| Total unrestricted revenue | <u>8,978,385</u> | <u>8,469,453</u> |
| EXPENSES: | | |
| Salaries and wages | 3,793,347 | 3,549,999 |
| Employee benefits | 841,318 | 831,816 |
| Contract labor | <u>86,365</u> | <u>82,903</u> |
| Total labor expenses | 4,721,030 | 4,464,718 |
| Supplies | 1,468,953 | 1,430,933 |
| Purchased services | 857,177 | 775,408 |
| Depreciation and amortization | 479,882 | 464,750 |
| Occupancy | 370,404 | 348,864 |
| Medical claims | 238,209 | 210,245 |
| Interest | 110,533 | 102,781 |
| Other | <u>410,448</u> | <u>401,745</u> |
| Total expenses | <u>8,656,636</u> | <u>8,199,444</u> |
| OPERATING INCOME BEFORE CONSOLIDATION COSTS | 321,749 | 270,009 |
| CONSOLIDATION COSTS | <u>(16,950)</u> | <u>-</u> |
| OPERATING INCOME | <u>304,799</u> | <u>270,009</u> |
| NONOPERATING ITEMS: | | |
| Investment income (loss) | 325,646 | (19,159) |
| Change in market value and cash payments of interest rate swaps | 45,818 | (114,468) |
| Loss from early extinguishment of debt | - | (13,458) |
| Gain on bargain purchase and inherent contribution | - | 216,796 |
| Other, including income taxes | <u>(9,824)</u> | <u>27,333</u> |
| Total nonoperating items | <u>361,640</u> | <u>97,044</u> |
| EXCESS OF REVENUE OVER EXPENSES | 666,439 | 367,053 |
| LESS EXCESS OF REVENUE OVER EXPENSES ATTRIBUTABLE TO NONCONTROLLING INTEREST | <u>10,566</u> | <u>8,312</u> |
| EXCESS OF REVENUE OVER EXPENSES — Net of noncontrolling interest | <u>\$ 655,873</u> | <u>\$ 358,741</u> |

| | 2013 | | |
|--|---------------------------------|------------------------------------|---------------------|
| | Controlling Interest | Noncontrolling Interest | Total |
| UNRESTRICTED NET ASSETS: | | | |
| Excess of revenue over expenses | \$ 655,873 | \$ 10,566 | \$ 666,439 |
| Net assets released from restrictions for capital acquisitions | 15,594 | - | 15,594 |
| Net change in retirement plan related items | 261,557 | - | 261,557 |
| Other | <u>(3,646)</u> | <u>(8,968)</u> | <u>(12,614)</u> |
| Increase in unrestricted net assets before discontinued operations | 929,378 | 1,598 | 930,976 |
| Discontinued operations — Battle Creek Health System (BCHS) — loss from operations | <u>(9,503)</u> | <u>-</u> | <u>(9,503)</u> |
| Increase in unrestricted net assets | <u>919,875</u> | <u>1,598</u> | <u>921,473</u> |
| TEMPORARILY RESTRICTED NET ASSETS: | | | |
| Contributions | 35,831 | - | 35,831 |
| Net investment gain | 3,246 | - | 3,246 |
| Net assets released from restrictions | (29,160) | - | (29,160) |
| Other | <u>543</u> | <u>-</u> | <u>543</u> |
| Increase in temporarily restricted net assets | <u>10,460</u> | <u>-</u> | <u>10,460</u> |
| PERMANENTLY RESTRICTED NET ASSETS: | | | |
| Contributions for endowment funds | 1,230 | - | 1,230 |
| Net investment gain | 2,278 | - | 2,278 |
| Other | <u>(1,417)</u> | <u>-</u> | <u>(1,417)</u> |
| Increase in permanently restricted net assets | <u>2,091</u> | <u>-</u> | <u>2,091</u> |
| INCREASE IN NET ASSETS | 932,426 | 1,598 | 934,024 |
| NET ASSETS — Beginning of year | <u>4,850,850</u> | <u>18,160</u> | <u>4,869,010</u> |
| NET ASSETS — End of year | <u>\$ 5,783,276</u> | <u>\$ 19,758</u> | <u>\$ 5,803,034</u> |

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

(Continued)

| | 2012 | | |
|--|---------------------------------|------------------------------------|---------------------|
| | Controlling Interest | Noncontrolling Interest | Total |
| UNRESTRICTED NET ASSETS: | | | |
| Excess of revenue over expenses | \$ 358,741 | \$ 8,312 | \$ 367,053 |
| Net assets released from restrictions for capital acquisitions | 20,496 | - | 20,496 |
| Net change in retirement plan related items | (673,340) | - | (673,340) |
| Other | <u>6,090</u> | <u>(6,287)</u> | <u>(197)</u> |
| (Decrease) increase in unrestricted net assets before discontinued operations | (288,013) | 2,025 | (285,988) |
| Discontinued operations — BCHS: | | | |
| Net change in retirement plan-related items | 21,678 | - | 21,678 |
| Loss on transfer of shares | (28,534) | - | (28,534) |
| Loss from operations | (5,447) | - | (5,447) |
| Decrease due to transfer | <u>-</u> | <u>(81,153)</u> | <u>(81,153)</u> |
| Decrease in unrestricted net assets | <u>(300,316)</u> | <u>(79,128)</u> | <u>(379,444)</u> |
| TEMPORARILY RESTRICTED NET ASSETS: | | | |
| Contributions | 38,022 | - | 38,022 |
| Net assets released from restrictions | (32,616) | - | (32,616) |
| Decrease due to transfer of shares of BCHS | (1,628) | (1,628) | (3,256) |
| Acquisition of Loyola University Health System (LUHS) | 20,362 | - | 20,362 |
| Acquisition of Mercy Health System of Chicago (MHSC) | 4,016 | - | 4,016 |
| Other | <u>1,535</u> | <u>-</u> | <u>1,535</u> |
| Increase (decrease) in temporarily restricted net assets | <u>29,691</u> | <u>(1,628)</u> | <u>28,063</u> |
| PERMANENTLY RESTRICTED NET ASSETS: | | | |
| Contributions for endowment funds | 636 | - | 636 |
| Net investment loss | (421) | - | (421) |
| Decrease due to transfer of shares of BCHS | (129) | (129) | (258) |
| Acquisition of LUHS | 6,671 | - | 6,671 |
| Other | <u>(549)</u> | <u>-</u> | <u>(549)</u> |
| Increase (decrease) in permanently restricted net assets | <u>6,208</u> | <u>(129)</u> | <u>6,079</u> |
| DECREASE IN NET ASSETS | (264,417) | (80,885) | (345,302) |
| NET ASSETS — Beginning of year | <u>5,115,267</u> | <u>99,045</u> | <u>5,214,312</u> |
| NET ASSETS — End of year | <u>\$ 4,850,850</u> | <u>\$ 18,160</u> | <u>\$ 4,869,010</u> |

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

(Concluded)

TRINITY HEALTH

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

| | 2013 | 2012 |
|---|------------|--------------|
| OPERATING ACTIVITIES: | | |
| Increase (decrease) in net assets | \$ 934,024 | \$ (345,302) |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 479,882 | 464,750 |
| Provision for bad debts | 480,302 | 431,457 |
| Deferred retirement (gain) loss arising during the year | (168,009) | 718,203 |
| Change in net unrealized and realized gains on investments | (262,870) | 80,538 |
| Change in market values of interest rate swaps | (65,387) | 97,189 |
| Undistributed equity earnings from unconsolidated affiliates | (33,738) | (33,584) |
| Restricted contributions and investment income received | (10,972) | (19,583) |
| Restricted net assets acquired related to LUHS and MHSC | - | (31,610) |
| Gain on bargain purchase agreement and inherent contribution — LUHS and MHSC | - | (216,796) |
| Net change in retirement plan related items due to transfer of shares of BCHS | - | (21,678) |
| Loss on transfer of shares of BCHS | - | 28,534 |
| Decrease in noncontrolling interest due to transfer of BCHS | - | 82,910 |
| Loss from extinguishment of debt | - | 5,557 |
| Gain on sale of assets and other adjustments | (10,788) | (2,302) |
| Changes in, excluding assets and liabilities acquired: | | |
| Patient accounts receivable | (454,796) | (478,813) |
| Other assets | 55,018 | (42,829) |
| Accounts payable and accrued expenses | (2,215) | 43,872 |
| Estimated receivables from third-party payors | (14,920) | - |
| Estimated payables to third-party payors | 16,043 | 8,003 |
| Self-insurance reserves | (26,682) | 31,342 |
| Accrued pension and retiree health costs | (203,990) | (67,444) |
| Other liabilities | 12,262 | (32,063) |
| Total adjustments | (210,860) | 1,045,653 |
| Net cash provided by operating activities | 723,164 | 700,351 |

| | 2013 | 2012 |
|---|-------------------|-------------------|
| INVESTING ACTIVITIES: | | |
| Purchases of investments | \$ (1,858,000) | \$ (1,672,413) |
| Proceeds from sales of investments | 1,638,138 | 1,602,586 |
| Purchases of property and equipment | (732,213) | (605,288) |
| Acquisition of subsidiaries — net of \$85.0 million in cash assumed in 2012 | (14,087) | (85,889) |
| Dividends received from unconsolidated affiliates and other changes | 32,006 | 25,748 |
| Increase in assets limited as to use | (6,406) | (3,678) |
| Proceeds received from the transfer of shares of BCHS | - | 15,843 |
| Proceeds from sales and disposal of assets | <u>12,914</u> | <u>7,178</u> |
| Net cash used in investing activities | <u>(927,648)</u> | <u>(715,913)</u> |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of debt | 18,941 | 1,073,790 |
| Repayments of debt | (58,568) | (961,604) |
| Net increase in commercial paper | 233,933 | 35,011 |
| Increase in financing costs and other | - | (9,647) |
| Restricted net assets acquired related to LUHS and MHSC | - | 31,049 |
| Proceeds from restricted contributions and restricted investment income | <u>10,972</u> | <u>19,583</u> |
| Net cash provided by financing activities | <u>205,278</u> | <u>188,182</u> |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 794 | 172,620 |
| CASH AND CASH EQUIVALENTS — Beginning of year | <u>708,889</u> | <u>536,269</u> |
| CASH AND CASH EQUIVALENTS — End of year | <u>\$ 709,683</u> | <u>\$ 708,889</u> |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest (net of amounts capitalized) | \$ 110,090 | \$ 96,115 |
| New capital lease obligations for buildings and equipment | 1,486 | 5,822 |
| Accruals for purchases of property and equipment and other long-term assets | 95,771 | 37,457 |
| Unsettled investment trades — purchases | 9,124 | 11,367 |
| Unsettled investment trades — sales | 4,027 | 12,346 |
| Decrease in security lending collateral | 15,837 | 18,940 |
| Decrease in payable under security lending agreements | (15,837) | (18,940) |

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

TRINITY HEALTH

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2013 AND 2012

1. ORGANIZATION AND MISSION

Trinity Health, an Indiana not-for-profit corporation, and its subsidiaries are collectively referred to as the Corporation. Effective May 1, 2013, the Corporation and Catholic Health East, a Pennsylvania nonprofit corporation, consolidated to form CHE Trinity, Inc., a unified Catholic national health system that enhances the mission of service to people and communities across the United States. This transaction was accounted for as a merger and thus the Corporation's balance sheet continues to be recorded at its historical basis under the carryover method. Transition and integration are on-going with the Corporation incurring approximately \$17 million in costs during the year ended June 30, 2013, as a result of the transaction, which are included in consolidation costs in the consolidated statement of operations and changes in net assets. These consolidated financial statements reflect the results of operations and financial position of the Corporation only.

The Corporation is sponsored by Catholic Health Ministries (CHM), a Public Juridic Person of the Holy Roman Catholic Church. The Corporation operates a comprehensive integrated network of health services, including inpatient and outpatient services, physician services, managed care coverage, home health care, long-term care, assisted living care, and rehabilitation services located in 10 states. The mission statement for the Corporation is as follows:

We, CHE Trinity Health, serve together in the spirit of the Gospel as a compassionate and transforming healing presence within our communities.

Community Benefit Ministry — 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, including those persons who cannot afford health insurance or other payments, such as copays and deductibles because of inadequate resources and/or are uninsured or underinsured, and to improve 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' (CHA), *A Guide for Planning and Reporting Community Benefit, 2012 Edition*.

The quantifiable costs of the Corporation's community benefit ministry for the years ended June 30, 2013 and 2012, are as follows:

| | 2013 | 2012 |
|---|-----------------------|-------------------|
| | (In thousands) | |
| | <u> </u> | <u> </u> |
| Ministry for the poor and underserved: | | |
| Charity care at cost | \$ 183,482 | \$ 177,747 |
| Unpaid cost of Medicaid and other public programs | 181,020 | 211,104 |
| Programs for the poor and the underserved: | | |
| Community health services | 19,451 | 18,210 |
| Subsidized health services | 34,950 | 39,296 |
| Financial contributions | 3,972 | 5,362 |
| Community building activities | 1,792 | 1,908 |
| Community benefit operations | <u>3,117</u> | <u>2,268</u> |
| Total programs for the poor and underserved | <u>63,282</u> | <u>67,044</u> |
| Ministry for the poor and underserved | <u>427,784</u> | <u>455,895</u> |
| Ministry for the broader community: | | |
| Community health services | 7,858 | 8,452 |
| Health professions education | 85,840 | 89,649 |
| Subsidized health services | 23,624 | 18,876 |
| Research | 7,006 | 9,203 |
| Financial contributions | 25,895 | 25,631 |
| Community building activities | 3,143 | 4,410 |
| Community benefit operations | <u>1,871</u> | <u>3,061</u> |
| Ministry for the broader community | <u>155,237</u> | <u>159,282</u> |
| Community benefit ministry | <u>\$ 583,021</u> | <u>\$ 615,177</u> |

The Corporation provides a significant amount of uncompensated care to its uninsured and underinsured patients, which is reported as bad debt at cost and not included in the amounts reported above. During the years ended June 30, 2013 and 2012, the Corporation reported bad debt at cost (determined using a cost to charge ratio applied to the provision for bad debts) of \$170.6 million and \$157.5 million, respectively.

