Passavant Area Hospital Association and Affiliates

Jacksonville, Illinois

Consolidated Financial Statements

Years Ended September 30, 2013 and 2012

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WIPFLi LLP

Independent Auditor's Report

Board of Directors
Passavant Area Hospital Association
Jacksonville, Illinois

We have audited the accompanying consolidated financial statements of Passavant Area Hospital Association and Affiliates, which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the 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; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Passavant Area Hospital Association and Affiliates as of September 30, 2013 and 2012, and the results of their operations, changes in their net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States.

Wipfli LLP

Wipfli LLP

January 3, 2014
Milwaukee, Wisconsin

Passavant Area Hospital Association and Affiliates

Consolidated Balance Sheets

September 30, 2013 and 2012

Assets	2013	2012
Current assets:		
Cash and cash equivalents	$ 7,173,060	$ 7,864,770
Short-term investments	6,068,424	6,181,503
Assets limited as to use	1,005,000	965,000
Accounts receivable:		
Patient - Net	15,436,603	16,065,034
Other	1,781,963	119,371
Inventory	803,245	746,200
Prepaid expenses	1,558,543	1,608,436
Insurance recoveries receivable	3,848,219	-
Total current assets	37,675,057	33,550,314
Assets limited as to use	54,758,763	50,491,440
Property and equipment - Net	47,936,293	49,007,211
Other assets:		
Beneficial interest in perpetual trusts	19,775,034	16,991,019
Other	1,250,638	1,551,206
Total other assets	21,025,672	18,542,225
TOTAL ASSETS	$161,395,785	$151,591,190

Liabilities and Net Assets	2013	2012
Current liabilities:		
Current portion of long-term debt	$ 1,580,589	$ 1,475,400
Accounts payable	1,529,292	2,002,745
Accrued liabilities	7,360,319	6,585,337
Estimated amounts due to third-party payers	3,794,653	3,981,317
Professional liability claims payable	4,300,000	-
Total current liabilities	18,564,853	14,044,799
Long-term liabilities:		
Long-term debt, less current portion	28,730,036	29,903,787
Interest rate swap agreements	2,431,107	3,267,404
Other	78,127	-
Total long-term liabilities	31,239,270	33,171,191
Total liabilities	49,804,123	47,215,990
Net assets:		
Unrestricted	88,350,828	83,894,261
Temporarily restricted	698,916	723,036
Permanently restricted	22,541,918	19,757,903
Total net assets	111,591,662	104,375,200
TOTAL LIABILITIES AND NET ASSETS	$161,395,785	$151,591,190

See accompanying notes to consolidated financial statements.

Passavant Area Hospital Association and Affiliates

Consolidated Statements of Operations

Years Ended September 30, 2013 and 2012

	2013	2012
Revenue:		
Patient service revenue (net of contractual allowances and discounts)	$ 84,883,180	$ 86,613,997
Provision for bad debts	(68,506)	(29,039)
Net patient service revenue, less provision for bad debts	84,814,674	86,584,958
Contributions	257,901	1,437,107
Other operating revenue	3,550,783	1,932,855
Total revenue	88,623,358	89,954,920
Expenses:		
Salaries and wages	38,819,397	38,288,507
Employee benefits	15,067,110	13,148,842
Purchased services and professional fees	8,363,611	6,683,437
Supplies and other	19,675,511	20,293,676
Depreciation and amortization	6,363,141	6,179,020
Interest	1,604,547	1,564,480
Total expenses	89,893,317	86,157,962
Income (loss) from operations	(1,269,959)	3,796,958
Other income (expense):		
Investment income	4,838,256	7,002,455
Grants	(33,234)	(16,617)
Other	85,207	(15,000)
Total other income - Net	4,890,229	6,970,838
Revenue in excess of expenses	3,620,270	10,767,796
Change in fair value of interest rate swap agreements	836,297	(107,114)
Increase in unrestricted net assets	$ 4,456,567	$ 10,660,682

See accompanying notes to consolidated financial statements.

Passavant Area Hospital Association and Affiliates

Consolidated Statements of Changes in Net Assets

Years Ended September 30, 2013 and 2012

	2013	2012
Unrestricted net assets:		
Revenue in excess of expenses	$ 3,620,270	$ 10,767,796
Change in fair value of interest rate swap agreements	836,297	(107,114)
Increase in unrestricted net assets	4,456,567	10,660,682
Temporarily restricted net assets:		
Contributions	-	70,376
Investment income (loss)	19,122	(33,469)
Net assets released from restrictions	(43,242)	(57,463)
Decrease in temporarily restricted net assets	(24,120)	(20,556)
Increase in permanently restricted net assets - Change in beneficial interest in perpetual trusts	2,784,015	3,081,585
Change in net assets	7,216,462	13,721,711
Net assets at beginning	104,375,200	90,653,489
Net assets at end	$ 111,591,662	$ 104,375,200

See accompanying notes to consolidated financial statements.

