



**UNION HOSPITAL INC. AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AUGUST 31, 2012 AND 2011**

*CPAs / ADVISORS*



# UNION HOSPITAL INC. AND SUBSIDIARIES

## TABLE OF CONTENTS AUGUST 31, 2012 AND 2011

---

	Page
<b>Report of Independent Auditors</b> .....	1
<b>Financial Statements</b>	
Consolidated Balance Sheets .....	3
Consolidated Statements of Operations and Changes in Net Assets .....	5
Consolidated Statements of Cash Flows .....	6
Notes to Consolidated Financial Statements .....	7
<b>Supplementary Information</b>	
Consolidating Balance Sheets - 2012 .....	35
Consolidating Balance Sheets - 2011 .....	37
Consolidating Statements of Operations – 2012.....	39
Consolidating Statements of Operations – 2011 .....	40
Schedule of Expenditures of Federal Awards – Year Ended August 31, 2012 .....	41
<b>Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i></b> .....	42
<b>Report of Independent Auditors on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133</b> .....	44
<b>Schedule of Findings and Questioned Costs – Year Ended August 31, 2012</b> .....	46

---



Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282  
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

## REPORT OF INDEPENDENT AUDITORS

Board of Directors  
Union Hospital  
Terre Haute, Indiana

We have audited the accompanying consolidated balance sheets of Union Hospital, Inc. and Subsidiaries (the Corporation) as of August 31, 2012 and 2011, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and Guidelines for Examinations of Entities Receiving Financial Assistance from Governmental Sources, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

As explained in Note 1 to the consolidated financial statements, the Corporation is part of an affiliated group of entities and has entered into transactions with the group members. The Corporation is also included in the reporting entity, Union Health System, Inc., and the accompanying consolidated financial statements include only the financial position, results of operations, changes in net assets and cash flows of the Corporation.

Board of Directors  
Union Hospital  
Terre Haute, Indiana

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2012, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements. The supplementary information listed in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements of the Corporation. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

November 13, 2012

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS AUGUST 31, 2012 AND 2011

<b>ASSETS</b>	2012	2011
<b>Current assets</b>		
Cash and cash equivalents	\$ 33,232,355	\$ 30,851,734
Funds held by trustee, current portion	9,357,980	9,495,137
Board designated funds, current portion	11,931,261	1,920,497
Patient accounts receivable, net	51,218,192	49,370,995
Other receivables	26,765	103,332
Estimated third party settlements	-0-	610,058
Inventories	4,361,427	4,386,794
Prepaid expenses and other current assets	4,249,478	4,366,387
Total current assets	114,377,458	101,104,934
<b>Investments limited as to use, less current portion</b>		
Funds held by trustee	24,270,756	35,640,930
Board designated funds	31,448,900	23,082,881
Permanently restricted	976,358	958,445
Total investments limited as to use	56,696,014	59,682,256
<b>Property and equipment</b>		
Land and improvements	37,291,582	36,075,662
Buildings and fixed equipment	314,488,563	303,802,717
Movable equipment	119,468,982	108,778,840
	471,249,127	448,657,219
Less allowances for depreciation	191,837,773	170,172,589
	279,411,354	278,484,630
Construction in progress	16,123,962	11,882,607
Total property and equipment, net	295,535,316	290,367,237
<b>Other assets</b>		
Due from Union Hospital Foundation, Inc.	4,495,347	5,334,560
Deferred financing costs, net	3,090,878	3,260,902
Intangible assets, net	5,982,856	4,651,848
Other assets	1,876,586	350,488
	15,445,667	13,597,798
Total assets	\$ 482,054,455	\$ 464,752,225

See accompanying notes to consolidated financial statements.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS AUGUST 31, 2012 AND 2011