Ministry for the poor and underserved represents the financial commitment to seek out and serve those who need help the most, especially the poor, the uninsured, and the indigent. This is done with the conviction that health care is a basic human right.

Ministry for the broader community represents the cost of services provided for the general benefit of the communities in which the Corporation operates. Many programs are targeted toward populations that may be poor, but also include those areas that may need special health services and support. These programs are not intended to be financially self-supporting.

Charity care at cost represents the cost of services provided to patients who cannot afford health care services due to inadequate resources and/or are uninsured or underinsured. A patient is classified as a charity patient in accordance with the Corporation's established policies as further described in Note 4. The cost of charity care is calculated using a cost to charge ratio methodology.

Unpaid cost of Medicaid and other public programs represents 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 governmental and managed care contract payments.

Community health 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. Some examples include community health education, free immunization services, free or low cost prescription medications, and rural and urban outreach programs. The Corporation actively collaborates with community groups and agencies to assist those in need in providing such services.

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

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 free-standing community clinics, hospice care, mobile units and behavioral health services.

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

Financial contributions are made by the Corporation on behalf of the poor and underserved to community agencies. These amounts include special system-wide 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. Amounts included here also represent certain in-kind donations.

Community building activities include the costs of programs that improve the physical environment, promote economic development, enhance other community support systems, develop leadership 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.

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. Investments where the Corporation holds less than 20% of the ownership interest are accounted for using the cost method. All other investments that are not controlled by the Corporation are accounted for using the equity method of accounting. The Corporation has included its equity share of income or losses from investments in unconsolidated affiliates in other revenue in the consolidated statements of operations and changes in net assets. All material intercompany transactions and account balances have been eliminated in consolidation.

As further described in Note 3, the Corporation transferred its shares of BCHS to Bronson Healthcare Group, Inc., effective July 1, 2011. The consolidated financial statements have been reclassified to present the operations of BCHS as a discontinued operation. The consolidated statements of cash flows include impacts of cash flows related to BCHS. Notes to these consolidated financial statements exclude BCHS.

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; provisions for bad debts and charity care; recorded values of investments and goodwill; reserves for losses and expenses related to health care professional and general liability; and risks and assumptions for measurement of pension and retiree medical 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 – For purposes of the consolidated statements of cash flows, cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

Investments – Investments, inclusive of assets limited or restricted as to use, include marketable debt and equity securities. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value and are classified as trading securities. Investments also include investments in commingled funds, hedge funds and other investments structured as limited liability corporations or partnerships. Commingled funds and hedge funds that hold securities directly are stated at the fair value of the underlying securities, as determined by the administrator, based on readily determinable market values or based on net asset value, which is calculated using the most recent fund financial statements. Limited liability corporations and partnerships are accounted for under the equity method.

Investment Earnings – Investment earnings include interest, dividends, realized gains and losses on investments, holding gains and losses, and equity earnings. Investment earnings on assets held by trustees under bond indenture agreements, assets designated by the Board for debt redemption, assets held for borrowings under the intercompany loan program, and assets deposited in trust funds by a captive insurance company for self-insurance purposes in accordance with industry practices are included in other revenue in the consolidated statements of operations and changes in net assets. Investment earnings from all other unrestricted investments and board-designated funds are included in nonoperating investment income, unless the income or loss is restricted by donor or law.

Derivative Financial Instruments – The Corporation periodically utilizes various financial instruments (e.g., options and swaps) to hedge interest rates, equity downside risk and other exposures. The Corporation's policies prohibit trading in derivative financial instruments on a speculative basis.

Securities Lending – The Corporation participates in securities lending transactions whereby a portion of its investments are loaned, through its agent, to various parties in return for cash and securities from the parties as collateral for the securities loaned. Each business day the Corporation, through its agent, and the borrower determine the market value of the collateral and the borrowed securities. If on any business day, the market value of the collateral is less than the required value, additional collateral is

obtained as appropriate. The amount of cash collateral received under securities lending is reported as an asset and a corresponding payable in the consolidated balance sheets and is up to 105% of the market value of securities loaned. At June 30, 2013 and 2012, the Corporation had securities loaned of \$121.9 million and \$141.4 million, respectively, and received collateral (cash and noncash) totaling \$125.7 million and \$143.4 million, respectively, relating to the securities loaned. The fees received for these transactions are recorded in investment income (loss) in the consolidated statements of operations and changes in net assets.

Assets Limited as to Use – Assets set aside by the Board for future capital improvements, future funding of retirement programs and insurance claims, retirement of debt, held for borrowings under the intercompany loan program, and other purposes over which the Board retains control and may at its discretion subsequently use for other purposes, assets held by trustees under bond indenture and certain other agreements, and self-insurance trust and benefit plan arrangements are included in assets limited as to use.

Donor-Restricted Gifts – Unconditional promises to give cash and other assets to the Corporation's various ministry organizations are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to 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 statements of operations and changes in net assets.

Inventories – Inventories are stated at the lower of cost or market. The cost of inventories is determined principally by the weighted average cost method.

Property and Equipment – Property and equipment, including internal-use software, are recorded at cost, if purchased, or at fair value at the date of donation, if donated. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using either the straight-line or an accelerated method and includes capital lease and internal-use software amortization. The useful lives of these assets range from 2 to 50 years. Interest costs incurred during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets, such as land, buildings, or equipment are reported as unrestricted support and are excluded from the excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support.

Goodwill – Goodwill represents the future economic benefits arising from assets acquired in a business combination that are not individually identified and separately recognized.

Intangible Assets – Intangible assets include both definite and indefinite-lived intangible assets. The majority of the net balance of definite-lived intangible assets include noncompete agreements and physician guarantees with finite lives amortized using the straight-line method over their estimated useful lives, which range from 2 to 23 years and 2 to 12 years, respectively. Indefinite-lived intangible assets include trade names and renewable licenses.

Asset Impairment –

Property and Equipment – Impairment testing is performed following a triggering event or whenever events or changes in circumstances indicate an asset’s carrying value may not be recoverable.

Goodwill – Goodwill is tested for impairment on an annual basis or when an event or change in circumstance indicates the value of a reporting unit may have changed. Testing is conducted at the reporting unit level. There is a two-step process for determining goodwill impairment. Step one compares the carrying value of each reporting unit with its fair value. If this test indicates the fair value is less than the carrying value, then step two is required. Step two compares the implied fair value of the reporting unit’s goodwill with the carrying value of reporting unit’s goodwill. The Corporation estimates the fair value of its reporting units using a discounted cash flow analysis.

Intangible Assets:

Definite-Lived – Impairment testing is performed if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. The Corporation estimates the fair value of its intangible assets using an undiscounted cash flow analysis.

Indefinite-Lived – Impairment testing is performed on an annual basis or more frequently if events or changes in circumstance indicate the asset may be impaired. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. The Corporation estimates the fair value of its intangible assets using a discounted cash flow analysis including the use of net revenue associated with the trade names.

The following table provides information on changes in the carrying amount of goodwill, which is included in the accompanying consolidated financial statements of the Corporation at June 30:

| | 2013 | 2012 |
|------------------------------------|-----------------------|-------------------|
| | (In thousands) | |
| As of July 1: | | |
| Goodwill | \$ 115,559 | \$ 116,152 |
| Accumulated impairment loss | <u>(7,855)</u> | <u>(7,855)</u> |
| Total | 107,704 | 108,297 |
| Goodwill acquired during the year | 10,858 | 2,090 |
| Decrease due to sale of subsidiary | - | (2,683) |
| Impairment loss | <u>(20)</u> | <u>-</u> |
| Total | <u>\$ 118,542</u> | <u>\$ 107,704</u> |
| As of June 30: | | |
| Goodwill | \$ 126,417 | \$ 115,559 |
| Accumulated impairment loss | <u>(7,875)</u> | <u>(7,855)</u> |
| Total | <u>\$ 118,542</u> | <u>\$ 107,704</u> |

The following table provides information regarding other intangible assets, which are included in the accompanying consolidated balance sheets of the Corporation at June 30:

| | (In thousands) | | |
|--|----------------------------------|-------------------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
| As of June 30, 2013: | | | |
| Definite-lived intangible assets: | | | |
| Noncompete agreements | \$ 21,169 | \$ 15,968 | \$ 5,201 |
| Physician guarantees | 7,888 | 2,615 | 5,273 |
| Other | <u>6,190</u> | <u>604</u> | <u>5,586</u> |
| Total definite-lived intangible assets | <u>35,247</u> | <u>19,187</u> | <u>16,060</u> |
| Indefinite-lived intangible assets: | | | |
| Trade names | 43,702 | - | 43,702 |
| Other | <u>6,889</u> | <u>1,242</u> | <u>5,647</u> |
| Total indefinite-lived intangible assets | <u>50,591</u> | <u>1,242</u> | <u>49,349</u> |
| Total intangible assets | <u>\$ 85,838</u> | <u>\$ 20,429</u> | <u>\$ 65,409</u> |
| As of June 30, 2012: | | | |
| Definite-lived intangible assets: | | | |
| Noncompete agreements | \$ 19,439 | \$ 13,199 | \$ 6,240 |
| Physician guarantees | 5,256 | 2,384 | 2,872 |
| Other | <u>6,085</u> | <u>187</u> | <u>5,898</u> |
| Total definite-lived intangible assets | <u>30,780</u> | <u>15,770</u> | <u>15,010</u> |
| Indefinite-lived intangible assets: | | | |
| Trade names | 43,762 | - | 43,762 |
| Other | <u>7,022</u> | <u>1,319</u> | <u>5,703</u> |
| Total indefinite-lived intangible assets | <u>50,784</u> | <u>1,319</u> | <u>49,465</u> |
| Total intangible assets | <u>\$ 81,564</u> | <u>\$ 17,089</u> | <u>\$ 64,475</u> |

The following is a schedule of estimated future amortization of definite-lived intangible assets as of June 30, 2013:

| | (In thousands) |
|-----------------------|-----------------------|
| Years ending June 30: | |
| 2014 | \$ 5,459 |
| 2015 | 2,617 |
| 2016 | 1,491 |
| 2017 | 1,127 |
| 2018 | 569 |
| Thereafter | <u>4,797</u> |
| Total | <u>\$ 16,060</u> |

Temporarily and Permanently Restricted 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.

Patient Accounts Receivable, Estimated Receivables from and Payables to Third-Party Payors and Net Patient Service Revenue – The Corporation has agreements with third-party payors that provide for payments to the Corporation’s ministry organizations at amounts different from 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. Estimated retroactive adjustments under reimbursement agreements with third-party payors are included in net patient service revenue and estimated receivables from and payables to third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Estimated receivables from third-party payors include amounts receivable from Medicare and state Medicaid meaningful use programs.

Allowance for Doubtful Accounts – The Corporation recognizes a significant amount of patient service revenue at the time the services are rendered even though the Corporation does not assess the patient’s ability to pay at that time. As a result, the provision for bad debts is presented as a deduction from patient service revenue (net of contractual provisions and discounts). For uninsured patients that do not qualify for charity care, the Corporation establishes an allowance to reduce the carrying value of such receivables to their estimated net realizable value. This allowance is established based on the aging of accounts receivable and the historical collection experience by ministry organization and for each type of payor. A significant portion of the Corporation’s provision for doubtful accounts relates to self-pay patients, as well as co-payments and deductibles owed to the Corporation by patients with insurance.

Short-Term Borrowings – Short-term borrowings include puttable variable rate demand bonds supported by self liquidity or liquidity facilities considered short-term in nature.

Other Long-Term Liabilities – Other long-term liabilities include accrued payments for the acquisition of Loyola University Health System as stipulated in the Definitive Agreement, deferred compensation, asset retirement obligations and interest rate swaps.

Premium and Capitation Revenue – The Corporation has certain ministry organizations 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 a yearly basis. Premiums are due

monthly and are recognized as revenue during the period in which the Corporation is obligated to provide services to enrollees. Premiums received prior to the period of coverage are recorded as deferred revenue and included in accrued expenses in the consolidated balance sheets.

Certain of the Corporation's ministry organizations have entered into capitation arrangements whereby they accept the risk for the provision of certain health care services to health plan members. Under these agreements, the Corporation's ministry organizations are financially responsible for services provided to the health plan members by other institutional health care providers. Capitation revenue is recognized during the period for which the ministry organization is obligated to provide services to health plan enrollees under capitation contracts. Capitation receivables are included in other receivables in the consolidated balance sheets.

Reserves for incurred but not reported claims have been established to cover the unpaid costs of health care services covered under the premium and capitation arrangements. The premium and capitation arrangement reserves are classified with accrued expenses in the consolidated balance sheets. The liability is estimated based on actuarial studies, historical reporting, and payment trends. Subsequent actual claim experience will differ from the estimated liability due to variances in estimated and actual utilization of health care services, the amount of charges, and other factors. As settlements are made and estimates are revised, the differences are reflected in current operations.

Income Taxes – The Corporation and substantially all of its subsidiaries have been recognized as tax-exempt pursuant to Section 501(a) of the Internal Revenue Code. The Corporation also has taxable subsidiaries, which are included in the consolidated financial statements. Certain of the taxable subsidiaries have entered into tax sharing agreements and file consolidated federal income tax returns with other corporate taxable subsidiaries. The Corporation includes penalties and interest, if any, with its provision for income taxes in other nonoperating items in the consolidated statements of operations and changes in net assets.

Excess of Revenue Over Expenses – The consolidated statements of operations and changes in net assets include excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over expenses, consistent with industry practice, include the effective portion of the change in market value of derivatives that meet hedge accounting requirements, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets received or gifted (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), net change in retirement plan related items, discontinued operations, extraordinary items and cumulative effects of changes in accounting principles.