Passavant Area Hospital Association and Affiliates

Consolidated Statements of Cash Flows

Years Ended September 30, 2013 and 2012

	2013	2012
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Change in net assets	$ 7,216,462	$ 13,721,711
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	6,363,141	6,179,020
Provision for bad debts	68,506	29,039
Net change in unrealized gains on investments	(1,475,920)	(4,331,132)
Net realized losses on investments	21,871	40,958
Change in fair value of interest rate swap agreements	(836,297)	107,114
Change in beneficial interest in perpetual trusts	(2,784,015)	(3,081,585)
Loss on disposal of equipment	125,066	24,227
Equity in (earnings) losses of unconsolidated affiliate	71,664	(90,756)
Forgiveness of loans to physicians	317,178	283,297
Changes in operating assets and liabilities:		
Accounts receivable	(1,102,667)	(2,114,834)
Inventory	(57,045)	(58,344)
Prepaid expenses	49,893	207,611
Insurance recoveries receivable	(3,848,219)	-
Other assets	-	98,620
Accounts payable	(473,453)	360,460
Accrued liabilities	774,982	(1,144,091)
Estimated amounts due to third-party payers	(186,664)	(379,450)
Professional liability claims payable	4,300,000	-
Other liabilities	78,127	-
Net cash provided by operating activities	8,622,610	9,851,865

Passavant Area Hospital Association and Affiliates

Consolidated Statements of Cash Flows (Continued)

Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from investing activities:		
Purchases of property and equipment	$ (5,402,396)	$ (4,492,779)
Proceeds from sale of equipment	5,933	800
Purchases of investments	(29,238,271)	(23,623,785)
Proceeds from sales and maturities of investments	26,498,076	18,317,886
Loans made to physicians	(109,100)	(96,839)
Net cash used in investing activities	(8,245,758)	(9,894,717)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	425,380	1,674,620
Principal payments on long-term debt	(1,493,942)	(1,332,092)
Net cash provided by (used in) financing activities	(1,068,562)	342,528
Net increase (decrease) in cash and cash equivalents	(691,710)	299,676
Cash and cash equivalents at beginning	7,864,770	7,565,094
Cash and cash equivalents at end	$ 7,173,060	$ 7,864,770

Supplemental cash flow information:

	2013	2012
Cash paid during the year for interest, net of amount capitalized of $36,838 in 2012	$ 1,604,547	$ 1,527,642

Note 1 Summary of Significant Accounting Policies

The Entity

Passavant Memorial Area Hospital Association (the "Hospital") primarily earns revenues by providing inpatient, outpatient, and emergency care services to patients in Jacksonville, Illinois, and the surrounding area. The Hospital also provides physician services in the same geographic area through its separate wholly-owned subsidiary corporation, Passavant Physician Association. The Hospital is the sole corporate member of a nonprofit corporation, Jacksonville CRNA's Inc. ("CRNA"). The Hospital employs certain nurse anesthetists and sells their services to CRNA. The Hospital is the sole corporate member of Passavant Area Hospital Foundation (the "Foundation"), which commenced operations during 2013. The Foundation was established to generate philanthropic support for the Hospital.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Hospital, Passavant Physician Association, CRNA, and the Foundation (collectively the "Association"). All material intercompany accounts and transactions have been eliminated in consolidation.

Financial Statement Presentation

The Association follows accounting standards contained in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). The ASC is the single source of authoritative accounting principles generally accepted in the United States (GAAP) for nongovernmental entities in the preparation of financial statements in conformity with GAAP.

Use of Estimates in Preparation of Financial Statements

The preparation of the accompanying consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that directly affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Note 1 Summary of Significant Accounting Policies (Continued)

Cash Equivalents

The Association considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents, excluding amounts whose use is limited or restricted and amounts held as short-term investments.

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payer agreements. The Association bills third-party payers on the patients' behalf, or if a patient is uninsured, the patient is billed directly. Once claims are settled with the primary payer, any secondary insurance is billed, and patients are billed for copay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivable are applied to the specific claim identified on the remittance advice or statement. The Association does not have a policy to charge interest on past due accounts.

The carrying amounts of patient accounts receivable are reduced by allowances that reflect management's best estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectible amounts, primarily from uninsured patients and amounts patients are personally responsible for, through a charge to operations and a credit to the allowance for doubtful accounts based on its assessment of historical collection likelihood and the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to patient accounts receivable.

Note 1 Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

In evaluating the collectability of patient accounts receivable, the Association analyzes past results and identifies trends for each major payer source of revenue for the purpose of estimating the appropriate amounts of the allowance for doubtful accounts and the provision for bad debts. Data in each major payer source are regularly reviewed to evaluate the adequacy of the allowance for doubtful accounts. Specifically, for receivables relating to services provided to patients having third-party coverage, an allowance for doubtful accounts and a corresponding provision for bad debts are established based on historical write-off percentages; for receivables relating to self-pay patients, a provision for bad debt is made in the period services are rendered based on experience indicating the inability or unwillingness of patients to pay amounts for which they are financially responsible.

Patient accounts receivable are recorded in the accompanying consolidated balance sheets net of contractual adjustments and an allowance for doubtful accounts.

Inventory

Inventory is valued at the lower of weighted average cost or market.

Investments and Investment Income

Investments, including short-term investments and assets limited as to use, are recorded at fair value in the accompanying consolidated balance sheets. Investment income includes unrealized and realized gains and losses on investments, interest, and dividends. The Association includes investment income from the funds held by trustees under bond indenture agreements in other operating revenue. Other investment income is reflected in the consolidated statements of operations and changes in net assets as other income (expense) or as changes in temporarily restricted net assets if the terms of gifts impose restrictions on the use of the income.

