Southern Indiana Rehabilitation Hospital

Financial Statements

Years Ended December 31, 2012 and 2011

With Independent Auditor's Report

0512-0698572

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Financial Statements

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BKD LLP
CPAs & Advisors

600 N. Hurstbourne Parkway, Suite 350
P.O. Box 22127
Louisville, KY 40252-0127
502.581.0435 Fax 502.581.0723 www.bkd.com

Independent Auditor's Report

Board of Directors
Southern Indiana Rehabilitation Hospital
New Albany, Indiana

We have audited the accompanying financial statements of Southern Indiana Rehabilitation Hospital (Hospital), which comprise the balance sheets as of December 31, 2012 and 2011, and the related 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 Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 we plan and perform the audit to obtain reasonable assurance about whether the 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 financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital's preparation and fair presentation of the 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 Hospital'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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Louisville, Kentucky
July 23, 2013

Southern Indiana Rehabilitation Hospital

Balance Sheets

	December 31, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	**$ 3,871,011**	$ 3,646,840
Patient accounts receivable, less allowance for doubtful accounts of $226,269 in 2012 and $150,456 in 2011	**2,758,391**	2,432,539
Prepaid expenses and other current assets	**75,172**	188,983
Advances to JHSMH	**–**	5,645
Total current assets	**6,704,574**	6,274,007
Property and equipment, net	**5,219,667**	5,837,003
Deferred financing costs	**71,534**	93,545
Total assets	**$ 11,995,775**	$ 12,204,555
Liabilities and Net Assets		
Current liabilities:		
Accounts payable:		
Trade	**$ 250,507**	$ 287,499
Advances from JHSMH	**183,475**	–
Accrued expenses	**1,052,178**	983,676
Current portion of long-term debt	**600,000**	600,000
Estimated liability for excess third party payments	**115,738**	130,211
Total current liabilities	**2,201,898**	2,001,386
Long-term debt	**1,350,000**	1,950,000
Liability for defined benefit pension plan	**3,465,584**	3,414,192
Interest rate swap liability	**90,540**	140,320
Net assets:		
Unrestricted	**4,887,753**	4,698,657
Total liabilities and net assets	**$ 11,995,775**	$ 12,204,555

See accompanying notes to financial statements.

Southern Indiana Rehabilitation Hospital

Statements of Operations and Changes in Net Assets

	Year Ended December 31, 2012	2011
Revenue:		
Net patient service revenue	**$ 18,137,378**	$17,177,551
Other revenue	**182,376**	179,718
Total revenue	**18,319,754**	17,357,269
Expenses:		
Personnel	**11,339,338**	11,136,337
Purchased services	**3,379,681**	3,428,544
Interest	**102,183**	129,398
Depreciation and amortization	**792,125**	837,635
Supplies	**837,453**	814,896
Professional fees	**288,696**	413,198
Provision for doubtful accounts	**160,868**	(59,695)
Other	**829,410**	735,005
Total operating expenses	**17,729,754**	17,435,318
Operating income (loss)	**590,000**	(78,049)
Interest income	**2,303**	8,822
Change in fair value of interest rate swap	**49,780**	40,675
Excess (deficiency) of revenue over expenses	**642,083**	(28,552)
Net assets released for specific capital purposes	**27,492**	–
Change in pension net loss and prior service cost	**(480,479)**	(1,413,451)
Increase (decrease) in unrestricted net assets	**189,096**	(1,442,003)
Unrestricted net assets at beginning of year	**4,698,657**	6,140,660
Unrestricted net assets at end of year	**$ 4,887,753**	$ 4,698,657

See accompanying notes to financial statements.