Adopted Accounting Pronouncements –

On July 1, 2012, the Corporation adopted Accounting Standard Update (ASU) 2011-04, "*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*" This guidance amends the fair value disclosure requirements regarding transfers between Level 1 and Level 2 of the fair value hierarchy, and also the categorization by level of the fair value hierarchy for items that are not measured at fair value in the financial statements but for which the fair value is required to be disclosed. The adoption of this guidance resulted in additional disclosures in the footnotes to the Corporation's consolidated financial statements.

On July 1, 2012, the Corporation adopted ASU 2011-07, "*Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities.*" This guidance requires certain health care entities to present the provision for bad debts related to patient service revenues as a deduction from revenue,

net of contractual allowances and discounts, versus as an expense in the statement of operations. In addition, it also requires enhanced disclosures regarding revenue recognition policies and the assessment of bad debt. The adoption of this guidance resulted in a reduction of net patient service revenue, operating revenue, and operating expense but had no impact on operating income in the consolidated statement of operations and changes in net assets. All periods presented have been reclassified in accordance with the provisions of ASU 2011-07. The adoption of this guidance also resulted in additional disclosures as presented in the allowance for doubtful accounts policy within Note 2 and net patient service revenue disclosures presented within Note 4.

On July 1, 2012, the Corporation adopted ASU 2011-08, *“Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment.”* This guidance provides entities the option of first assessing qualitative factors about the likelihood of goodwill impairment to determine whether further impairment assessment is necessary. The adoption of this guidance had no impact on the Corporation’s consolidated financial statements.

Forthcoming Accounting Pronouncements –

In December 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-11, *“Disclosures About Offsetting Assets and Liabilities.”* This guidance contains new disclosure requirements regarding the nature of an entity’s rights of setoff and related arrangements associated with its financial instruments and derivative instruments. This guidance is effective for the Corporation beginning July 1, 2013, and retrospective application is required. The Corporation does not expect this guidance to have an impact on its consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, *“Intangibles Goodwill and Other (Topic 350): Testing Indefinite-lived Intangible Assets for Impairment.”* This guidance provides entities the option of first assessing qualitative factors about the likelihood that an indefinite-lived intangible asset is impaired to determine whether further impairment assessment is necessary. It also enhances the consistency of the impairment testing guidance among long-lived asset categories by permitting entities to assess qualitative factors to determine whether it is necessary to calculate the asset’s fair value when testing an indefinite-lived intangible asset for impairment. This guidance is effective for the Corporation beginning July 1, 2013, with early adoption permitted. The Corporation does not expect this guidance to have an impact on its consolidated financial statements.

In October 2012, the FASB issued ASU 2012-05, *“Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows.”* This guidance provides clarification on how entities classify cash receipts arising from the sale of certain donated financial assets in the statement of cash flows. This guidance is effective for the Corporation beginning July 1, 2013, with early adoption permitted. The Corporation does not expect this guidance to have a material impact on its consolidated statement of cash flows.

In January 2013, the FASB issued ASU 2013-01, *“Clarifying the Scope of Disclosures About Offsetting Assets and Liabilities.”* This guidance provides clarification on the scope of the offsetting disclosure requirements in ASU 2011-11. This guidance is effective for the Corporation beginning July 1, 2013, with early adoption permitted. The Corporation does not expect this guidance to have a material impact on its consolidated balance sheets.

In February 2013, the FASB issued ASU 2013-04, *“Obligations Resulting From Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date.”* This guidance requires entities to measure obligations resulting from the joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at

the reporting date. This guidance is effective for the Corporation beginning July 1, 2014, with early adoption permitted. The Corporation has not yet evaluated the impact this guidance may have on its consolidated financial statements.

3. INVESTMENTS IN UNCONSOLIDATED AFFILIATES, BUSINESS ACQUISITIONS AND DIVESTITURES

Investments in Unconsolidated Affiliates – The Corporation and certain of its ministry organizations have investments in entities that are recorded under the cost and equity methods of accounting. At June 30, 2013, the Corporation maintained investments in unconsolidated affiliates with ownership interests ranging from 3% to 50%. The Corporation's share of equity earnings from entities accounted for under the equity method was \$33.7 million and \$33.6 million for the years ended June 30, 2013 and 2012, respectively, which is included in other revenue 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 June 30 are as follows:

| | 2013 | | | | | Total |
|---------------------------------|---|---|---|---|----------------------------|--------------|
| | (In thousands) | | | | | |
| | Medical Office Buildings | Outpatient and Diagnostic Services | Ambulatory Surgery Centers | Physician Hospital Organizations | Other Investees | |
| Total assets | \$ 63,069 | \$ 94,075 | \$ 71,019 | \$ 25,728 | \$ 167,523 | \$ 421,414 |
| Total debt | 36,094 | 11,685 | 37,027 | 17 | 38,609 | 123,432 |
| Net assets | 22,481 | 58,804 | 26,425 | 6,806 | 100,543 | 215,059 |
| Revenue, net | 11,712 | 165,426 | 116,943 | 29,663 | 205,753 | 529,497 |
| Excess of revenue over expenses | 7,954 | 19,295 | 34,938 | 916 | 14,927 | 78,030 |

| | 2012 | | | | | Total |
|---|---|---|---|---|----------------------------|--------------|
| | (In thousands) | | | | | |
| | Medical Office Buildings | Outpatient and Diagnostic Services | Ambulatory Surgery Centers | Physician Hospital Organizations | Other Investees | |
| Total assets | \$ 88,425 | \$ 116,970 | \$ 76,078 | \$ 17,530 | \$ 137,711 | \$ 436,714 |
| Total debt | 51,182 | 17,804 | 36,003 | 27 | 35,800 | 140,816 |
| Net assets | 30,765 | 69,368 | 29,733 | 5,576 | 80,235 | 215,677 |
| Revenue, net | 22,823 | 155,521 | 125,615 | 20,537 | 169,724 | 494,220 |
| Excess of revenue over (under) expenses | 1,607 | 24,908 | 44,245 | (188) | 13,972 | 84,544 |

Business Acquisitions – The Corporation entered into the following significant acquisition activities during the year ended June 30, 2012:

Acquisition of Mercy Health System of Chicago (MHSC) – Effective April 1, 2012, the Corporation became the sole member of MHSC. MHSC is the parent of Mercy Hospital and Medical Center (Mercy Hospital) and other subsidiaries and affiliates that provide health care services in Chicago, Illinois. Mercy Hospital has a network of primary care clinics, physician offices and satellite facilities. The fair value of assets acquired exceeded liabilities assumed resulting in an inherent contribution of \$140.8 million, which was recorded in gain on bargain purchase and inherent contribution in the consolidated statement of operations and changes in net assets for the year ended June 30, 2012. Transactions costs accrued and paid totaled \$0.8 million, primarily for legal and consulting services, and are included in purchased services in the consolidated statement of operations and changes in net assets.

Summarized consolidated opening balance sheet information for MHSC is shown below:

| (In thousands) | | | |
|--|------------------|---------------------------------------|-------------------|
| Cash, cash equivalents and investments | \$ 13,777 | Current portion of long-term debt | \$ 819 |
| Patient accounts receivable, net | 42,746 | Accounts payable and accrued expenses | 41,815 |
| Other current assets | 35,018 | Other current liabilities | 12,957 |
| Assets limited or restricted as to use | 16,451 | Long-term debt | 48,907 |
| Property and equipment | 166,529 | Self-insurance reserves | <u>36,362</u> |
| Intangibles | 11,000 | | |
| Other assets | <u>749</u> | Total liabilities acquired | <u>\$ 140,860</u> |
| Total assets acquired | <u>\$286,270</u> | | |
| | | Unrestricted noncontrolling interest | \$ 561 |
| | | Temporarily restricted net assets | <u>4,016</u> |
| | | Total net assets | <u>\$ 4,577</u> |

The operating results of MHSC for the year ended June 30, 2013, include total unrestricted revenue of \$244.3 million, operating income of \$4.6 million and excess of revenue over expense of \$4.5 million. The operating results of MHSC for the period April 1, 2012 through June 30, 2012, included total unrestricted revenue of \$64.0 million, operating income of \$4.7 million, and excess of revenue over expense of \$4.5 million.

Acquisition of Loyola University Health System (LUHS) – On July 1, 2011, the Corporation replaced Loyola University of Chicago (University) as the sole member of LUHS, an Illinois not-for-profit corporation. LUHS is the sole member of Loyola University Medical Center and Gottlieb Memorial Hospital (Gottlieb), both Illinois not-for-profit corporations. LUHS was also the sole shareholder of Loyola University of Chicago Insurance Company (LUCIC), a Cayman Islands Corporation until December 31, 2011, as further described in Note 7. The Corporation will coordinate with the University to support health science education and research. The entities seek to work collaboratively both within and outside the Chicago market to become one of the nation’s leading providers of Catholic health care, research and medical education.

The Corporation acquired LUHS for \$212.9 million, \$88.3 million in cash at the effective date, \$49.6 million in cash based on a post closing reconciliation adjustment to the purchase price as stipulated in the Definitive Agreement paid in October 2011, and an accrual of an additional \$75.0 million to be paid over future years, which remains outstanding as of June 30, 2013. The Corporation recorded indefinite-lived intangible assets, primarily for a trade name, of \$36.1 million in the consolidated balance sheet at the acquisition date. Based on the purchase price allocation, the fair value of assets acquired and liabilities assumed exceeded the fair value of consideration paid and accrued. As a result, the Corporation recognized a gain of \$76.0 million in gain on bargain purchase and inherent contribution in the consolidated statement of operations and changes in net assets. Transaction costs accrued and paid totaled \$6.0 million, primarily for legal and consulting services, and are included in purchased services in the consolidated statement of operations and changes in net assets.

Summarized consolidated opening balance sheet information for LUHS is shown below:

| (In thousands) | | | |
|--|---------------------|--|-------------------|
| Cash, cash equivalents and investments | \$ 76,865 | Current portion of long-term debt | \$ 163,834 |
| Patient accounts receivable, net | 153,006 | Accounts payable and accrued expenses | 50,947 |
| Inventory | 15,276 | Estimated payables to third party payors | 72,320 |
| Other current assets | 49,568 | Other current liabilities | 48,245 |
| Assets limited or restricted as to use | 298,997 | Long-term debt | 212,536 |
| Property and equipment | 522,076 | Self-insurance reserves | 242,058 |
| Intangibles | 36,170 | Pension and post retirement plan obligations | 59,866 |
| Other assets | <u>32,378</u> | Other liabilities | <u>18,596</u> |
| | | | |
| Total assets acquired | <u>\$ 1,184,336</u> | Total liabilities acquired | <u>\$ 868,402</u> |
| | | Temporarily restricted net assets | \$ 20,362 |
| | | Permanently restricted net assets | <u>6,671</u> |
| | | | |
| | | Total net assets | <u>\$ 27,033</u> |

As of August 8, 2011, all of LUHS' debt was retired with the proceeds from the Corporation's issuance of \$234 million of taxable commercial paper and cash on hand as further described in Note 6.

As part of the LUHS acquisition, certain executed agreements provide for ongoing financial support from the Corporation including:

- A Definitive Agreement upon which the Corporation has agreed that over the seven year period from July 1, 2011 to 2018, at least \$300 million will be expended on capital projects and, if certain operating thresholds are met, the amount may be increased to \$400 million.
- An Academic Affiliation Agreement, which has an initial term of ten years starting July 1, 2011, and provides for an annual academic support payment from the Corporation to the University adjusted annually for inflation. The payment totaled \$22.7 million and \$22.5 million for the years ended June 30, 2013 and 2012, respectively.
- A Shared Services Agreement between the University and LUHS who have agreed on a cost sharing agreement related to common employees and services. Cost incurred to the University totaled \$7.1 million and \$9.6 million for the years ended June 30, 2013 and 2012, respectively.

The operating results of LUHS for the years ended June 30, 2013 and 2012 include total unrestricted revenue of \$1.2 billion and \$1.1 billion, respectively, operating income of \$42.1 million and \$0.3 million, respectively, and excess (deficiency) of revenue over expense of \$51.6 million and (\$13.0) million, respectively.

The amount of the Corporation's revenue, earnings, and changes in net assets had the acquisitions of LUHS and MHSC occurred on July 1, 2011, are as follows:

| | 2013 | 2012 |
|---|-----------------------|--------------|
| | (In thousands) | |
| Total operating revenue | \$ 8,978,385 | \$ 8,662,121 |
| Excess of revenue over expenses | 666,439 | 374,352 |
| Change in unrestricted net assets | 921,473 | (372,145) |
| Change in temporarily restricted net assets | 10,460 | 27,871 |
| Change in permanently restricted net assets | 2,091 | 6,079 |

Business Divestitures:

On July 1, 1991, Battle Creek Health System (BCHS) was formed through an agreement between the Corporation and Community Hospital Association of Battle Creek, Michigan, with the Corporation owning 50% of the stock of BCHS with effective control of BCHS. Effective July 1, 2011, the Corporation transferred its shares of BCHS to Bronson Healthcare Group, Inc., for \$76.0 million. As described in Note 2, the consolidated financial statements for year ended June 30, 2012, present the operations of BCHS as a discontinued operation. As a result of the transfer, the Corporation reported a loss of \$28.5 million, which includes a pension curtailment gain of \$5.8 million and settlement loss of \$27.5 million in discontinued operations in the consolidated statements of operations and changes in net assets. For the years ended June 30, 2013 and 2012, the Corporation reported a loss on operations of \$9.5 million and \$5.4 million, respectively, in discontinued operations in the consolidated statements of operations and changes in net assets.

4. NET PATIENT SERVICE REVENUE

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 items 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.

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, per diem payments, and discounts from established charges.