Note 1 Summary of Significant Accounting Policies (Continued)

Assets Limited as to Use

Assets limited as to use include (1) assets set aside by the Board of Directors for future capital improvements over which the board retains control and may subsequently be used for other purposes at its discretion, (2) assets accumulated from unrestricted donations and bequests, including earnings thereon, which the Board of Directors has set aside for future specific purposes, (3) assets restricted by donors, and (4) assets held by trustees under bond indenture agreements. Assets limited as to use that are required for obligations classified as current liabilities are reported as current assets.

Fair Value Measurements

The Association measures fair value of its financial instruments using a three-tier hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Association has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable for the asset or liability.
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurements.

Note 1 Summary of Significant Accounting Policies (Continued)

Fair Value Measurements (Continued)

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

Property, Equipment, and Depreciation

Property and equipment acquisitions are recorded at cost or, if donated, at fair value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital leases is amortized using the straight-line method over the shorter of the estimated useful life of the equipment or the lease term. Amortization of equipment under capital leases is included in depreciation and amortization in the accompanying consolidated statements of operations. Estimated useful lives range from 2 to 20 years for land improvements, 10 to 40 years for buildings and improvements, and 5 to 20 years for equipment.

Interest costs incurred on borrowed funds during the period of construction of capital assets is 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 revenue in excess of 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 contributions in temporarily restricted net assets. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported as net assets released from restrictions when the donated or acquired long-lived assets are placed in service.

Note 1 Summary of Significant Accounting Policies (Continued)

Asset Retirement Obligations

ASC Topic 410-20, *Asset Retirement Obligations*, clarifies when an entity is required to recognize a liability for a conditional asset retirement obligation. The Association has considered ASC Topic 410-20 specifically as it relates to its legal obligation to perform asset retirement activities, such as asbestos removal, on its existing properties. The Association believes there is an indeterminate settlement date for the asset retirement obligations because the range of time over which the Association may settle the obligation is unknown and cannot be estimated. As a result, the Association cannot reasonably estimate the liability related to these asset retirement activities as of September 30, 2013 and 2012.

Deferred Financing Costs

Costs related to the issuance of long-term debt, included in other assets in the accompanying consolidated balance sheets, are amortized over the life of the related debt using the effective interest method. Amortization is included in depreciation and amortization in the accompanying consolidated statements of operations.

Beneficial Interest in Perpetual Trusts

The Association is the income beneficiary along with other beneficiaries of several trusts controlled by unrelated third parties. The beneficial interest in the assets of these trusts are included in the Association's accompanying consolidated balance sheets as permanently restricted net assets. Income is distributed in accordance with the individual trust documents and is included in investment income. Trust income distributed to the Association for the years ended September 30, 2013 and 2012, was $96,039 and $75,687, respectively.

Note 1 Summary of Significant Accounting Policies (Continued)

Interest Rate Swap Agreements

The Association uses derivative instruments to manage its risk related to interest rate movements. The interest rate risk management strategy is to stabilize cash flow requirements by maintaining the interest rate swaps to convert the variable rate debt to fixed rate. At the inception of the interest rate swap agreements, the risk management strategy and the hedges' effectiveness were documented. Management has determined the swaps to be highly effective. The interest rate swap agreements are reported at fair value in the accompanying consolidated balance sheets, with subsequent changes in fair value included as other changes in unrestricted net assets for the effective portion and other income (expense) for the ineffective portion. If the ineffectiveness exceeds certain prescribed levels, the interest rate swap agreements would no longer be eligible for hedge accounting, all future changes in the fair value would be reported in other income (expense) in the consolidated statements of operations, and the change that was recorded through net assets from the beginning of the interest rate swap would be amortized into earnings over the remaining life of the swap. In the event the interest rate swap is terminated, the total amount that was recorded in net assets from the beginning of the interest rate swap would be reclassified into earnings.

Net Assets

Unrestricted net assets consist of net assets that are not subject to donor-imposed stipulations and include those expendable resources which have been designated for special use by the Association’s Board of Directors. Temporarily restricted net assets are those whose use by the Association 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 Association in perpetuity.

The Board of Directors of the Association treats any appreciation in endowment funds as unrestricted unless specified otherwise by the donor. Interest and dividends from permanently restricted investments are credited to unrestricted net assets unless donor stipulations restrict such earnings.

Note 1 Summary of Significant Accounting Policies (Continued)

Patient Service Revenue (net of contractual allowances and discounts)

Patient service revenue includes amounts from patients and third-party payers for services provided. The Association recognizes patient service revenue associated with services provided to patients who have third-party payer coverage primarily on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Association recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates based on the Association's uninsured patients policy). Based on historical experience of the Association, a significant portion of uninsured patients will be unwilling or unable to pay for the services provided. Thus, the Association records a provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue also includes estimated retroactive adjustments under reimbursement agreements with third-party payers. 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.

Charity Care

The Association provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Association maintains records to identify the amount of charges foregone for services and supplies furnished under the charity care policy. Amounts determined to qualify as charity care are not reported as net patient service revenue.