Southern Indiana Rehabilitation Hospital

Statements of Cash Flows

	Year Ended December 31 2012	2011
Operating activities		
Increase (Decrease) in net assets	**$ 189,096**	$ (1,442,003)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	**792,125**	837,635
Provision for doubtful accounts	**160,868**	(59,695)
Change in fair value of interest rate swap agreement	**(49,780)**	(40,675)
Change in pension net loss and prior service cost	**480,479**	1,413,451
Changes in operating assets and liabilities:		
Patient accounts receivable	**(486,720)**	434,210
Estimated amounts due to/from third parties	**(14,473)**	138,131
Prepaid expenses and other current assets	**113,811**	38,672
Accounts payable–trade	**(36,992)**	(217,194)
Advances to/from JHSMH	**189,120**	(144,987)
Accrued expenses	**68,502**	17,931
Liability for defined benefit pension plan	**(429,087)**	(39,530)
Net cash provided by operating activities	**976,949**	935,946
Investing activities		
Maturity of short term investments	**–**	1,250,000
Purchases of property and equipment	**(152,778)**	(50,603)
Net cash provided by (used in) investing activities	**(152,778)**	1,199,397
Financing activities		
Principal payments on long-term debt	**(600,000)**	(600,000)
Net cash used in financing activities	**(600,000)**	(600,000)
Increase in cash and cash equivalents	**224,171**	1,535,343
Cash and cash equivalents at beginning of year	**3,646,840**	2,111,497
Cash and cash equivalents at end of year	**$ 3,871,011**	$ 3,646,840
Additional cash flow information:		
Cash paid during the period for interest	**$ 94,981**	$ 124,198

See accompanying notes to financial statements.

1. Organization and Accounting Policies

Organization

Southern Indiana Rehabilitation Hospital (the Hospital) is a not-for-profit unincorporated association located in Floyd County, Indiana. The Hospital was formed to provide inpatient long-term care and rehabilitation services for patients suffering brain and spinal cord injuries, strokes, amputations, burns, pulmonary conditions and other disorders. The Hospital also provides acute and chronic outpatient services. Effective March 1, 2002, the Hospital converted from an acute long-term care facility to an acute rehabilitation facility. Effective July 16, 2007, the Hospital converted 22 acute beds to form a skilled nursing unit.

The Hospital is a joint venture owned equally by Clark Memorial Hospital (Clark), Floyd Memorial Hospital and Health Services (Floyd) and Jewish Hospital & St. Mary's HealthCare, Inc. (JHSMH) (collectively, the Affiliates).

Following are the Hospital's significant accounting policies:

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents.

Effective July 21, 2010, the Federal Deposit Insurance Corporation's (FDIC) insurance limits were permanently increased to $250,000. At December 31, 2012, the Hospital's cash exceeded federally insured limits by approximately $3,828,000.

1. Organization and Accounting Policies (continued)

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients, and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debt based on individual credit evaluation and specific circumstances of the account.

Property and Equipment

Property and equipment are recorded at cost if purchased, or at fair value if donated. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets.

Long-lived Asset Impairment

The Hospital evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. There were no impairments recognized during the years ended December 31, 2012 and 2011.

Deferred Financing Costs

Deferred financing costs are being amortized on the straight-line basis over the term of the related debt.

1. Organization and Accounting Policies (continued)

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive revenue adjustments due to future audits by third-party payors. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits by third-party payors. Changes to prior year estimates had no effect on net patient service revenue for the years ended December 31, 2012 and 2011.

Charity and Uncompensated Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge. The Hospital's charity care policy allows for flexibility in identifying patients that need assistance but have not cooperated with ability-to-pay verification requirements. The Hospital applies certain demographic and credit criteria that is modeled after criteria used in the healthcare industry. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, revenue is not recorded for such services. The Hospital's policy is to estimate the charity care cost by using cost accounting software. The Hospital's charity care at cost for the years ended December 31, 2012 and 2011, is $54,600 and $44,000, respectively.

Functional Expenses

The Hospital's general and administrative costs represented approximately 13% and 15% of total operating expenses for the years ended December 31, 2012 and 2011, respectively.

Excess of Revenue Over Expenses

The 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 changes in pension net loss and prior service costs 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).

1. Organization and Accounting Policies (continued)

Income Taxes

The Hospital is exempt from federal income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. However, some of its income may be subject to taxation as unrelated business income. The Hospital files tax returns in the U.S. federal jurisdictions. With a few exceptions, the Hospital is no longer subject to U.S. federal examinations by tax authorities for years before 2008.