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 significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Charity Care – The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify for charity care, they are not reported as net patient service revenue in the consolidated statements of operations and changes in net assets.

Patient service revenues, net of contractual and other allowances (but before the provision for bad debts), recognized during the years ended June 30 is as follows:

| | 2013 | 2012 |
|----------------------|-----------------------------|-----------------------------|
| | (In thousands) | |
| | <u> </u> | <u> </u> |
| Medicare | \$3,149,767 | \$2,958,591 |
| Blue Cross | 1,899,297 | 1,865,238 |
| Medicaid | 1,005,540 | 828,620 |
| Uninsured | 350,887 | 314,292 |
| Commercial and other | <u>1,883,500</u> | <u>1,882,420</u> |
| Total | <u>\$8,288,991</u> | <u>\$7,849,161</u> |

A summary of net patient service revenue before provision for bad debts for the years ended June 30 is as follows:

| | 2013 | 2012 |
|--|-----------------------------|-----------------------------|
| | (In thousands) | |
| | <u> </u> | <u> </u> |
| Gross charges: | | |
| Acute inpatient | \$ 9,496,833 | \$ 9,226,067 |
| Outpatient, nonacute inpatient, and other | <u>10,744,217</u> | <u>10,045,912</u> |
| Gross patient service revenue | 20,241,050 | 19,271,979 |
| Less: | | |
| Contractual and other allowances | (11,228,833) | (10,725,957) |
| Charity care charges | (552,429) | (541,490) |
| Allowance for self-insured health benefits | <u>(170,797)</u> | <u>(155,371)</u> |
| Net patient service revenue before provision for bad debts | <u>\$ 8,288,991</u> | <u>\$ 7,849,161</u> |

In October 2012, the Corporation received cash of \$50.0 million, net of legal costs, as a result of an industry-wide settlement with the U.S. Department of Health and Human Services (HHS), the Secretary of HHS and the Centers for Medicare and Medicaid Services that corrects Medicare payments made to providers for inpatient hospital services for a number of prior periods. The net gain is recorded in patient service revenue, net of contractals and other allowances, for the year ended June 30, 2013.

5. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30 is as follows:

| | 2013 | 2012 |
|-----------------------------------|-------------------------|-------------------------|
| | (In thousands) | |
| Land | \$ 246,363 | \$ 237,551 |
| Buildings and improvements | 4,880,923 | 4,651,308 |
| Equipment | 3,405,298 | 3,158,288 |
| Capital leased assets | <u>87,022</u> | <u>84,083</u> |
| Total | 8,619,606 | 8,131,230 |
| Less accumulated depreciation | (4,542,149) | (4,220,346) |
| Less accumulated amortization | (24,818) | (19,969) |
| Construction in progress | <u>496,269</u> | <u>330,912</u> |
| Property and equipment, net | <u>\$ 4,548,908</u> | <u>\$ 4,221,827</u> |

At June 30, 2013, commitments to purchase property and equipment of approximately \$367 million were outstanding. Significant commitments are primarily for facility expansion at existing campuses and related infrastructures at the following ministry organizations: Holy Cross Hospital in Silver Spring, Maryland - \$182 million; Mount Carmel Health System in Columbus, Ohio - \$54 million; Saint Joseph Mercy Oakland in Pontiac, Michigan - \$34 million; St. Joseph Mercy Ann Arbor, Michigan - \$33 million; LUHS in Chicago, Illinois - \$26 million, and MHSC in Chicago, Illinois - \$14 million. Costs of these projects are expected to be financed by proceeds from bond issuances, available funds, future operations of the hospitals and contributions.

6. LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

A summary of short-term borrowings and long-term debt at June 30 is as follows:

| | 2013 | 2012 |
|--|-----------------------|--------------------|
| | (In thousands) | |
| | <u> </u> | <u> </u> |
| Short-term borrowings: | | |
| Variable rate demand bonds with contractual maturities through 2048. Interest payable monthly at rates ranging from 0.04% to 0.82% during 2013 and from 0.02% to 0.86% during 2012 | \$ 867,130 | \$ 892,865 |
| Long-term debt: | | |
| Tax-exempt revenue bonds and refunding bonds, fixed rate term and serial bonds, payable at various dates through 2048. Interest rate ranges from 2.0% to 6.5% during 2013 and 2012 | \$2,134,525 | \$2,162,070 |
| Notes payable to banks. Interest payable at rates ranging from 2.0% to 7.8%, fixed and variable, payable in varying monthly installments through 2021 | 3,941 | 4,582 |
| Capital lease obligations (excluding imputed interest of \$41.3 million and \$51.2 million at June 30, 2013 and 2012, respectively) | 73,126 | 72,746 |
| Mortgage obligations. Interest payable at rates ranging from 4.1% to 6.5% during 2013 and 4.1% to 6.0% during 2012 | 82,507 | 64,000 |
| Other | <u>7,888</u> | <u>-</u> |
| Total long-term debt | 2,301,987 | 2,303,398 |
| Less current portion, net of current discounts | (30,862) | (32,362) |
| Unamortized premiums, net | <u>28,469</u> | <u>31,200</u> |
| Long-term debt, net of current portion | <u>\$2,299,594</u> | <u>\$2,302,236</u> |

Contractually obligated principal repayments on short-term borrowings and long-term debt as of June 30, 2013, are as follows:

| | (In thousands) | |
|-----------------------|-----------------------|--------------------|
| | Short-Term | Long-Term |
| | Borrowings | Debt |
| | <u> </u> | <u> </u> |
| Years ending June 30: | | |
| 2014 | \$ 33,250 | \$ 31,131 |
| 2015 | 23,710 | 41,189 |
| 2016 | 25,015 | 48,289 |
| 2017 | 26,590 | 42,466 |
| 2018 | 28,000 | 43,700 |
| Thereafter | <u>730,565</u> | <u>2,095,212</u> |
| Total | <u>\$ 867,130</u> | <u>\$2,301,987</u> |

A summary of interest costs on borrowed funds primarily under the revenue bond indentures during the years ended June 30 is as follows:

| | 2013 | 2012 |
|---|-----------------------|-------------------|
| | (In thousands) | |
| Interest costs incurred | \$ 118,901 | \$ 108,390 |
| Less capitalized interest | <u>(8,368)</u> | <u>(5,609)</u> |
| Interest expense included in operations | <u>\$ 110,533</u> | <u>\$ 102,781</u> |

Obligated Group and Other Requirements – The Corporation has debt outstanding under a Master Trust Indenture dated July 1, 1998, as amended and supplemented thereto, the Amended and Restated Master Indenture (ARMI). The ARMI permits the Corporation to issue obligations to finance certain activities. Obligations issued under the ARMI are general, direct obligations of the Corporation and any future members of the Trinity Health Obligated Group. Proceeds from the tax-exempt bonds and refunding bonds are to be used to finance the construction, acquisition and equipping of capital improvements. Since the implementation of the ARMI, the Corporation is the sole member of the Trinity Health Obligated Group. Certain ministry organizations of the Corporation constitute designated affiliates and the Corporation covenants to cause each designated affiliate to pay, loan, or otherwise transfer to the Corporation such amounts necessary to pay the amounts due on all obligations issued under the ARMI. The Corporation, the designated affiliates and all other controlled affiliates are referred to as the Credit Group. The Corporation has granted a security interest in certain pledged property and has caused not less than 85% of the designated affiliates representing, when combined with the Corporation and any future members, not less than 85% of the consolidated net revenue of the Credit Group to grant to the Corporation security interests in certain pledged property in order to secure all obligations issued under the ARMI. The aggregate amount of obligations outstanding using the ARMI (other than obligations that have been advance refunded) were \$3,002 million and \$3,055 million at June 30, 2013 and 2012, respectively.

There are several conditions and covenants required by the ARMI with which the Corporation must comply, including covenants that require the Corporation to maintain a minimum debt service coverage and limitations on liens or security interests in property, except for certain permitted encumbrances, affecting the property of the Corporation or any Material Designated Affiliate (a designated affiliate whose total revenues for the most recent fiscal year exceed 5% of the total revenues of the Credit Group for the most recent fiscal year). Long-term debt outstanding at June 30, 2013 and 2012, excluding amounts issued under the ARMI, is generally collateralized by certain property and equipment.

MHSC has a commitment from the U.S. Department of Housing and Urban Development (HUD) to insure an approximate \$66 million mortgage loan, under the Federal Housing Administration's Section 242 Hospital Mortgage Insurance Program. At June 30, 2013 and 2012, the outstanding obligation was \$63 million and \$53 million, respectively. MHSC's main hospital campus and two satellite facilities are collateral for the mortgage. The mortgage loan agreement with HUD contains various covenants, including those relating to limitations on incurring additional debt, disposing of designated property, financial performance, insurance coverage and timely submission of specified financial reports.

Issuance and Defeasance of Debt – In May 2012, the Corporation issued \$101.9 million in tax-exempt, fixed rate hospital revenue bonds (Series 2012 Bonds) under its ARMI. The proceeds, along with cash, were used to refund the Corporation's \$126.2 million series 2002C bonds and pay costs of issuance. Concurrently, with the series 2012 financing, the Corporation re-offered approximately \$192.8 million

of its existing series 2008C, series 2009B and series 2009C variable rate demand bonds in a long-term fixed rate mode. The Corporation also defeased \$35.0 million of outstanding hospital revenue bonds. These transactions resulted in a loss from extinguishment of debt of \$7.0 million, which has been included in nonoperating items in the consolidated statement of operations and changes in net assets. In addition, on June 1, 2012, the Corporation converted \$189.3 million of its currently outstanding variable rate bonds (Series 2008D-2 Bonds) from a weekly mode to a flexible mode.

In December 2011, the Corporation defeased \$36.2 million of outstanding hospital revenue bonds. This transaction resulted in a loss from extinguishment of debt of \$0.7 million, which has been included in nonoperating items in the consolidated statement of operations and changes in net assets.

In October 2011, the Corporation issued \$648.7 million in tax-exempt, fixed rate hospital revenue bonds and \$100.0 million in variable rate hospital revenue bonds (Series 2011 Bonds) under its ARMI. The proceeds were used to finance, refinance and reimburse a portion of the costs of acquisition, construction, renovation and equipping of health facilities, and to pay related costs of issuance. Proceeds, together with assets released from bond trustees, were used to retire \$69.4 million of the Corporation's then outstanding fixed rate hospital revenue bonds and \$102.9 million of the Corporation's then outstanding variable rate hospital revenue bonds. These transactions resulted in a loss from extinguishment of debt of \$2.5 million, which has been included in nonoperating items in the consolidated statement of operations and changes in net assets. In addition, \$354.0 million of the proceeds were used to pay off commercial paper obligations.

In July 2011, the Corporation extinguished \$338.4 million of outstanding hospital revenue bonds related to LUHS through the issuance of commercial paper. These transactions resulted in a loss from extinguishment of debt of \$3.3 million, which has been included in nonoperating items in the consolidated statement of operations and changes in net assets.

The outstanding balance of all bonds advance refunded through net defeasance and excluded from the consolidated balance sheets was \$170.0 million and \$318.5 million at June 30, 2013 and 2012, respectively. The Corporation advance refunded the bonds by depositing funds in trustee-held escrow accounts exclusively for the payment of principal and interest. The trustees/escrow agents are solely responsible for the subsequent extinguishment of the bonds. The trustee-held escrow accounts are invested in U.S. government securities.

Commercial Paper – The Corporation's commercial paper program is authorized for borrowings up to \$600 million. In fiscal year 2013, the Corporation issued \$234 million in commercial paper with a total of \$368.9 million and \$135.0 million outstanding at June 30, 2013 and 2012, respectively. Proceeds from this program are to be used for general purposes of the Corporation. The notes are payable from the proceeds of subsequently issued notes and from other funds available to the Corporation, including funds derived from the liquidation of securities held by the Corporation in its investment portfolio. The interest rate charged on borrowings outstanding during the years ended June 30, 2013 and 2012, ranged from 0.07% to 0.20% and 0.08% to 0.22%, respectively.

Liquidity Facilities – In July 2012, the Corporation renewed the Amended and Restated 2010 Revolving Credit Agreements (2012 Credit Agreements) with U.S. Bank National Association, which acts as an administrative agent for a group of lenders thereunder. The 2012 Credit Agreements establish a revolving credit facility for the Corporation under which that group of lenders agrees to lend to the Corporation amounts that may fluctuate from time to time, but as of June 30, 2013, the amount available was \$731 million. Amounts drawn under the 2013 Credit Agreements can only be used to support the Corporation's obligation to pay the purchase price of bonds that are subject to tender and that have not been successfully remarketed, and the maturing principal of and interest on commercial paper notes. Of

the \$731 million, \$150 million expires in July 2013, \$110 million expires in July 2014, \$256 million expires in July 2015, and \$215 million expires in July 2016. In addition, in August 2012, the Corporation added a second general purpose facility of \$200 million, which expires in July 2016. There were no draws on these credit agreements during the years ended June 30, 2013 or 2012.

Standby Letters of Credit – The Corporation entered into various standby letters of credit totaling approximately \$22.9 million and \$21.5 million at June 30, 2013 and 2012, respectively. These standby letters of credit are renewed annually and are available to the Corporation as necessary under its insurance programs and for unemployment liabilities. There were no draws on these letters of credit during the years ended June 30, 2013 or 2012.

7. PROFESSIONAL AND GENERAL LIABILITY PROGRAMS

The Corporation's insurance company, Venzke Insurance Company, Ltd. (Venzke), a wholly owned subsidiary of Trinity Health, qualifies as a captive insurance company in the domicile where it operates and provides certain insurance coverage to the Corporation's ministry organizations. The Corporation is self-insured for certain levels of general and professional liability, workers' compensation, and certain other claims. The Corporation, through Venzke, has limited its liability by purchasing reinsurance and commercial coverage from unrelated third-party insurers.