Note 1 Summary of Significant Accounting Policies (Continued)

Donor-Restricted Gifts

Contributions are considered available for unrestricted use unless specifically restricted by the donor. Unconditional promises to give cash and other assets to the Association 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 as unrestricted net assets and reported in the consolidated financial statements as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

Revenue in Excess of Expenses

The accompanying consolidated statements of operations and changes in net assets include the classification revenue in excess of expenses, which is considered the operating indicator. Changes in unrestricted net assets which are excluded from the operating indicator include the effective portion of the change in fair value of interest rate swap agreements and contributions of long-lived assets, including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.

Advertising Costs

Advertising costs are expensed as incurred.

Note 1 Summary of Significant Accounting Policies (Continued)

Income Taxes

The Hospital, CRNA, and the Foundation are tax-exempt corporations as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital, CRNA, and the Foundation are also exempt from state income taxes on related income. Passavant Physician Association is a taxable nonprofit corporation subject to federal and state income taxes. Income taxes are not signficant to the accompanying financial statements.

In order to account for any uncertain tax positions, the Association determines whether it is more likely than not that a tax position will be sustained upon examination on the technical merits of the position assuming the taxing authority has full knowledge of all information. If the tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. The Association recorded no assets or liabilities for uncertain tax positions in 2013 or 2012 as management believes the Association has no material unrecognized income tax positions. Federal tax returns for tax years 2009 and beyond remain subject to examination by the Internal Revenue Service.

Subsequent Events

Subsequent events have been evaluated through January 3, 2014, which is the date the consolidated financial statements were available to be issued. See Notes 2 and 18 for descriptions of specific subsequent events.

Note 2 Reimbursement Arrangements With Third-Party Payers

The Association has agreements with third-party payers that provide for reimbursement at amounts which vary from its established rates. A summary of the basis of reimbursement with major third-party payers follows:

Medicare - Inpatient acute care services are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services related to Medicare beneficiaries are paid based on a cost-reimbursement methodology. Outpatient services are paid primarily on prospectively determined rates, also based on a patient classification system, or fixed fee schedules.

Medicaid - Inpatient services rendered to Medicaid program beneficiaries are paid primarily at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors similar to the Medicare system. Outpatient services are paid on a prospectively determined rate per occasion of service.

Physician services - Reimbursement for physician services rendered is based on charges, discounted charges, or in the case of government programs, prospectively determined reimbursement rates.

Blue Cross - The majority of Blue Cross subscribers are paid under a Preferred Provider Organization (PPO) plan. The Blue Cross PPO plan reimburses the Association for inpatient services based on the lesser of net covered charges or the established per diem rate. Outpatient services are reimbursed based on a specified discount from charges. Blue Cross processes claims under a uniform payment plan or an interim basis subject to monthly reconciliation between actual payments received and the agreed-upon contractual amounts. The monthly reconciliation process results in the recognition of a liability that will be liquidated within 60 days.

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

Note 2 Reimbursement Arrangements With Third-Party Payers (Continued)

Accounting for Contractual Arrangements

The Hospital is reimbursed by Medicare for certain cost reimbursable items at an interim rate, and final settlements are determined after audit of the Hospital's related annual cost report. Estimated provisions to approximate the final expected settlements after review by the fiscal intermediary are included in the accompanying consolidated financial statements. The Hospital's cost reports have been audited by the Medicare fiscal intermediary through September 30, 2009.

Hospital Assessments

On November 21, 2006, the Centers for Medicare & Medicaid Services (CMS) approved state of Illinois (the "State") legislation for a Medicaid Hospital Assessment Program (the "Program") relating to the period June 30, 2006 through June 30, 2008. On August 19, 2008, CMS approved an extension of the Program to June 30, 2013. Under the Program, the Hospital pays the state an assessment on the Hospital's inpatient services based on non-Medicare occupied bed days from the 2005 Medicare cost report and receives additional Medicaid reimbursement from the State. Total reimbursement revenue recognized by the Hospital relating to the Program amounted to $3,666,556 and $3,799,540 in 2013 and 2012, respectively, and is included in net patient service revenue, less provision for bed debts, in the accompanying consolidated statements of operations. The Hospital incurred assessment expenses for 2013 and 2012 of $1,099,545 in each year, included in supplies and other expense in the accompanying consolidated statements of operations.

Subsequent to the year ended September 30, 2013, an enhanced assessment program will be implemented by the State in order to further increase Medicaid payments to hospitals. Under the enhanced program, the inpatient assessment will be extended through December 31, 2014, and an additional annual asssessment on outpatient services will be imposed retroactive to June 10, 2012, continuing through December 31, 2014. The outpatient assessment will be a percentage of the Hospital's gross outpatient revenue from the 2009 Medicare cost report. As the amount of the retroactive assessment was not known and could not be estimated as of September 30, 2013, no amounts have been accrued in the accompanying consolidated financial statements. Management expects that the enhanced assessment program will result in additional Medicaid reimbursement to the Hospital in excess of amounts paid.

Note 2 Reimbursement Arrangements With Third-Party Payers (Continued)

Electronic Health Record Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA, collectively referred to as the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), are intended to promote the adoption and meaningful use of health information technology and qualified EHR technology.

Incentive payments to hospitals will generally be made in stages over a four year period. For the first stage, the Association must attest that it met the meaningful use criteria for a continuous 90-day period. For subsequent stages, the Association must demonstrate meaningful use for an entire year. The incentive payments are made based on a statutory formula, with the payments subject to final adjustment based in part on information from the Association's Medicare cost reports. The System recognizes revenue from the EHR program when the conditions of the program have been met and payment is reasonably assured.