Uncertain Tax Positions

Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 740 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Hospital does not have any uncertain tax positions recognized for 2012 or 2011.

2. Net Patient Service Revenue

Net patient service revenue for the years ended December 31, 2012 and 2011, is comprised of:

	2012	**2011**
Charges at established rates	**$ 57,014,037**	$ 55,134,780
Deductions for charity	**223,188**	179,969
	56,790,849	54,954,811
Medicare contractual adjustments	**26,934,589**	27,418,781
Medicaid contractual adjustments	**3,262,594**	3,054,933
Other contractual adjustments	**8,456,288**	7,303,546
	38,653,471	37,777,260
Net patient service revenue	**$ 18,137,378**	$ 17,177,551

2. Net Patient Service Revenue (continued)

Reimbursement from the Medicare and Medicaid programs are subject to annual cost reports, which are subject to audit by the programs. The Hospital's management believes that amounts recorded in the financial statements for estimated settlements will approximate the final settlements for open cost reports. The Hospital's cost reports have been audited and settled through December 31, 2008.

In the health care industry, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Hospital believes that it is in substantial compliance with all applicable laws and regulations. Compliance with health care industry 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. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Hospital has agreements with Medicare, Medicaid and other third-party payors that provide for payments at amounts different from their established rates. A summary of the payment arrangements with major third-party payors is described in the following paragraphs.

Medicare

Effective March 1, 2002, the Medicare program began reimbursing inpatient rehabilitation services on a prospective payment system based on principal diagnosis. Outpatient rehabilitation services are reimbursed based on a predetermined rate. Skilled nursing facility (SNF) services are reimbursed on a prospective payment system where rates are adjusted for case mix and geographical location.

Medicare revenue was approximately 66% and 69% of net patient service revenue for the years ended December 31, 2012 and 2011, respectively.

Medicaid

The Medicaid program reimburses the Hospital and SNF on a predetermined rate per patient day for inpatient and outpatient services. Medicaid revenue was approximately 3% and 2% of charges at established rates for the years ended December 31, 2012 and 2011, respectively.

2. Net Patient Service Revenue (continued)

Other

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

3. Property and Equipment

Property and equipment consists of the following at December 31:

	2012	**2011**
Land and land improvements	**$ 553,046**	$ 553,046
Buildings and improvements	**15,195,314**	15,178,539
Equipment	**4,812,627**	4,725,792
	20,560,987	20,457,377
Less accumulated depreciation	**15,341,320**	14,620,374
Property and equipment, net	**$ 5,219,667**	$ 5,837,003

4. Financing Arrangements

On April 26, 2001, the Indiana Health Facility Financing Authority issued $10,550,000 of Adjustable Rate Health Care Facilities Revenue Bonds, Series 2001 (the Bonds) on behalf of the Hospital. The proceeds of the Bonds were used to repay outstanding debt due to Affiliates, pay a portion of the costs related to the issuance of the Bonds, and finance a portion of the costs of various capital improvements to the Hospital's facility.

The Bonds, which are stated to mature on April 1, 2016, bear interest at an adjustable rate (.20% at December 31, 2012 and 2011) that is set weekly based upon current market conditions. The variable rate Bonds may be converted to a fixed rate at any time at the option of the Hospital.

4. Financing Arrangements (continued)

While the Bonds are at a variable rate, redemption can occur prior to maturity, at the option of the Hospital, at a redemption price of 100% of the principal amount, plus accrued interest. Likewise, the bondholders may tender the Bonds at a price of 100% of the principal amount, plus accrued interest. If the Bonds are converted to a fixed rate, redemption can occur thereafter, at the option of the Hospital, at par plus a call premium of 2% that reduces to par depending on the length of time between the date of conversion from a variable rate to a fixed rate and the maturity date of the Bonds.