As discussed in Note 3, on July 1, 2011, Trinity Health-Michigan, a wholly-owned subsidiary of Trinity Health, replaced LUHS as the sole shareholder of LUCIC, a captive insurance company in the domicile where it operates. Effective July 1, 2011, Venzke's policies include the facilities and individuals that were previously insured with LUCIC. Policies issued and reinsurance purchased by LUCIC prior to July 1, 2011, and all losses previous to July 1, 2011, were assumed through a merger with Venzke at December 31, 2011. On April 1, 2012, the Corporation became the sole member of MHSC, which included assuming MHSC's professional liability losses.

For the years ended June 30, 2013 and 2012, the Corporation's self-insurance program includes \$20 million per occurrence for the first layers of professional liability, as well as \$10 million per occurrence for hospital government liability, \$5 million per occurrence for errors and omission liability, and \$1 million per occurrence for directors' and officers' liability and the insured auto liability program. Additional layers of professional liability insurance are available with coverage provided through other insurance carriers and various reinsurance arrangements. The total amount available for these subsequent layers is \$100 million in aggregate. The Corporation also self-insures \$500,000 in property damage liability with commercial insurance providing coverage up to \$1 billion.

The liability for self-insurance reserves represents estimates of the ultimate net cost of all losses and loss adjustment expenses, which are incurred but unpaid at the consolidated balance sheet date. The reserves are based on the loss and loss adjustment expense factors inherent in the Corporation's premium structure. Independent consulting actuaries determined these factors from estimates of the Corporation's expenses and available industry-wide data. Beginning in fiscal year 2013, the Corporation began discounting the reserves to their present value using a discount rate of 3.0%. The impact of this change resulted in a decrease of \$43 million in expense in the consolidated statements of operations for fiscal year 2013, of which \$37 million was recorded in other expense and \$6 million was recorded in employee benefits. The reserves include estimates of future trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the liability for unpaid claims and related adjustment expenses is adequate based on the loss experience of the Corporation. The estimates are continually reviewed and adjusted as necessary.

Claims in excess of certain insurance coverage and the recorded self-insurance liability have been asserted against the Corporation by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. There are known incidents occurring through June 30, 2013, that may result in the assertion of additional claims, and other claims may be asserted arising from services provided in the past. While it is possible that settlement of asserted claims and claims that may be asserted in the future could result in liabilities in excess of amounts for which the Corporation has provided, management, based upon the advice of Counsel, believes that the excess liability, if any, should not materially affect the consolidated financial position, operations, or cash flows of the Corporation.

8. PENSION AND OTHER BENEFIT PLANS

Self-Insured Employee Health Benefits – The Corporation administers self-insured employee health benefit plans for employees. The majority of the Corporation’s employees participate in the programs. The provisions of the plans permit employees and their dependents to elect to receive medical care at either the Corporation’s ministry organizations or other health care providers. Gross patient service revenue has been reduced by an allowance for self-insured employee health benefits of \$170.8 million and \$155.4 million for the years ended June 30, 2013 and 2012, respectively, which represented revenue attributable to medical services provided by the Corporation to its employees and dependents in such years.

Deferred Compensation – The Corporation has nonqualified deferred compensation plans at certain ministry organizations that permit eligible employees to defer a portion of their compensation. The deferred amounts are distributable in cash after retirement or termination of employment. As of June 30, 2013 and 2012, the assets under these plans totaled \$74.8 million and \$60.8 million, and liabilities totaled \$80.3 million and \$67.4 million, respectively.

Retirement Plan Acquisitions – The Corporation acquired LUHS on July 1, 2011, including its benefit plans. LUHS maintains three qualified, noncontributory defined benefit pension plans that provide retirement benefits for substantially all full-time employees. Two of these plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). One of the ERISA plans was frozen by LUHS for employees with service through March 2004. This plan is a multiple-employer plan and administration of the plan is the responsibility of Loyola University of Chicago. LUHS’s calculated accrued benefit obligation represents approximately 62% of the total multiple-employer plan accrued benefit obligation. The third plan is a Church plan as determined by the Internal Revenue Service and is not governed by ERISA. This plan was merged into the Corporation’s Church plan on January 1, 2013. The Corporation amended the remaining two plans to freeze accrued benefits effective December 31, 2012, and participants in those plans became participants of the Corporation’s defined benefit plan effective January 1, 2013. The amendments to freeze both plans resulted in a decrease in the plans’ liabilities of \$27.0 million at June 30, 2012.

LUHS also maintains qualified defined contribution plans for certain eligible employees as well as nonqualified pension programs and deferred compensation arrangements for eligible executives. In addition, LUHS provides other postretirement benefits (primarily health benefits) to an eligible group of employees. LUHS discontinued contributions to the cost of retiree health coverage in 2001 for certain future retirees. This plan is closed to new participants. Health benefits are provided subject to various cost-sharing features and are not prefunded.

The Corporation acquired MHSC on April 1, 2012, including its defined contribution plan. The plan covers substantially all of MHSC’s employees and provides a 1.5% employer contribution and an employer matching contribution of up to 2% of compensation.

Defined Contribution Benefits – The Corporation sponsors defined contribution pension plans covering substantially all of its employees. The plans include discretionary employer matching contributions of up to 3% of compensation. Effective January 1, 2013, the Corporation suspended the majority of employer matching contributions for the calendar year 2013. Employer and employee contributions are self-directed by plan participants in defined contribution plans. Contribution expense under the plans totaled \$35.2 million and \$71.4 million during the years ended June 30, 2013 and 2012, respectively.

Noncontributory Defined Benefit Pension Plans (Pension Plans) – Substantially all of the Corporation's employees participate in a qualified, noncontributory defined benefit pension plan. Certain non-qualified, supplemental plan arrangements also provide retirement benefits to specified groups of participants. For the majority of plan participants prior to June 30, 2010, benefits were based on years of service and employees' highest five years of compensation at which time an accrued frozen benefit was calculated for all active participants. As of July 1, 2010, participants accrue benefits based on a cash balance formula, which credits participants annually with a percentage of eligible compensation based on age and years of service, as well as an interest credit based on a benchmark interest rate. A transition adjustment is provided to participants who were vested as of June 30, 2010, whose age and service met certain requirements at that date. The transition adjustment applies to the pension benefit earned through June 30, 2010, and increased compensation under the final average pay formula over a five-year period. Because the Pension Plan has Church Plan status as defined in the ERISA, funding in accordance with ERISA is not required. The Corporation's adopted funding policy for its qualified plan, which is reviewed annually, is to fund the current normal cost based on the accumulated benefit obligation at the plans' December 31 year-end, and amortization of any under or over funding over a ten year period. The Corporation funded \$27.2 million in excess of the stated funding policy for the combined fiscal years 2013 and 2012.

During the year ended June 30, 2012, the Corporation recorded a pension curtailment gain of \$5.8 million and a pension settlement loss of \$27.5 million related to the sale of BCHS described in Note 3. The net loss is included in the loss from discontinued operations in the 2012 consolidated statement of operations and changes in net assets.

Postretirement Health Care and Life Insurance Benefits (Postretirement Plans) – The Corporation sponsors both funded and unfunded contributory plans to provide health care benefits to certain of its retirees. All of the Postretirement Plans are closed to new participants. The plans cover certain hourly and salaried employees who retire from certain ministry organizations. Medical benefits for these retirees are subject to deductibles and co-payment provisions. Effective January 1, 2011, the funded plans provide benefits to certain retirees at fixed dollar amounts in Health Reimbursement Account arrangements for Medicare eligible participants.

The following table sets forth the changes in projected benefit obligations, accumulated postretirement obligations, and changes in plan assets and funded status of the plans for both the Pension and Postretirement Plans for the years ended June 30, 2013 and 2012:

| | 2013 | 2012 | 2013 | 2012 |
|--|---------------------|-----------------------|----------------------|--------------------|
| | (In thousands) | | | |
| | Pension Plans | | Postretirement Plans | |
| Change in benefit obligation: | | | | |
| Benefit obligation, beginning of year | \$ 5,161,197 | \$ 3,961,864 | \$ 116,721 | \$ 110,739 |
| Service cost | 143,567 | 141,408 | 884 | 1,023 |
| Interest cost | 255,483 | 256,058 | 5,371 | 6,254 |
| Amendments | (1,998) | (32,761) | - | - |
| Actuarial (gain) loss | (214,944) | 601,102 | (10,137) | (482) |
| Benefits paid | (176,572) | (159,211) | (5,067) | (5,707) |
| Medicare Part D reimbursement | - | - | 96 | 674 |
| Acquisition of LUHS | - | 392,737 | - | 4,220 |
| | <u>5,166,733</u> | <u>5,161,197</u> | <u>107,868</u> | <u>116,721</u> |
| Change in plan assets: | | | | |
| Fair value of plan assets, beginning of year | 4,141,192 | 3,647,407 | 79,160 | 78,254 |
| Actual return on plan assets | 254,759 | 168,122 | 9,131 | 4,649 |
| Employer contributions | 285,132 | 146,347 | 1,299 | 1,964 |
| Benefits paid | (176,572) | (159,211) | (5,067) | (5,707) |
| Acquisition of LUHS | - | 338,527 | - | - |
| | <u>4,504,511</u> | <u>4,141,192</u> | <u>84,523</u> | <u>79,160</u> |
| Fair value of plan assets, end of year | <u>4,504,511</u> | <u>4,141,192</u> | <u>84,523</u> | <u>79,160</u> |
| Unfunded amount recognized June 30 | (662,222) | (1,020,005) | (23,345) | (37,561) |
| Recognized in prepaid assets | - | - | 1,379 | - |
| Recognized in accrued liabilities | <u>\$ (662,222)</u> | <u>\$ (1,020,005)</u> | <u>\$ (24,724)</u> | <u>\$ (37,561)</u> |

Actuarial gains and losses incurred during the years ended June 30, 2013 and 2012 are primarily related to changes in discount rates used to measure the plan's liabilities.

The accumulated benefit obligation and fair value of plan assets for the qualified defined benefit pension plans for the years ended June 30 are as follows:

| | 2013 | 2012 |
|--------------------------------|---------------------|---------------------|
| | (In thousands) | |
| | Pension Plans | |
| Accumulated benefit obligation | \$ 5,074,277 | \$ 5,038,497 |
| Fair value of plan assets | <u>4,504,511</u> | <u>4,141,192</u> |
| Funded status | <u>\$ (569,766)</u> | <u>\$ (897,305)</u> |

Components of net periodic benefit cost for the years ended June 30 consisted of the following:

| | 2013 | | 2012 | |
|------------------------------------|-------------------|-------------------|----------------------|-------------------|
| | (In thousands) | | | |
| | Pension Plans | | Postretirement Plans | |
| Service cost | \$ 143,567 | \$ 141,408 | \$ 884 | \$ 1,023 |
| Interest cost | 255,483 | 255,990 | 5,371 | 6,254 |
| Expected return on assets | (317,426) | (317,290) | (5,675) | (6,025) |
| Amortization of prior service cost | (23,092) | (19,438) | (7,318) | (7,318) |
| Recognized net actuarial loss | <u>122,718</u> | <u>70,336</u> | <u>1,243</u> | <u>1,283</u> |
| Net periodic benefit cost (income) | <u>\$ 181,250</u> | <u>\$ 131,006</u> | <u>\$ (5,495)</u> | <u>\$ (4,783)</u> |

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

| | (In thousands) | | |
|---|---------------------|---------------------|---------------------|
| | Pension Plans | | |
| | Net Loss (Gain) | Prior Service Cost | Total |
| Balance at July 1, 2011 | \$ 1,183,248 | \$ (198,349) | \$ 984,899 |
| Curtailments/settlements | (21,678) | - | (21,678) |
| Reclassified into net periodic benefit cost | (70,336) | 19,438 | (50,898) |
| Arising during the year | <u>750,047</u> | <u>(32,762)</u> | <u>717,285</u> |
| Balance at June 30, 2012 | 1,841,281 | (211,673) | 1,629,608 |
| Reclassified into net periodic benefit cost | (122,718) | 23,092 | (99,626) |
| Arising during the year | <u>(158,207)</u> | <u>3,785</u> | <u>(154,422)</u> |
| Balance at June 30, 2013 | <u>\$ 1,560,356</u> | <u>\$ (184,796)</u> | <u>\$ 1,375,560</u> |

| | (In thousands) | | | All Plans Grand Total |
|---|----------------------|----------------------|-------------------|-----------------------|
| | Postretirement Plans | | | |
| | Net Loss (Gain) | Prior Service Credit | Total | |
| Balance at July 1, 2011 | \$ 18,480 | \$ (24,795) | \$ (6,315) | \$ 978,584 |
| Curtailments/settlements | - | - | - | (21,678) |
| Reclassified into net periodic benefit cost | (1,283) | 7,318 | 6,035 | (44,863) |
| Arising during the year | <u>918</u> | <u>-</u> | <u>918</u> | <u>718,203</u> |
| Balance at June 30, 2012 | 18,115 | (17,477) | 638 | 1,630,246 |
| Reclassified into net periodic benefit cost | (1,243) | 7,318 | 6,075 | (93,551) |
| Arising during the year | <u>(13,584)</u> | <u>-</u> | <u>(13,584)</u> | <u>(168,006)</u> |
| Balance at June 30, 2013 | <u>\$ 3,288</u> | <u>\$ (10,159)</u> | <u>\$ (6,871)</u> | <u>\$ 1,368,689</u> |

The following are estimated amounts to be amortized from unrestricted net assets into net periodic benefit cost during 2014:

| | <u>(In thousands)</u> | |
|--------------------------------------|--------------------------|---------------------------------|
| | Pension Plans | Postretirement Plans |
| Amortization of prior service credit | \$ (22,738) | \$ (5,763) |
| Recognized net actuarial loss (gain) | <u>98,729</u> | <u>(167)</u> |
| Total | <u>\$ 75,991</u> | <u>\$ (5,930)</u> |

Assumptions used to determine benefit obligations and net periodic benefit cost were as follows:

| | 2013 | 2012 | 2013 | 2012 |
|--|----------------------|-------------|-----------------------------|-------------|
| | Pension Plans | | Postretirement Plans | |
| Benefit obligations: | | | | |
| Discount rate | 4.95%–5.45% | 4.70%–5.05% | 4.40%–5.20% | 4.25%–4.85% |
| Rate of compensation increase in 2013 graduated to 4% by 2017 | 3.0 % | 2.0 % | N/A | N/A |
| Net periodic benefit cost: | | | | |
| Discount rate | 4.70%–5.10% | 5.95%–6.0% | 4.25%–4.85% | 5.10%–5.75% |
| Expected long-term return on plan assets | 7.00%–7.50% | 7.80%–8.0% | 7.50 % | 8.00 % |
| Rate of compensation | 2.0 % | 4.0 % | N/A | N/A |

Approximately 95% of the Corporation's pension plan liabilities are measured using the 5.45% discount rate at June 30, 2013.