The Association recorded approximately $1,684,000 in EHR incentive revenue from the Medicare program in 2013 which is recorded in other operating revenue in the accompanying consolidated statements of operations.

Compliance

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, particularly those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Violation of these laws and regulations could result in the imposition of fines and penalties, as well as repayments of previously billed and collected revenue from patient services. Management believes that the Association is in substantial compliance with current laws and regulations.

Note 2 Reimbursement Arrangements With Third-Party Payers (Continued)

Compliance (Continued)

CMS uses recovery audit contractors (RACs) as part of CMS's efforts to ensure accurate payments. RACs search for potentially inaccurate Medicare payments which may have been made to health care providers and not detected through existing CMS program integrity efforts. Once a RAC identifies a claim it believes is inaccurate, it makes a deduction from or addition to the provider's Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. The outcome of any potential reviews is unknown and cannot be reasonably estimated as of September 30, 2013.

Note 3 Patient Accounts Receivable

Patient accounts receivable consisted of the following at September 30:

	2013	2012
Patient accounts receivable	$ 39,050,219	$ 48,572,927
Less:		
Contractual adjustments	14,546,191	25,401,918
Allowance for doubtful accounts	9,067,425	7,105,975
Patient accounts receivable - Net	$ 15,436,603	$ 16,065,034

The Association increased its allowance for doubtful accounts from 14.6% of gross accounts receivable at September 30, 2012 to 23.2% of gross accounts receivable at September 30, 2013. A majority of the increase is due to the State becoming more current in making Medicaid payments; in 2012 the State was significantly behind with their Medicaid payments which inflated gross accounts receivable. Amounts written off during 2013 for self-pay patients and third-party payers were approximately $4,700,000 and $4,400,000, respectively. Amounts written off during 2012 for self-pay patients and third-party payers were approximately $5,400,000 and $3,000,000, respectively.

Note 4 Short-Term Investments and Assets Limited as to Use

Short-Term Investments

Short-term investments consisted of the following at September 30:

	2013	2012
Cash equivalents	$ 2,081,415	$ 24,734
Mutual funds	3,987,009	6,156,769
Total short-term investments	$ 6,068,424	$ 6,181,503

Assets Limited as to Use

Assets limited as to use consisted of the following at September 30:

	2013	2012
Board designated for future specific purposes	$ 49,119,416	$ 44,828,044
Restricted by donors	4,058,025	4,072,317
Funds held by trustees under bond indenture agreements	2,586,322	2,556,079
Total assets limited as to use	55,763,763	51,456,440
Less - Current portion	1,005,000	965,000
Assets limited as to use - Less current portion	$ 54,758,763	$ 50,491,440

Note 4 Short-Term Investments and Assets Limited as to Use (Continued)

Assets limited as to use are invested as follows at September 30:

	2013	2012
Cash and cash equivalents	$ 3,469,529	$ 4,524,286
Certificates of deposit	474,918	669,599
U.S. Government and agency obligations	5,306,603	2,092,918
Corporate obligations	10,817,485	8,781,480
Mutual funds	24,924,661	25,106,643
Real estate investment trusts	228,336	77,854
Equity securities	7,516,725	6,973,888
Farmland	3,018,098	3,098,609
Accrued income	7,408	131,163
Total assets limited as to use	$ 55,763,763	$ 51,456,440

Investment Income

Investment income, including gains and losses on cash equivalents, investments, and assets limited as to use, consisted of the following for the years ended September 30:

	2013	2012
Unrestricted net assets:		
Other operating revenue	$ 923	$ 1,527
Other income (expense):		
Interest and dividends	3,384,207	2,712,281
Net realized losses	(21,871)	(40,958)
Net unrealized gains	1,475,920	4,331,132
Total other income	4,838,256	7,002,455
Temporarily restricted net assets	19,122	(33,469)
Total investment income	$ 4,858,301	$ 6,970,513

Note 4 Short-Term Investments and Assets Limited as to Use (Continued)

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

Note 5 Fair Value Measurements

Following is a description of the valuation methodology used for assets and liabilities measured at fair value:

Cash equivalents, which primarily consistent of money market funds, are valued using a net asset value (NAV) of $1. Mutual funds and real estate investment trusts are valued at the daily closing price as reported by the fund. These funds are registered with the Securities and Exchange Commission and are required to publish their daily NAV and to transact at that price. U.S. Government and agency obligations and domestic corporate and foreign obligations are valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings. Domestic and foreign equity securities listed on exchanges are valued at the closing price reported on the active market on which the individual securities are traded. The interest rate swap agreements are valued based on estimates by a third-party valuation service, which uses a discounted cash flow analysis using observable market-based inputs, including forward interest rate curves.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Association believes its valuation methods 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.