The Hospital has entered into a remarketing agreement with an agent to resell the Bonds should a bondholder exercise their option to sell. The Bonds are secured through a direct-pay letter of credit and reimbursement agreement (Agreement) provided by a bank that expires on April 15, 2016 with repayment terms in 12 equal quarterly installments commencing on the 367th calendar day after such unsuccessful remarketing of the Bonds. The Agreement places certain limits on the incurrence of additional borrowings and requires that certain measures of financial performance be maintained so long as the Agreement is outstanding.

The Bonds are subject to redemption in semi-annual amounts. The agreement with the Bond Trustee is that the Hospital is to make semi-annual payments to the nearest $100,000 redemption denomination in accordance with the maturity schedule. The Hospital has made all of the semi-annual payments in accordance with the agreement for the years 2002 through 2012.

The Hospital's aggregate annual maturities of long-term debt, reflecting the terms of the Bonds for the years ended December 31 are as follows:

2013	$ 600,000
2014	600,000
2015	600,000
2016	150,000
	$ 1,950,000

4. Financing Arrangements (continued)

Subsequent to the issuance of the 2001 Bonds, the Hospital entered into an interest rate swap agreement for interest rate management purposes. Under the terms of the agreement, the Hospital pays a fixed rate of 4.59% and receives a floating rate on the basis of the London Interbank Offered Rate (LIBOR BBA) on a notional amount of 67% of the par value of the Bonds ($1,306,500 and $1,708,500 at December 31, 2012 and 2011). The interest rate swap agreement expires on April 1, 2016. The interest rate swap was originally designated by the Hospital as a cash flow hedge of variable-rate debt with no hedge ineffectiveness; therefore, changes in the fair value of the interest rate swap agreement were recorded as a change in unrestricted net assets. However, on January 8, 2007, the Hospital voluntarily discontinued hedge accounting related to the interest rate swap agreement. Any changes in the fair value of the interest rate swap agreement that occurred after March 31, 2007, were recorded as income or expense in the statements of operations. The interest differential to be paid or received under the interest rate swap agreement is accrued and recognized as an adjustment to interest expense.

The Hospital has recognized a liability of approximately $91,000 and $140,000 for the years ended December 31, 2012 and 2011, respectively, which represents the fair value of the interest rate swap agreement.

5. Related Party Transactions

The Hospital has a management agreement with JHSMH. Under the agreement, JHSMH provides certain management services to the Hospital, which primarily includes administrative services including JHSMH providing a full-time chief executive officer. JHSMH provides the services at cost, as defined in the management agreement.

Clark and Floyd have also agreed to provide certain ancillary services to the Hospital at cost, as defined.

Transactions with related parties for the years ended December 31, 2012 and 2011, are summarized below:

	2012	**2011**
Personnel costs and management fees charged by JHSMH	**$ 1,220,004**	$ 1,220,004
Ancillary services provided by		
Clark	**$ 728,489**	$ 778,209
Floyd	**$ 684,532**	$ 681,260

5. Related Party Transactions (continued)

Personnel and ancillary services provided by the Affiliates for the years ended December 31, 2012 and 2011, are included in purchased services in the statements of operations and changes in net assets.

The balance sheets as of December 31, 2012 and 2011, carried the following ancillary services payable to Clark and Floyd, and personnel costs and management fees payable to JHSMH:

	2012	2011
Payables to		
Clark	**$ 117,986**	$ 60,254
Floyd	**67,574**	60,352
JHSMH	**183,475**	-

At December 31, 2011, the Hospital had a receivable of $5,645 from JHSMH.

6. Concentration of Credit Risk

The Hospital grants credit to, without requiring collateral from, its patients. The mix of receivables from patients and third-party payors at December 31, 2012 and 2011, follows:

	2012	**2011**
Medicare	**55%**	42%
Medicaid	**13**	12
Blue Cross	**12**	16
Other payors	**20**	30
Total	**100%**	100%

7. Insurance

Because of the nature of its operations, the Hospital is at all times subject to pending and threatened legal actions, which arise in the normal course of its activities. Effective January 1, 2004, the Hospital changed its insurance coverage from an occurrence basis to a claims-made basis. Because the claims-made policy only covers claims that have been asserted and incidents reported to the insurance carrier, these unknown incidents are not yet covered by insurance. Management intends to maintain the current claims-made excess insurance coverage to cover any unknown incidents that may be asserted.