The Corporation uses an efficient frontier analysis approach in determining its asset allocation and long-term rate of return for plan assets. Efficient frontier analysis models the risk and return trade-offs among asset classes while taking into consideration the correlation among the asset classes. Historical market returns and risks are examined as part of this process, but risk-based adjustments are made to correspond with modern portfolio theory. Long-term historical correlations between asset classes are used, consistent with widely accepted capital markets principles. Current market factors, such as inflation and interest rates, are evaluated before long-term capital market assumptions are determined. The long-term rate of return is established using the efficient frontier analysis approach with proper consideration of asset class diversification and rebalancing. Peer data and historical returns are reviewed to check for reasonableness and appropriateness.

Health Care Cost Trend Rates – Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement plans. The postretirement benefit obligation includes assumed health care cost trend rates as follows:

| | 2013 | 2012 |
|-------------------------------------|-------------|-------------|
| Medical and drugs, pre-age 65 | 7.8 % | 8.3 % |
| Medical and drugs, post-age 65 | 7.8 % | 8.3 % |
| Ultimate trend rate | 5.0 % | 5.0 % |
| Year rate reaches the ultimate rate | 2018 | 2018 |

A one-percentage point change in assumed health care cost trend rates would have the following effects at June 30, 2013:

| | (In thousands) | |
|--|-----------------------------------|-----------------------------------|
| | One-Percentage- Point Increase | One-Percentage- Point Decrease |
| Effect on postretirement benefit obligation | \$ 3,181 | \$ (2,721) |
| Effect on total of service cost and interest | 251 | (210) |

The Corporation's investment allocations at June 30, by investment category, are as follows:

| Investment category: | 2013 | 2012 | 2013 | 2012 |
|------------------------------------|------------------|------------------|-------------------------|-------------------------|
| | Pension Plans | Pension Plans | Postretirement Plans | Postretirement Plans |
| Cash and cash equivalents | 10 % | 10 % | 1 % | 2 % |
| Marketable securities: | | | | |
| U.S. and non-U.S equity securities | 5 | 7 | 65 | 59 |
| Equity mutual funds | 7 | 2 | - | - |
| Debt securities | 30 | 35 | 34 | 39 |
| Other investments: | | | | |
| Commingled funds | 9 | 11 | - | - |
| Hedge funds | 30 | 30 | - | - |
| Private equity funds | 6 | 5 | - | - |
| Other | 3 | - | - | - |
| Total | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |

The Corporation employs a total return investment approach whereby a mix of equities and fixed-income investments are used to maximize the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity and fixed-income investments. Furthermore, equity investments are diversified across U.S. and non-U.S. stocks, as well as growth, value, and small and large capitalizations. Other investments, such as hedge funds, interest rate swaps, and private equity are used judiciously to enhance long-term returns while improving portfolio diversification. Derivatives may be used to gain market exposure in an efficient and timely manner; however, derivatives may not be used to leverage the portfolio beyond the market value of the underlying investments. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements, and periodic asset/liability studies. For the majority of the Corporation's pension plan investments, the combined target investment allocation at June 30, 2013 was U.S. and non-U.S. equity securities 15%; fixed-income obligations 35%; hedge funds 20%; long/short equity 15%; private equity 5%; opportunistic fixed income 7%; and real assets 3%.

The following tables summarize the Pension and Postretirement Plans' assets measured at fair value at June 30, 2013 and 2012. See Note 10 for definitions of Levels 1, 2, and 3 of the fair value hierarchy.

| | 2013 | | | |
|--|---|--|--|-----------------------------|
| | (In thousands) | | | |
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Pension plans: | | | | |
| Cash and cash equivalents | \$ 452,032 | \$ 11,073 | \$ - | \$ 463,105 |
| Equity securities | 238,493 | - | - | 238,493 |
| Debt securities | | | | |
| Government and government agency obligations | - | 322,538 | - | 322,538 |
| Corporate bonds | - | 1,000,922 | 1,632 | 1,002,554 |
| Asset backed securities | - | 34,342 | - | 34,342 |
| Mutual funds | | | | |
| Equity mutual funds | 309,119 | - | - | 309,119 |
| Fixed-income mutual funds | 95,504 | 9,533 | - | 105,037 |
| Commingled funds | - | 416,453 | - | 416,453 |
| Hedge funds | - | 344,730 | 1,016,262 | 1,360,992 |
| Private equity | - | - | 251,228 | 251,228 |
| Real estate partnerships | - | - | 52 | 52 |
| Other | 598 | - | - | 598 |
| | <u>\$ 1,095,746</u> | <u>\$ 2,139,591</u> | <u>\$ 1,269,174</u> | <u>\$ 4,504,511</u> |
| Total pension plans' assets at fair value | | | | |
| Postretirement plans: | | | | |
| Mutual funds | | | | |
| Short-term investment mutual funds | \$ 817 | \$ - | \$ - | \$ 817 |
| Fixed-income mutual fund | 28,321 | - | - | 28,321 |
| Commingled funds | - | 55,385 | - | 55,385 |
| | <u>\$ 29,138</u> | <u>\$ 55,385</u> | <u>\$ -</u> | <u>\$ 84,523</u> |
| Total postretirement plans' assets at fair value | | | | |

| | 2012 | | | |
|--|--|---|--|---------------------|
| | (In thousands) | | | |
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Pension plans: | | | | |
| Cash and cash equivalents | \$396,043 | \$ 1,422 | \$ - | \$ 397,465 |
| Equity securities | 273,125 | 682 | - | 273,807 |
| Debt securities | | | | |
| Government and government agency obligations | - | 433,634 | - | 433,634 |
| Corporate bonds | - | 1,010,844 | - | 1,010,844 |
| Asset backed securities | - | 23,046 | - | 23,046 |
| Mutual funds | | | | |
| Equity mutual funds | 96,352 | - | - | 96,352 |
| Fixed-income mutual funds | 11,393 | 7,617 | - | 19,010 |
| Commingled funds | - | 438,575 | - | 438,575 |
| Hedge funds | - | 39,693 | 1,211,388 | 1,251,081 |
| Private equity | - | - | 204,250 | 204,250 |
| Real estate partnerships | - | - | 520 | 520 |
| Other | (7,392) | - | - | (7,392) |
| Total pension plans' assets at fair value | <u>\$769,521</u> | <u>\$ 1,955,513</u> | <u>\$ 1,416,158</u> | <u>\$ 4,141,192</u> |
| Postretirement plans: | | | | |
| Mutual funds | | | | |
| Short-term investment mutual funds | \$ 1,178 | \$ - | \$ - | \$ 1,178 |
| Fixed-income mutual fund | 31,291 | - | - | 31,291 |
| Commingled funds | - | 46,638 | - | 46,638 |
| Other | 53 | - | - | 53 |
| Total postretirement plans' assets at fair value | <u>\$ 32,522</u> | <u>\$ 46,638</u> | <u>\$ -</u> | <u>\$ 79,160</u> |

Unfunded capital commitments related to Level 3 private equity investments totaled \$181.8 million and \$191.5 million at June 30, 2013 and 2012, respectively.

The Corporation's policy is to recognize transfers between all levels as of the beginning of the reporting period. There were no significant transfers to or from Levels 1 and 2 during the years ended June 30, 2013 or 2012.

See Note 10 for the Corporation's methods and assumptions to estimate the fair value of equity and debt securities, mutual funds, commingled funds, and hedge funds.

Private Equity – These assets include several private equity funds that invest primarily in the United States, Asia and Europe, both directly and on the secondary market, pursuing distressed opportunities and natural resources, primarily energy. These funds are valued at net asset value, which is calculated using the most recent fund financial statements.

Real Estate Partnerships – These assets are reported at fair value based on either independent appraisals performed by the general partner during the year, or estimated using discounted cash flow and market analysis, supported by sales comparison information.

Other – Represents unsettled transactions relating primarily to purchases and sales of plan assets, accrued income, and derivatives. Due to the short maturity of these assets and liabilities, the fair value is equal to the carrying amounts. Concerning derivatives, the Pension Plans are party to certain agreements, which are designed to manage exposures to equities and interest rate risks. These instruments are used for the purpose of hedging changes in the fair value of assets and actuarial present value of accumulated plan benefits that result from interest rate changes or as an efficient substitute for traditional securities. The fair value of the derivatives is estimated utilizing the terms of the derivative instruments and publicly available market yield curves. The Pension Plans’ investment policies specifically prohibit the use of derivatives for speculative purposes.

The following tables summarize the changes in Level 3 Pension Plan assets for the years ended June 30:

| | (In thousands) | | | | |
|--------------------------|--------------------|---------------------|-------------------|-----------------------------|---------------------|
| | Corporate Bonds | Hedge Funds | Private Equity | Real Estate Partnerships | Total |
| Balance at July 1, 2011 | \$ - | \$ 1,045,751 | \$ 134,336 | \$ 3,848 | \$ 1,183,935 |
| Acquisition of LUHS | - | - | 7,038 | 119 | 7,157 |
| Realized gain | - | 24,990 | 6,761 | 18 | 31,769 |
| Unrealized (loss) gain | - | (29,924) | 3,730 | (480) | (26,674) |
| Purchases | - | 537,598 | 75,340 | - | 612,938 |
| Sales | - | (367,524) | (2,911) | (36) | (370,471) |
| Settlements | - | 497 | (20,044) | (2,949) | (22,496) |
| Balance at June 30, 2012 | - | 1,211,388 | 204,250 | 520 | 1,416,158 |
| Realized gain | - | 82,063 | 7,711 | - | 89,774 |
| Unrealized (loss) gain | (142) | 33,232 | 11,444 | 81 | 44,615 |
| Purchases | 1,774 | 286,768 | 63,668 | - | 352,210 |
| Sales | - | (389,652) | (2,180) | (452) | (392,284) |
| Settlements | - | (240) | (33,665) | (97) | (34,002) |
| Transfers to Level 2 | - | (207,297) | - | - | (207,297) |
| Balance at June 30, 2013 | <u>\$ 1,632</u> | <u>\$ 1,016,262</u> | <u>\$ 251,228</u> | <u>\$ 52</u> | <u>\$ 1,269,174</u> |

Transfers out of Level 3 to Level 2 were made for direct hedge funds where initial lock-up periods expired during fiscal 2013.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation believes the valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Expected Contributions – The Corporation expects to contribute \$163.0 million to its Pension Plans, and \$1.4 million to its Postretirement Plans during the year ended June 30, 2014 under the Corporation’s stated funding policy.

Expected Benefit Payments – The Corporation expects to pay the following for pension benefits, which reflect expected future service as appropriate, and expected postretirement benefits, before deducting the Medicare Part D subsidy.

| | (In thousands) | | |
|-----------------|------------------|-------------------------|--|
| | Pension Plans | Postretirement Plans | Postretirement Medicare Part D Subsidy |
| 2014 | \$ 223,491 | \$ 7,508 | \$ 107 |
| 2015 | 231,604 | 7,707 | 104 |
| 2016 | 253,976 | 7,929 | 99 |
| 2017 | 280,171 | 8,092 | 94 |
| 2018 | 309,031 | 8,186 | 88 |
| Years 2019–2023 | 1,938,177 | 40,463 | 335 |

9. COMMITMENTS AND CONTINGENCIES

Operating Leases – The Corporation leases various land, equipment, and facilities under operating leases. Total rental expense, which includes provisions for maintenance in some cases, was \$105.1 million and \$103.2 million for the years ended June 30, 2013 and 2012, respectively.

The following is a schedule of future minimum lease payments under operating leases as of June 30, 2013, that have initial or remaining lease terms in excess of one year:

| | (In thousands) |
|-----------------------|-------------------|
| Years ending June 30: | |
| 2014 | \$ 73,886 |
| 2015 | 58,281 |
| 2016 | 48,131 |
| 2017 | 39,093 |
| 2018 | 29,995 |
| Thereafter | <u>94,327</u> |
| Total | <u>\$ 343,713</u> |

Asset Retirement Obligations – The Corporation has conditional asset retirement obligations for certain fixed assets mainly related to the removal of asbestos contained within facilities and the removal of underground storage tanks.