Note 5 Fair Value Measurements (Continued)

The following table sets forth by level, within the fair value hierarchy, the Association's assets and liabilities at fair value as of September 30:

	2013			
	Level 1	Level 2	Level 3	Total Assets/Liabilities at Fair Value
Assets:				
Money market funds	$ -	$ 5,374,715	$ -	$ 5,374,715
U.S. Government and agency obligations	-	5,306,603	-	5,306,603
Domestic corporate obligations	-	10,257,801	-	10,257,801
Foreign obligations	-	559,684	-	559,684
Fixed income mutual funds	8,797,670	-	-	8,797,670
Balanced mutual funds	2,538,342	-	-	2,538,342
Equity mutual funds	16,715,469	-	-	16,715,469
International mutual funds	860,189	-	-	860,189
Real estate investment trusts	228,336	-	-	228,336
Domestic equity securities	7,123,269	-	-	7,123,269
Foreign equity securities	393,456	-	-	393,456
Total assets	$ 36,656,731	$ 21,498,803	$ -	$ 58,155,534
Liabilities - Interest rate swap agreements	$ -	$ 2,431,107	$ -	$ 2,431,107

Note 5 Fair Value Measurements (Continued)

	2012			
	Level 1	Level 2	Level 3	Total Assets/Liabilities at Fair Value
Money market funds	$ -	$ 4,424,946	$ -	$ 4,424,946
U.S. Government and agency obligations	-	2,092,918	-	2,092,918
Domestic corporate obligations	-	8,522,280	-	8,522,280
Foreign obligations	-	259,200	-	259,200
Fixed income mutual funds	13,721,432	-	-	13,721,432
Balanced mutual funds	1,683,439	-	-	1,683,439
Equity mutual funds	15,395,774	-	-	15,395,774
International mutual funds	462,767	-	-	462,767
Real estate investment trusts	77,854	-	-	77,854
Domestic equity securities	6,547,255	-	-	6,547,255
Foreign equity securities	426,633	-	-	426,633
Total assets	$ 38,315,154	$ 15,299,344	$ -	$ 53,614,498
Liabilities - Interest rate swap agreements	$ -	$ 3,267,404	$ -	$ 3,267,404

Note 6 Property and Equipment

Property and equipment consisted of the following at September 30:

	2013	2012
Land and land improvements	$ 3,469,929	$ 3,469,929
Buildings and improvements	85,174,249	84,423,734
Equipment	43,967,504	40,712,685
Total property and equipment	132,611,682	128,606,348
Less - Accumulated depreciation	85,777,163	82,070,781
Net depreciated value	46,834,519	46,535,567
Construction in progress	1,101,774	2,471,644
Property and equipment - Net	$ 47,936,293	$ 49,007,211

Note 6 Property and Equipment (Continued)

Equipment under capital lease obligations had an original cost of $2,708,831, and accumulated amortization of $539,152 and $386,616 at September 30, 2013 and 2012, respectively.

Depreciation expense on property and equipment totaled $6,342,315 and $6,140,838 for the years ended September 30, 2013 and 2012, respectively.

Construction in progress at September 30, 2013 and 2012, relates to various renovation projects.

Note 7 Long-Term Debt

Long-term debt consisted of the following at September 30:

	2013	2012
Revenue Bonds (Series 2006A), variable interest rate of 2.22% at September 30, 2013, maturing December 2031	$ 16,805,000	$ 17,375,000
Revenue Bonds (Series 2006B), variable interest rate of 2.22% at September 30, 2013, maturing December 2031	10,275,000	10,670,000
Capital lease obligations, due through November 2016, collateralized by property and equipment	1,242,231	1,659,567
Jacksonville Savings Bank equipment note, variable interest rate of 3.25% at September 30, 2013, maturing September 2025	1,988,394	1,674,620
Totals	30,310,625	31,379,187
Less - Current portion	1,580,589	1,475,400
Total long-term debt, less current portion	$ 28,730,036	$ 29,903,787

Note 7 Long-Term Debt (Continued)

The Series 2006A and 2006B Revenue Bonds consist of adjustable rate demand industrial revenue bonds (the "Bonds") in the original amounts of $19,905,000 and $12,485,000, respectively, both issued December 14, 2006. The variable interest rate on the Bonds is adjusted daily and is payable monthly. Principal is payable in annual installments through 2031.

The city of Jacksonville, Illinois (the "City") issued the Bonds on behalf of the Association. The proceeds of the Bonds were loaned to the Association under a trust indenture and loan agreement dated December 1, 2006. The proceeds of the Series 2006A Revenue Bonds were to provide funds for the advance refunding and defeasance of previous borrowings. The proceeds of the Series 2006B Revenue Bonds were to provide funds for the construction and development of budgeted capital expenditures and campus-wide refurbishments. The trust indenture requires that certain funds be established with the trustee. These funds are included in assets limited as to use in the accompanying consolidated balance sheets.

Prior to December 2010, the Bonds were secured by an irrevocable direct pay letter of credit with Comerica Bank. In December 2010, the oustanding bonds were purchased by Comerica Bank and the bond documents were amended. Under the amended documents, the Bonds are paid under the original scheduled revenue bond maturities until the fifth year, at which time the bonds are subject to tender for mandatory purchase by Comerica Bank. However, Comerica Bank may elect to continue to hold the bonds. In the event Comerica Bank does not elect to hold the bonds, the bonds would be remarketed. Management believes if Comercia Bank does not continue to hold the bonds, then the Association will be able to successfully remarket the bonds. Accordingly, the scheduled principal payments following reflect the original scheduled maturities.

The amended documents require the Association to comply with certain restrictive covenants, including minimum insurance coverage, restrictions on the incurrence of additional indebtedness, and maintenance of certain leverage, liquidity, and debt service coverage ratios. Mangement believes the Association is in compliance with all restrictive covenants at September 30, 2013.