8. Retirement Plan

The Hospital provides a defined benefit pension plan covering substantially all of the Hospital's employees. The funding policy of the defined benefit plan is consistent with the funding requirements of federal law and regulations. The plan's measurement dates and fiscal year end dates are December 31 for both years presented. Components of net periodic pension benefit cost for the years ended December 31, 2012 and 2011, are as follows:

	2012	**2011**
Service cost	**$ 495,219**	$ 409,052
Interest cost	**368,743**	329,512
Expected return on plan assets	**(370,916)**	(322,084)
Recognized actuarial loss	**242,867**	103,990
Net periodic pension cost	**$ 735,913**	$ 520,470

The net loss recognized in unrestricted net assets for the years ended December 31, 2012 and 2011, was ($480,479) and ($1,413,451) respectively. Included in unrestricted net assets at December 31, 2012 and 2011, respectively, are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized actuarial loss of $3,380,009 and $2,899,530. The actuarial loss expected to be recognized during the year ending December 31, 2013, is $274,241.

8. Retirement Plan (continued)

The change in benefit obligation and the fair value of plan assets, and the funded status of the plan assets for the year ended December 31, 2012 and 2011, are as follows:

	2012	2011
Benefit obligation, beginning of year	**$ 7,428,751**	$ 5,532,911
Service cost	**495,219**	409,052
Interest cost	**368,743**	329,512
Actuarial loss	**943,036**	1,216,950
Benefits paid	**(89,923)**	(59,674)
Benefit obligation, end of year	**9,145,826**	7,428,751
Fair value of plan assets, beginning of year	**4,014,559**	3,492,640
Actual return on plan assets	**590,606**	21,593
Employer contributions	**1,165,000**	560,000
Benefits paid	**(89,923)**	(59,674)
Fair value of plan assets, end of year	**5,680,242**	4,014,559
Funded status/net recorded liability	**$ (3,465,584)**	$ (3,414,192)

The above net recorded liability is included in the Hospital's financial statements as a noncurrent liability.

The accumulated benefit obligation for the plan was approximately $7,823,000 and $6,347,000 at December 31, 2012 and 2011, respectively.

The weighted-average assumptions used to determine net periodic pension costs for the years ended December 31, 2012 and 2011, are as follows:

	2012	2011
Discount rate	**5.00%**	6.00%
Expected return on plan assets	**8.50%**	8.50%
Rate of compensation increase	**3.00%**	3.00%

8. Retirement Plan (continued)

The weighted-average assumptions used to determine benefit obligations at December 31 are as follows:

	2012	**2011**
Discount rate	**4.45%**	5.00%
Expected return on plan assets	**8.50%**	8.50%
Rate of compensation increase	**3.00%**	3.00%

The plan assets were invested in the JP Morgan Equity Index Fund Class A (the Fund) at December 31, 2012 and 2011.

The investment objective of the Fund with regard to the plan assets seeks investment results that correspond to the aggregate price and dividend performance of securities in the Standard & Poor 500 Corporate Stock Price Index (S&P 500 Index).

The Fund invests mainly in stocks included in the S&P 500 Index. The Fund also may invest in stock index futures and other equity derivatives. The Fund manager attempts to track the investment performance of the S&P 500 Index to achieve a correlation of 0.95 between the performance of the Fund and that of the S&P 500 Index without taking into account the Fund's expenses.

Following is a description of the valuation methodologies and inputs used for pension plan assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of pension plan assets pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, plan assets are classified within Level 1 of the valuation hierarchy. Level 1 plan assets include money market funds and mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of plan assets with similar characteristics or discounted cash flows. In certain cases where Level 1 or Level 2 inputs are not available, plan assets are classified within Level 3 of the hierarchy. There are no Level 2 or 3 plan assets.