A reconciliation of the asset retirement obligations at June 30 is as follows:

| | 2013 | 2012 |
|--|------------------|------------------|
| | (In thousands) | |
| Asset retirement obligation, beginning of year | \$ 18,857 | \$ 17,487 |
| Accretion | 716 | 587 |
| Liabilities incurred | 27 | 877 |
| Liabilities settled | <u>(111)</u> | <u>(94)</u> |
| Asset retirement obligation, end of year | <u>\$ 19,489</u> | <u>\$ 18,857</u> |

Litigation and Settlements –

On September 21, 2007, in Boise, Idaho a jury awarded \$58.9 million in damages to MRI Associates, LLP, an Idaho limited partnership (MRIA) against Saint Alphonsus Regional Medical Center and its subsidiary Saint Alphonsus Diversified Care, Inc. (collectively, “Saint Alphonsus”). The lawsuit involved Saint Alphonsus’ withdrawal from the MRIA partnership. The jury’s award was reduced by the trial judge to \$36.3 million, which was offset by the award of \$4.6 million to Saint Alphonsus, the value of its partnership interest in MRIA. St. Alphonsus appealed and, in October 2009, the Idaho Supreme Court overturned the trial court decision and remanded the case for a new trial. The second trial was held during October 2011 with a jury awarding approximately \$52 million in damages to MRIA. After Saint Alphonsus filed an objection, the trial court entered amended judgments indicating that the plaintiffs could execute alternative judgments which vary in amount from approximately \$20 million to \$52 million. Saint Alphonsus continues to have an offset of \$4.6 million plus 10% interest running from September 21, 2007. Saint Alphonsus filed a Notice of Appeal to the Idaho Supreme Court in May 2012, because the Corporation believes that the proof of damages is insufficient to sustain the jury’s award under Idaho law. The Corporation recorded management’s estimation for litigation expense of \$20 million in the consolidated statement of operations and changes in net assets during the year ended June 30, 2007. As of June 30, 2013 and 2012, the liability is included in other long-term liabilities in the consolidated balance sheets in the event of an unfavorable resolution of this matter.

In June 2007, the Corporation was added to litigation pending in the United States District Court for the Eastern District of Michigan, alleging that certain hospitals in Southeastern Michigan conspired to suppress the wages of nurses over a period of five years. The plaintiffs brought the action on their own behalf and on behalf of all others similarly situated and seeking certification of the class. The complaint alleges that there was a direct agreement among the executives of defendant hospitals to suppress compensation and that they shared non-public compensation information, which had an anticompetitive effect on wages. The complaint specifically references certain of the Corporation’s Southeast Michigan hospitals. Mediation was held in November 2011 and the parties reached a settlement in March 2013, the amount of which is immaterial to these financial statements.

The Corporation is involved in other litigation and regulatory investigations arising in the course of doing business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation’s future consolidated financial position or results of operations.

10. FAIR VALUE MEASUREMENTS

The Corporation’s consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets and liabilities measured at fair value on a recurring basis in the Corporation’s consolidated balance sheets include cash, cash equivalents, equity securities, debt securities, mutual funds, commingled funds, hedge funds, securities lending collateral, and derivatives. Defined benefit retirement plan assets are measured at fair value on an annual basis. Liabilities measured at fair value on a recurring basis for disclosure only include debt.

Fair value is 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. The fair value should be based on assumptions that market participants would use, including a consideration of non-performance risk.

To determine fair value, the Corporation uses various valuation methodologies based on market inputs. For many instruments, pricing inputs are readily observable in the market; the valuation methodology is widely accepted by market participants and involves little to no judgment. For other instruments, pricing inputs are less observable in the marketplace. These inputs can be subjective in nature and involve uncertainties and matters of considerable judgment. The use of different assumptions, judgments and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The Corporation assesses the inputs used to measure fair value using a three-level hierarchy based on the extent to which inputs used in measuring fair value are observable in the market. The fair value hierarchy is as follows:

Level 1 – Quoted (unadjusted) prices for identical instruments in active markets

Level 2 – Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar instruments in active markets
- Quoted prices for identical or similar instruments in non-active markets (few transactions, limited information, non-current prices, high variability over time, etc.)
- Inputs other than quoted prices that are observable for the instrument (interest rates, yield curves, volatilities, default rates, etc.)
- Inputs that are derived principally from or corroborated by other observable market data

Level 3 – Unobservable inputs that cannot be corroborated by observable market data

Valuation Methodologies – Exchange-traded securities whose fair value is derived using quoted prices in active markets are classified as Level 1. In instances where quoted market prices are not readily available, fair value is estimated using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models, and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve, as well as other relevant economic measures. The inputs to these models depend on the type of security being priced, but are typically benchmark yields, credit spreads, prepayment speeds, reported trades and broker-dealer quotes, all with reasonable levels of transparency. Generally, significant changes in any of those inputs in isolation would result in a significantly different fair value measurement. The Corporation classifies these securities as Level 2 within the fair value hierarchy.

The Corporation maintains policies and procedures to value instruments using the best and most relevant data available. The Corporation's Level 3 securities are primarily investments in hedge funds. The fair values of Level 3 investments in these securities are predominately valued using a net asset value per share, which is provided by third-party administrators; however, in some cases, they are obtained directly from the investment fund manager. We have not adjusted the prices we have obtained. Third-party administrators do not provide access to their proprietary valuation models, inputs, and assumptions. Accordingly, the Corporation reviews the independent reports of internal controls for these service providers. In addition, on a quarterly basis, the Corporation performs reviews of investment consultant industry peer group benchmarking and supporting relevant market data. Finally, all of the fund managers of the Corporation's Level 3 securities have an annual independent audit performed by an accredited accounting firm. The Corporation reviews these audited financials for ongoing validation of pricing used. Based on the information available, we believe that the fair values provided by the third-party administrators and investment fund managers are representative of prices that would be received to sell the assets at June 30, 2013 and 2012, respectively.

In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest-level input that is significant to the fair value measurement in its entirety. The Corporation's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

Following is a description of the valuation methodologies the Corporation used for instruments recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Cash and Cash Equivalents – The carrying amounts reported in the consolidated balance sheets approximate their fair value. Certain cash and cash equivalents are included in investments and assets limited or restricted as to use in the consolidated balance sheets.

Commercial Paper – The fair value of commercial paper is based on amortized cost. Commercial paper is designated as Level 2 investments with significant observable inputs, including security cost, maturity, and credit rating. Commercial paper is classified as either cash and cash equivalents or marketable securities in the consolidated balance sheets depending upon the length to maturity when purchased.

Security Lending Collateral – The security lending collateral is invested in a Northern Trust sponsored commingled collateral fund, which is comprised primarily of short-term securities. The fair value amounts of the commingled collateral fund are determined using the calculated net asset value per share (or its equivalent) for the fund with the underlying investments valued using techniques similar to those used for marketable securities noted below.

Equity Securities – Equity securities are valued at the closing price reported on the applicable exchange on which the security is traded or are estimated using quoted market prices for similar securities.

Debt Securities – Debt securities are valued using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve, as well as other relevant economic measures.

Mutual Funds – Mutual funds are valued using the net asset value based on the value of the underlying assets owned by the fund, minus liabilities, divided by the number of shares outstanding, and multiplied by the number of shares owned.

Commingled Funds – Commingled funds are developed for investment by institutional investors only and therefore do not require registration with the Securities and Exchange Commission. Commingled funds are recorded at fair value based on either the underlying investments that have a readily determinable market value or based on net asset value, which is calculated using the most recent fund financial statements. Commingled funds are categorized as Level 2 unless they have a redemption restriction greater than 90 days, in which case they are categorized as Level 3.

Hedge Funds – The Corporation invests in various hedge fund strategies. These funds utilize either a direct or a “fund-of-funds” approach resulting in diversified multi-strategy, multi-manager investments. Underlying investments in these funds may include equities, fixed income securities, commodities, currencies and derivatives. These funds are valued at net asset value, which is calculated using the most recent fund financial statements. Hedge funds are categorized as Level 2, unless they have a redemption restriction greater than 90 days, in which case, they are categorized as Level 3.

The Corporation classifies its equity and debt securities, mutual funds, commingled funds and hedge funds as trading securities. Holding gains (losses) included in the excess of revenue over expenses for the years ended June 30, 2013 and 2012, were \$238.9 million and (\$44.3) million, respectively.

Equity Method Investments – The Corporation accounts for certain other investments using the equity method. These investments are structured as limited liability corporations and partnerships and are designed to produce stable investment returns regardless of market activity. These investments utilize a combination of “fund-of-funds” and direct fund investment resulting in a diversified multi-strategy, multi-manager investments approach. Some of these funds are developed by investment managers specifically for the Corporation’s use and are similar to mutual funds, but are not traded on a public exchange. Underlying investments in these funds may include other funds, equities, fixed-income securities, commodities, currencies and derivatives. Audited information is only available annually based on the limited liability corporations, partnerships or funds’ year-end. Management’s estimates of the fair values of these investments are based on information provided by the third-party administrators and fund managers or the general partners. Management obtains and considers the audited financial statements of these investments when evaluating the overall reasonableness of the recorded value. In addition to a review of external information provided, management’s internal procedures include such things as review of returns against benchmarks and discussions with fund managers on performance, changes in personnel or process, along with evaluations of current market conditions for these investments. Investment managers meet with the Corporation’s Investment Subcommittee of the Finance and Stewardship Committee of the Board of Directors on a periodic basis. Because of the inherent uncertainty of valuations, values may differ materially from the values that would have been used had a ready market existed. The balance of these investments at June 30, 2013 and 2012, was \$781.5 million and \$999.8 million, respectively. Unfunded capital commitments related to equity method investments totaled \$113.7 million and \$89.1 million at June 30, 2013 and 2012, respectively.

Cash and cash equivalents, equity and debt securities, mutual funds, commingled funds, hedge funds, and equity method investments totaled \$5,906 million and \$5,308 million at June 30, 2013 and 2012, respectively.

Interest Rate Swaps – The fair value of the Corporation’s derivatives, which are mainly interest rate swaps, are estimated utilizing the terms of the swaps and publicly available market yield curves along with the Corporation’s nonperformance risk as observed through the credit default swap market and bond market and based on prices for recent trades. These swap agreements are classified as Level 2 within the fair value hierarchy.

The following tables present information about the fair value of the Corporation's financial instruments measured at fair value on a recurring basis and recorded at June 30:

| | 2013 | | | |
|--|---|--|--|-----------------------------|
| | (In thousands) | | | |
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Assets: | | | | |
| Cash and cash equivalents | \$ 1,283,675 | \$ 46,370 | \$ - | \$ 1,330,045 |
| Security lending collateral | - | 114,865 | - | 114,865 |
| Equity securities | 432,398 | 405 | 1,449 | 434,252 |
| Debt securities: | | | | |
| Government and government agency obligations | - | 297,195 | - | 297,195 |
| Corporate bonds | - | 260,138 | 2,886 | 263,024 |
| Asset backed securities | - | 30,412 | - | 30,412 |
| Other | - | 11,731 | - | 11,731 |
| Mutual funds: | | | | |
| Equity mutual funds | 494,910 | - | - | 494,910 |
| Fixed-income mutual funds | 725,890 | 2,944 | - | 728,834 |
| Real estate investment funds | 5,705 | - | - | 5,705 |
| Other | 5,218 | 2,674 | - | 7,892 |
| Commingled funds | - | 674,956 | - | 674,956 |
| Hedge funds | - | 304,262 | 419,509 | 723,771 |
| Interest rate swaps | - | 30,500 | - | 30,500 |
| Total assets | <u>\$ 2,947,796</u> | <u>\$ 1,776,452</u> | <u>\$ 423,844</u> | <u>\$ 5,148,092</u> |
| Liabilities: | | | | |
| Interest rate swaps | <u>\$ -</u> | <u>\$ 144,576</u> | <u>\$ -</u> | <u>\$ 144,576</u> |

| | 2012 | | | |
|--|--|---|--|---------------------|
| | (In thousands) | | | |
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Assets: | | | | |
| Cash and cash equivalents | \$ 1,295,525 | \$ 55,634 | \$ - | \$ 1,351,159 |
| Security lending collateral | - | 130,702 | - | 130,702 |
| Equity securities | 533,221 | 463 | 1,472 | 535,156 |
| Debt securities: | | | | |
| Government and government agency obligations | - | 405,740 | - | 405,740 |
| Corporate bonds | - | 273,845 | 1,114 | 274,959 |
| Asset backed securities | - | 76,537 | 559 | 77,096 |
| Other | - | 6,795 | - | 6,795 |
| Mutual funds: | | | | |
| Equity mutual funds | 199,080 | 39 | - | 199,119 |
| Fixed-income mutual funds | 157,334 | 3,338 | - | 160,672 |
| Real estate investment funds | 7,173 | - | - | 7,173 |
| Other | 2,403 | 2,363 | - | 4,766 |
| Commingled funds and hedge funds | - | 1,167,130 | 109,165 | 1,276,295 |
| Interest rate swaps | - | 27,183 | - | 27,183 |
| Total assets | <u>\$ 2,194,736</u> | <u>\$ 2,149,769</u> | <u>\$ 112,310</u> | <u>\$ 4,456,815</u> |
| Liabilities: | | | | |
| Interest rate swaps | <u>\$ -</u> | <u>\$ 205,111</u> | <u>\$ -</u> | <u>\$ 205,111</u> |

The Corporation's policy is to recognize transfers between all levels as of the beginning of the reporting period. There were no significant transfers to or from Levels 1 and 2 during the years ended June 30, 2013 or 2012. Transfers out of Level 3 to Level 2 were made for direct hedge funds where initial lock-up periods expired during fiscal 2013.