The Bonds are collateralized by substantially all of the property of the Association.

Note 7 Long-Term Debt (Continued)

Principal and interest is due quarterly on the Jacksonville Savings Bank equipment note. The note bears interest at the prime rate minus 2.0% with a maximum rate of 6.5% and a minimum rate of 3.25%. The note is collateralized by a security interest in the Association's patient accounts receivable.

Scheduled principal payments on the Revenue Bonds and the equipment note at September 30, 2013 are summarized as follows:

2014	$ 1,142,414
2015	1,181,998
2016	1,226,582
2017	1,271,626
2018	1,316,684
Thereafter	22,929,090
Total	$ 29,068,394

Minimum future payments under the capital lease obligations at September 30, 2013, are as follows:

2014	$ 489,578
2015	410,248
2016	370,584
2017	68,515
Total minimum lease payments	1,338,925
Less - Amount representing interest	96,694
Capital lease obligations	1,242,231
Less - Current portion	438,175
Capital lease obligations, less current portion	$ 804,056

Note 8 Interest Rate Swap Agreements

As a strategy to maintain acceptable levels of exposure to the risk of changes in the future cash flows due to interest rate fluctuations, the Association entered into two interest rate swap agreements on its floating rate Series 2006A and 2006B Revenue Bonds. The agreements provide for the Association to receive interest from the counterparties at 67% of LIBOR and to pay interest to the counterparties at a fixed rate of 2.95% and 3.45% on notional amounts of $17,375,000 and $10,670,000, respectively.

Management has designated the interest rate swap agreements as cash flow hedging instruments and has determined that the agreements are highly effective. The fair value of the interest rate swap agreements at September 30, 2013 and 2012, was a liability of $2,431,107 and $3,267,404, respectively. The change in fair value of the interest rate swap agreements was $836,297 and $(107,114) for the years ended September 30, 2013 and 2012, respectively, representing the effective portion of the change in fair value and is recorded as an increase (decreaase) in unrestricted net assets in the accompanying consolidated financial statements.

Note 9 Charity Care and Community Benefit

In support of its mission, the Association voluntarily provides free care, or care at substantially reduced fees, to patients who lack financial resources and are deemed to be medically indigent. Because the Association does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue, less provision for bad debts.

The amount of charges foregone for services and supplies furnished under the Association's charity care policy were as follows:

	2013	2012
Charity care allowances	$ 15,269,553	$ 11,090,715
Volunteer free clinic allowances	320,359	915,602
Charity care and partially reimbursed care based on charges foregone	$ 15,589,912	$ 12,006,317

Note 9 Charity Care and Community Benefit (Continued)

In addition, the Association provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts which are less than established charges for the services provided the recipients, and many times, the payments are less than the cost of rendering the services provided.

The Association's total cost of uncompensated care relating to these and other services are approximated as follows:

	2013	2012
State Medicaid and other public aid programs	$ 9,124,000	$ 8,004,000
Less - State critical hospital adjustment payments	544,000	564,000
Uncompensated cost of public aid programs - Net	8,580,000	7,440,000
Charity care	5,420,000	4,080,000
Total cost of uncompensated care	$ 14,000,000	$ 11,520,000

The estimated net uncompensated cost of state Medicaid and other public aid programs is determined by computing the cost of providing the care less amounts paid by the programs. State Medicaid and other public aid programs above exclude the activity of the Illinois Hospital Medical Assessment Program (see Note 2). The estimated cost of providing care to patients under public aid programs and the Association's charity care policy is calculated by multiplying the ratio of cost to gross charges by the gross uncompensated care charges.

In addition to the above cost of uncompensated care, the Association also commits significant time and resources to endeavors and services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, childbirth education programs, support to the local hospice program, "Doorbell Dinners" for elderly shut-ins, free community education programs, and a variety of support groups.

Note 10 Patient Service Revenue (Net of Contractual Allowances and Discounts)

The following table sets forth the detail of patient service revenue (net of contractual allowances and discounts) prior to the provision for bad debts for the years ended September 30:

	2013	2012
Gross patient service revenue:		
Hospital inpatient	$ 65,977,685	$ 74,617,769
Hospital outpatient	167,953,770	158,591,242
Physician services	8,807,803	8,129,175
Total gross patient service revenue	242,739,258	241,338,186
Deductions - Primarily contractual adjustments and third-party reimbursement agreements	157,856,078	154,724,189
Patient service revenue (net of contractual allowances and discounts)	$ 84,883,180	$ 86,613,997

During 2013 and 2012, approximately 46% and 39%, respectively, of patient service revenue (net of contractual allowances and discounts) related to patients participating in the Medicare and Medicaid programs.

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the years ended September 30, from these major payer sources, is as follows:

	2013	2012
Medicare, Medicaid, Health Maintenance Organization (HMO) Plans, and other third-party payers	$ 72,445,928	$ 73,217,282
Uninsured patients	12,437,252	13,396,715
Patient service revenue (net of contractual allowances and discounts)	$ 84,883,180	$ 86,613,997

Note 11 Self-Insured Health Benefits

Substantially all of the Association's employees are eligible to participate in the Association's health insurance plan. The Association is self-insured for health claims of participating employees and dependents up to limits provided for in an agreement with its insurance plan administrator. A provision is accrued for self-insured employee health claims, including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims, and other economic and social factors. The Association is insured for paid claims for a covered person during the year in excess of $225,000. The Association recorded approximately $9,433,000 and $7,739,000 of expense related to the self-insured plan for the years ended September 30, 2013 and 2012, respectively. The amount accrued for self-insured employee health claims was $648,000 and $422,000 at September 30, 2013 and 2012, respectively, and is included in accrued liabilities in the accompanying consolidated balance sheets.