8. Retirement Plan (continued)

The fair values of Hospital's pension plan assets at December 31 by asset category are as follows:

		2012		
		Fair Value Measurements Using		
Asset Category	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$ 50,907	$ 50,907	$ -	$ -
Mutual funds (A)	5,629,335	5,629,335	-	-
	$ 5,680,242	$ 5,680,242	$ -	$ -

		2011		
		Fair Value Measurements Using		
Asset Category	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	$ 55,218	$ 55,218	$ -	$ -
Mutual funds (A)	3,959,341	3,959,341	-	-
	$ 4,014,559	$ 4,014,559	$ -	$ -

8. Retirement Plan (continued)

(A) Mutual funds invest in common stock of large-cap U.S. companies and cash and cash equivalents

The Hospital expects to contribute approximately $283,500 to the defined benefit pension plan in 2013.

Benefits expected to be paid to the Plan's beneficiaries are as follows:

2013	$ 119,125
2014	$ 137,500
2015	$ 167,250
2016	$ 196,315
2017	$ 228,648
2018 through 2022	$ 1,787,787

9. Disclosures About Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurements*, defines fair value as 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. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy

9. Disclosures About Fair Value of Financial Instruments (continued)

Interest Rate Swap Agreement

The fair value of the interest rate swap is estimated by a third party principally using inputs that are not observable or that cannot be corroborated by observable market data and, therefore, are classified within Level 3 of the valuation hierarchy.

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012 and 2011:

		2012		
		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap agreement	$ (90,540)	$ -	$ -	$ (90,540)

		2011		
		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap agreement	$ (140,320)	$ -	$ -	$ (140,320)

9. Disclosures About Fair Value of Financial Instruments (continued)

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheets using significant unobservable (Level 3) inputs:

	Liability – Interest Rate Swap Agreement
Balance, January 1, 2011	$ (180,995)
Gain included in excess of (expense over revenue) revenue over expenses	40,675
Balance, December 31, 2011	(140,320)
Gain included in excess of revenue over expenses (expenses over revenue)	49,780
Balance, December 31, 2012	$ (90,540)

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value.

Cash and Short-term Investments

The carrying amount approximates fair value.

Long-term Debt

Fair value of debt is estimated based on borrowing rates currently available to the Hospital for debt with similar terms and maturities.

Interest Rate Swap Liability

The fair value was estimated by a third party.

9. Disclosures About Fair Value of Financial Instruments (continued)

Interest Rate Swap Liability (continued)

The carrying amounts and fair value of the Hospital's financial instruments at December 31, 2012 and 2011, are as follows:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 3,871,011	$ 3,871,011	$ 3,646,840	$ 3,646,840
Series 2001 Bonds	$ 1,950,000	$ 1,950,000	$ 2,550,000	$ 2,550,000
Interest rate swap agreement	$ 90,540	$ 90,540	$ 140,320	$ 140,320

10. Commitments and Contingencies

Future minimum annual rental payments under noncancelable operating lease and service agreements, which expire on various dates through 2015, as of December 31, 2012, are as follows:

2013	$ 119,046
2014	93,403
2015	22,344
	$ 234,793

11. Current Economic Conditions

The current economic situation continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

11. Current Economic Conditions (continued)

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values for defined benefit pension plan investments and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

12. Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid, and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees see insurance coverage through the insurance exchanges. It is possible that the reimbursement rates paid by insurers participating in the insurance exchange may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs such as Medicare low income patient adjustment, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

12. Patient Protection and Affordable Care Act (continued)

In April 2012, the state of Indiana submitted a waiver to the Centers for Medicare and Medicaid Services requesting permission to expand coverage to expansion-eligible residents through its Healthy Indiana Plan. The impact of that decision on the overall reimbursement to the Hospital cannot be quantified at this point.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible that it will have a negative impact on the Hospital's net patient service revenue. Additionally, it is possible the Hospital will experience payment delays and other operational challenges during the PPACA's implementation.

13. Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report which is the date the financial statements were available to be issued.