The following table summarizes the changes in Level 3 assets for the years ended June 30:

| | (In thousands) | | | | | Total |
|-----------------------------|-------------------|--|-----------------|-------------------------|------------------|------------------|
| | Equity Securities | Government and Government Agency Obligations | Corporate Bonds | Asset Backed Securities | Hedge Funds | |
| Balance at July 1, 2011 | \$ 500 | \$ 116 | \$ 2,467 | \$ 715 | \$ 8,600 | \$ 12,398 |
| Realized gain | 35 | - | (7) | 44 | - | 72 |
| Unrealized (loss) gain | (35) | - | (81) | - | 2,361 | 2,245 |
| Purchases | 972 | - | 992 | - | 98,227 | 100,191 |
| Settlements | - | - | - | (200) | - | (200) |
| Transfers to Level 2 | - | (116) | (2,257) | - | (23) | (2,396) |
| Balance at June 30, 2012 | 1,472 | - | 1,114 | 559 | 109,165 | 112,310 |
| Realized gain | - | - | (53) | (43) | - | (96) |
| Unrealized (loss) gain | (19) | - | (23) | 43 | 40,568 | 40,569 |
| Purchases | - | - | - | - | 310,000 | 310,000 |
| Settlements | (6) | - | (125) | (559) | - | (690) |
| Transfers (to) from Level 2 | 2 | - | 1,973 | - | (40,224) | (38,249) |
| Balance at June 30, 2013 | <u>\$ 1,449</u> | <u>\$ -</u> | <u>\$ 2,886</u> | <u>\$ -</u> | <u>\$419,509</u> | <u>\$423,844</u> |

Investments in Entities that Calculate Net Asset Value per Share: The Corporation holds shares or interests in investment companies at year-end, included in commingled funds and hedge funds, where the fair value of the investment held is estimated based on the net asset value per share (or its equivalent) of the investment company. There were no unfunded commitments as of June 30, 2013 or 2012. The fair value and redemption rules of these investments are as follows:

| (In thousands) | Investments Held at June 30, 2013 | | |
|------------------|-----------------------------------|-----------------------------------|--------------------------|
| | Fair Value | Redemption Frequency | Redemption Notice Period |
| Commingled funds | \$ 615,684 | Daily-Monthly | 0-60 days |
| Hedge funds | <u>723,771</u> | Monthly, quarterly, semi-annually | 30-95 days |
| Total | <u>\$ 1,339,455</u> | | |
| (In thousands) | Investments Held at June 30, 2012 | | |
| | Fair Value | Redemption Frequency | Redemption Notice Period |
| Commingled funds | \$ 965,096 | Monthly | 5 days |
| Hedge funds | <u>249,592</u> | Monthly, quarterly, semi-annually | 30-95 days |
| Total | <u>\$ 1,214,688</u> | | |

The hedge fund category includes equity long/short hedge funds, multi-strategy hedge funds and relative value hedge funds. Equity long/short hedge funds invest both long and short, primarily in U.S. common stocks. Management of the fund has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position. Multi-strategy hedge funds pursue multiple strategies to diversify risks and reduce volatility. Relative value hedge funds' strategy is to exploit structural and technical inefficiencies in the market by investing in financial instruments that are perceived to be inefficiently priced as a result of business, financial or legal uncertainties.

The commingled fund category primarily includes investments in funds that invest in financial instruments of U.S. and non-U.S. entities, primarily bonds, notes, bills, debentures, currencies, and interest rate and derivative products.

The composition of investment returns included in the consolidated statement of operations and changes in net assets for the years ended June 30 is as follows:

| | 2013 | 2012 |
|---|-----------------------|-------------------|
| | (In thousands) | |
| Dividend, interest income and other | \$ 77,900 | \$ 74,258 |
| Realized gain, net | 102,842 | 68,360 |
| Realized equity gain (loss), other investments | 69,693 | (2,258) |
| Change in net unrealized gain (loss) on investments | <u>90,335</u> | <u>(146,640)</u> |
| Total investment return | <u>\$ 340,770</u> | <u>\$ (6,280)</u> |
| Included in: | | |
| Operating income | \$ 9,600 | \$ 13,300 |
| Nonoperating items | 325,646 | (19,159) |
| Changes in restricted net assets | <u>5,524</u> | <u>(421)</u> |
| Total investment return | <u>\$ 340,770</u> | <u>\$ (6,280)</u> |

In addition to investments, assets restricted as to use include receivables for unconditional promises to give cash and other assets net of allowances for uncollectible promises to give. Unconditional promises to give consist of the following at June 30:

| | 2013 | 2012 |
|--|-----------------------|------------------|
| | (In thousands) | |
| Amounts expected to be collected in: | | |
| Less than one year | \$ 10,904 | \$ 8,632 |
| One to five years | 18,905 | 13,896 |
| More than five years | <u>4,059</u> | <u>3,676</u> |
| | 33,868 | 26,204 |
| Discount to present value of future cash flows | (2,523) | (2,094) |
| Allowance for uncollectible amounts | <u>(2,829)</u> | <u>(2,301)</u> |
| Total unconditional promises to give, net | <u>\$ 28,516</u> | <u>\$ 21,809</u> |

Patient Accounts Receivable, Estimated Receivables from Third-Party Payors, and Current Liabilities – The carrying amounts reported in the consolidated balance sheets approximate their fair value.

Long-Term Debt – The carrying amounts of the Corporation's variable rate debt approximate their fair values. The fair value of the Corporation's fixed rate long-term debt is estimated using discounted cash flow analyses, based on current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the fixed rate long-term revenue and refunding bonds was

\$2,247 million and \$2,389 million at June 30, 2013 and 2012, respectively. Under the fair value hierarchy, these financial instruments are valued primarily using Level 2 inputs. The related carrying value of the fixed rate long-term revenue and refunding bonds was \$2,135 million and \$2,162 million at June 30, 2013 and 2012, respectively. The fair values of the remaining fixed rate capital leases, notes payable to banks, and mortgage loans are not materially different from their carrying values.

11. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative Financial Instruments – In the normal course of business, the Corporation is exposed to market risks, including the effect of changes in interest rates and equity market volatility. To manage these risks the Corporation enters into various derivative contracts, primarily interest rate swaps. Interest rate swaps are used to manage the effect of interest rate fluctuations.

Management reviews the Corporation's hedging program, derivative position, and overall risk management on a regular basis. The Corporation only enters into transactions it believes will be highly effective at offsetting the underlying risk.

Interest Rate Swaps – The Corporation utilizes interest rate swaps to manage interest rate risk related to the Corporation's variable interest rate debt, variable rate leases and a fixed-income investment portfolio. Cash payments on interest rate swaps totaled \$19.6 million and \$17.3 million for the years ended June 30, 2013 and 2012, respectively, and are included in nonoperating income.

Certain of the Corporation's interest rate swaps contain provisions that give certain counterparties the right to terminate the interest rate swap if a rating is downgraded below specified thresholds. If a ratings downgrade threshold is breached, the counterparties to the derivative instruments could demand immediate termination of the swaps. Such termination could result in a payment from the Corporation or a payment to the Corporation depending on the market value of the interest rate swap.

Certain of the Corporation's interest rate swaps are secured by \$11.2 million and \$89.4 million of collateral included in prepaid expenses and other current assets in the Corporation's consolidated balance sheets at June 30, 2013 and 2012, respectively.

Effect of Derivative Instruments on Excess of Revenue over Expenses – The following table represents the effect derivative instruments had on the Corporation's financial performance for the years ended June 30:

| Derivatives Not Designated as Hedging Instruments | Location of Net Gain (Loss) Recognized in Excess of Revenue over Expenses or Unrestricted Net Assets | 2013 | 2012 |
|---|--|---|--------------------|
| | | (In thousands) | |
| | | Amount of Net Gain (Loss) Recognized in Excess of Revenue over Expenses | |
| Excess of revenue over expenses: | | | |
| Interest rate swaps | Change in market value and cash payment on interest rate swaps | \$ 45,818 | \$(114,468) |
| Interest rate swaps | Investment income | (1,953) | 1,087 |
| | | <u>\$ 43,865</u> | <u>\$(113,381)</u> |

Balance Sheet Effect of Derivative Instruments - The following table summarizes the estimated fair value of the Corporation's derivative financial instruments at June 30:

| Derivatives Not Designated as Hedging Instruments | Consolidated Balance Sheet Location | 2013 (In Thousands) | 2012 (In Thousands) |
|--|--|--------------------------------|--------------------------------|
| Asset derivatives: | | | |
| Interest rate swaps | Investments | \$ 6,696 | \$ 8,401 |
| Interest rate swaps | Other assets | <u>23,804</u> | <u>18,782</u> |
| Total asset derivatives | | <u>\$ 30,500</u> | <u>\$ 27,183</u> |
| Liability derivatives: | | | |
| Interest rate swaps | Other long-term liabilities | <u>\$ 144,576</u> | <u>\$ 205,111</u> |

The counterparties to the interest rate swaps expose the Corporation to credit loss in the event of non-performance. At June 30, 2013 and 2012, an adjustment for non-performance risk reduced derivative assets by \$1.2 million and \$1.1 million and derivatives liabilities by \$5.3 million and \$14.6 million, respectively.

12. ENDOWMENTS

The Corporation's endowments consist of funds established for a variety of purposes. Endowments include both donor-restricted endowment funds and funds designated by the Board to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The Corporation considers various factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

The Corporation employs a total return investment approach whereby a mix of equities and fixed-income investments are used to maximize the long-term return of endowment funds for a prudent level of risk. The Corporation targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints. The Corporation can appropriate each year all available earnings in accordance with donor restrictions. The endowment corpus is to be maintained in perpetuity. Certain donor-restricted endowments require a portion of annual earnings to be maintained in perpetuity along with the corpus. Only amounts exceeding the amounts required to be maintained in perpetuity are expended.

Endowment net asset composition by type of fund at June 30 is as follows:

| | 2013 | | | Total |
|----------------------------------|------------------------------------|--|--|------------------|
| | (In thousands) | | | |
| | Unrestricted Net Assets | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | |
| Donor-restricted endowment funds | \$ - | \$456 | \$42,761 | \$43,217 |
| Board-designated endowment funds | <u>36,873</u> | <u>-</u> | <u>-</u> | <u>36,873</u> |
| Total endowment funds | <u>\$ 36,873</u> | <u>\$456</u> | <u>\$42,761</u> | <u>\$ 80,090</u> |

| | 2012 | | | Total |
|----------------------------------|------------------------------------|--|--|------------------|
| | (In thousands) | | | |
| | Unrestricted Net Assets | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | |
| Donor-restricted endowment funds | \$ - | \$438 | \$40,670 | \$41,108 |
| Board-designated endowment funds | <u>34,291</u> | <u>-</u> | <u>-</u> | <u>34,291</u> |
| Total endowment funds | <u>\$ 34,291</u> | <u>\$438</u> | <u>\$40,670</u> | <u>\$ 75,399</u> |

Changes in endowment net assets for the years ended June 30 include:

| | (In thousands) | | | Total |
|---|------------------------------------|--|--|------------------|
| | Unrestricted Net Assets | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | |
| Endowment net assets, July 1, 2011 | <u>\$ 34,988</u> | <u>\$446</u> | <u>\$ 34,462</u> | <u>\$ 69,896</u> |
| Investment return: | | | | |
| Investment gain | 1,477 | 7 | (30) | 1,454 |
| Change in net realized and unrealized gain and loss | <u>(1,651)</u> | <u>(10)</u> | <u>(391)</u> | <u>(2,052)</u> |
| Total investment return | (174) | (3) | (421) | (598) |
| Contributions | 91 | - | 636 | 727 |
| Appropriation of endowment assets for expenditures | (624) | (5) | - | (629) |
| Acquisition of LUHS | - | - | 6,671 | 6,671 |
| Other | <u>10</u> | <u>-</u> | <u>(678)</u> | <u>(668)</u> |
| Endowment net assets, June 30, 2012 | <u>34,291</u> | <u>438</u> | <u>40,670</u> | <u>75,399</u> |
| Investment return: | | | | |
| Investment gain (loss) | 1,139 | 13 | 1,071 | 2,223 |
| Change in net realized and unrealized gain and loss | <u>2,174</u> | <u>14</u> | <u>1,207</u> | <u>3,395</u> |
| Total investment return | 3,313 | 27 | 2,278 | 5,618 |
| Contributions | 51 | - | 1,230 | 1,281 |
| Appropriation of endowment assets for expenditures | (782) | (9) | - | (791) |
| Other | <u>-</u> | <u>-</u> | <u>(1,417)</u> | <u>(1,417)</u> |
| Endowment net assets, June 30, 2013 | <u>\$ 36,873</u> | <u>\$456</u> | <u>\$42,761</u> | <u>\$ 80,090</u> |

The table below describes endowment amounts classified as permanently restricted net assets and temporarily restricted net assets at June 30:

| | 2013 | 2012 |
|---|-----------------------|------------------|
| | (In thousands) | |
| Permanently restricted net assets: | | |
| Hospital operations support | \$ 18,053 | \$ 17,537 |
| Medical program support | 6,491 | 5,941 |
| Scholarship funds | 2,912 | 2,247 |
| Research funds | 7,869 | 8,241 |
| Community service funds | 5,756 | 5,496 |
| Other funds | <u>1,680</u> | <u>1,208</u> |
| Total endowment funds classified as permanently restricted net assets | <u>\$ 42,761</u> | <u>\$ 40,670</u> |
| Temporarily restricted net assets: | | |
| Term endowment funds | \$ 131 | \$ 127 |
| Other | <u>325</u> | <u>311</u> |
| Total endowment funds classified as temporarily restricted net assets | <u>\$ 456</u> | <u>\$ 438</u> |

Funds with Deficiencies – Periodically, the fair value of assets associated with the individual donor-restricted endowment funds may fall below the level that the donor requires the Corporation to retain as a fund of perpetual duration. Deficiencies of this nature are reported in unrestricted net assets. These deficiencies result from unfavorable market fluctuations and/or continued appropriation for certain programs that was deemed prudent by the Corporation.

13. SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 25, 2013, the date the consolidated financial statements were issued. The following subsequent events were noted:

Liquidity Facilities – In July 2013, the Corporation renewed the Amended and Restated 2010 Revolving Credit Agreements (2013 Credit Agreements) discussed in Note 6 with U.S. Bank National Association, which acts as an administrative agent for a group of lenders thereunder. The 2013 Credit Agreements establish a revolving credit facility for the Corporation, under which that group of lenders agrees to lend to the Corporation amounts that may fluctuate from time to time but, as of September 25, 2013, the amount available was \$731 million along with an option to increase that amount by \$200 million.

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