The Association offers, as an incentive for early retirement, health insurance coverage to retirees and their spouses until the employee or their spouse, whichever is younger, reaches age 65. The amount accrued for the retiree health insurance was $1,111,997 and $862,265 at September 30, 2013 and 2012, respectively, and is included in accrued liabilities in the accompanying consolidated balance sheets.

Note 12 Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets include assets set aside in accordance with donor restrictions as to time or use. Temporarily restricted net assets were available for the following purposes at September 30:

	2013	2012
Health education	$ 321,443	$ 345,563
To purchase equipment	10,000	10,000
To support health care services	367,473	367,473
Total temporarily restricted net assets	$ 698,916	$ 723,036

Note 12 Temporarily and Permanently Restricted Net Assets (Continued)

Permanently restricted net assets have been restricted by donors to be maintained in perpetuity, the income of which is expendable to support the following at September 30:

	2013	2012
To support health care services	$ 22,493,324	$ 19,709,309
To purchase equipment	46,594	46,594
To provide indigent care	2,000	2,000
Total permanently restricted net assets	$ 22,541,918	$ 19,757,903

Note 13 Pension Plan

The Association sponsors a defined contribution pension plan, which is available to substantially all Association employees. The Association contributes an amount equal to 6.0% of each eligible participant's annual compensation. Pension expense was approximately $1,679,000 and $1,711,000 in 2013 and 2012, respectively.

Note 14 Malpractice Insurance and Contingencies

The Association has joined together with other providers of health care services to form the Illinois Provider Trust and the Illinois Compensation Trust, two risk pools (the "Pools") currently operating as common risk management and insurance programs for its members. The Association pays annual premiums to the Pools for its general liability torts, medical malpractice, and employee injuries insurance coverage. The Pools' governing agreements specify that the Pools will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of specified stop-loss amounts.

Note 14 Malpractice Insurance and Contingencies (Continued)

The Association purchases medical malpractice insurance described above under a claims-made policy on a fixed premium basis. The policy is maintained for claim losses of $7,000,000 for each occurrence. Under a claims-made policy, the risk for claims and incidents not asserted within the policy period remains with the Association. In accordance with FASB ASC 954-450 *Health Care Entities Contingencies*, the Association has recorded $4,300,000 of liabilities for estimated malpractice claims incurred through September 30, 2013, with a corresponding receivable of $3,848,219 for expected recoveries from insurance related to these claims.

At September 30, 2013, the Association had letters of credit for employee injuries insurance coverage of approximately $1,311,000.

Note 15 Functional Expenses

The Association provides general health care services to residents within its geographic location. Expenses related to providing these services consisted of the following:

	2013	2012
Health care services	$ 71,760,879	$ 68,665,601
General and administrative	18,132,438	17,492,361
Total expenses	$ 89,893,317	$ 86,157,962

Note 16 Concentration of Credit Risk

Financial instruments that potentially subject the Association to possible credit risk consist principally of accounts receivable, cash deposits in excess of insured limits, and investments.

Accounts receivable consist of amounts due from patients, their insurers, or governmental agencies (primarily Medicare and Medicaid) for health care provided to the patients. The majority of the Association's patients are from Jacksonville, Illinois, and the surrounding area.

The mix of receivables from patients and third-party payers was as follows at September 30:

	2013	2012
Medicare	30 %	19 %
Medicaid	19 %	38 %
Other third-party payers	35 %	30 %
Patients	16 %	13 %
Totals	100 %	100 %

The Association maintains depository relationships with area financial institutions that are Federal Deposit Insurance Corporation (FDIC) insured institutions. The Association maintains cash in accounts at these institutions which are insured by the FDIC up to $250,000. At September 30, 2013, the Association had approximately $6,980,000 of cash in excess of insured limits. In addition, other investments held by financial institutions are uninsured.

Note 17 Reclassifications

Certain reclassifications have been made to the 2012 financial statements to conform to the 2013 classifications.

Note 18 Subsequent Event

On December 31, 2013, the Board of Directors of the Association approved an affiliation agreement with Memorial Health System (MHS), an Illinois nonprofit corporation located in Springfield, Illinois. The closing date of the affiliation is expected to be March 31, 2014, subject to the timely receipt of certain regulatory approvals. Under the terms of the affiliation agreement, MHS will become the sole member of the Hospital and elect the directors of the Hospital from a slate of candidates recommended by the Hospital Board of Directors. MHS and the Hospital Board of Directors will collaboratively appoint the Chief Executive Officer of the Hospital. The Hospital will remain as the sole member of each of its affiliates. There will be no transfer of assets or assumption of liabilities as a result of the affiliation.

The Association and MHS believe the affiliation will benefit the residents of central Illinois by enabling the Association and MHS to undertake joint efforts to create a comprehensive and integrated delivery system that will better service the residents of the Association's service area, and help meet the clinical, financial, and technological demands of delivering health care in central Illinois.