### LIABILITIES AND NET ASSETS

	<u>2012</u>	<u>2011</u>
<b>Current liabilities</b>		
Accounts payable and other current liabilities	\$ 22,725,206	\$ 20,963,832
Salaries, wages and related liabilities	19,782,599	17,219,558
Accrued interest	7,842,998	7,870,134
Estimated third party settlements	3,073,530	-0-
Current portion of long-term debt	3,476,124	4,199,893
Total current liabilities	<u>56,900,457</u>	<u>50,253,417</u>
<b>Long-term liabilities</b>		
Long-term debt, less current portion	271,498,185	274,379,897
Deferred revenue	301,122	401,447
Pension liability	3,420,210	10,216,562
Other long-term liabilities	5,313,254	2,174,649
Total long-term liabilities	<u>280,532,771</u>	<u>287,172,555</u>
Total liabilities	337,433,228	337,425,972
<b>Net assets</b>		
Unrestricted	139,069,623	121,024,721
Temporarily restricted	4,575,246	5,343,087
Permanently restricted	976,358	958,445
Total net assets	<u>144,621,227</u>	<u>127,326,253</u>
Total liabilities and net assets	<u>\$ 482,054,455</u>	<u>\$ 464,752,225</u>

See accompanying notes to consolidated financial statements.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED AUGUST 31, 2012 AND 2011

	2012	2011
<b>Operating revenue</b>		
Net patient service revenue (net of contractual allowances and discounts including charity care provisions of \$38,737,421 and \$33,138,608, respectively)	\$ 462,535,259	\$ 413,944,492
Provision for bad debts	<u>(41,305,687)</u>	<u>(41,961,395)</u>
Net patient service revenue less provision for bad debts	421,229,572	371,983,097
Other revenue	8,984,417	9,096,654
Total operating revenue	<u>430,213,989</u>	<u>381,079,751</u>
<b>Operating expenses</b>		
Salaries and wages	126,244,707	117,447,940
Employee benefits	27,386,336	27,981,720
Supplies and drugs	67,547,992	70,190,917
Physician services	10,742,853	10,360,628
Contract services	63,669,047	64,761,624
Rent and leases	12,068,132	11,725,759
Utilities, supplies, and other	38,867,921	33,540,280
Hospital assessment fee	17,902,630	-0-
Depreciation and amortization	24,499,566	24,960,978
Interest	14,902,184	13,922,753
Total operating expenses	<u>403,831,368</u>	<u>374,892,599</u>
Income from operations before special charge	26,382,621	6,187,152
<b>Special charge on early retirement</b>		
	-0-	(7,250,873)
Income from operations after special charge	<u>26,382,621</u>	<u>(1,063,721)</u>
<b>Non-operating gains (losses)</b>		
Investment income	583,708	589,620
Other	1,452,434	10,940
Total non-operating gains	<u>2,036,142</u>	<u>600,560</u>
Excess of revenue over (under) expenses	28,418,763	(463,161)
<b>Other changes in unrestricted net assets</b>		
Pension related changes other than net pension cost	(307,884)	3,085,712
Net unrealized gain on investments	845,821	739,114
Net assets released for property and equipment	1,159,747	1,822,200
Transfers to Union Health System	<u>(12,071,545)</u>	<u>(12,062,285)</u>
Change in unrestricted net assets	18,044,902	(6,878,420)
<b>Temporarily restricted net assets</b>		
Other changes in receivable from Union Hospital Foundation, Inc.	391,906	381,873
Net assets released for property and equipment	<u>(1,159,747)</u>	<u>(1,822,200)</u>
Change in temporarily restricted net assets	(767,841)	(1,440,327)
<b>Permanently restricted net assets</b>		
Net investment income	17,913	11,949
Change in net assets	<u>17,294,974</u>	<u>(8,306,798)</u>
<b>Net assets</b>		
Beginning of year	127,326,253	135,633,051
End of year	<u>\$ 144,621,227</u>	<u>\$ 127,326,253</u>

See accompanying notes to consolidated financial statements.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED AUGUST 31, 2012 AND 2011

	2012	2011
<b>Operating activities</b>		
Change in net assets	\$ 17,294,974	\$ (8,306,798)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	21,958,692	22,959,367
Amortization	2,540,874	2,001,611
Provision for bad debts	41,305,687	41,961,395
Transfers to Union Health System	12,071,545	12,062,285
Loss on property disposals	73,927	89,712
Other changes in receivable from Union Hospital Foundation, Inc.	(391,906)	(381,873)
Net unrealized gain on investments	(845,821)	(739,114)
Pension related changes other than net periodic pension cost	307,884	(3,085,712)
Changes in operating assets and liabilities		
Patient accounts receivable	(43,152,884)	(41,580,678)
Other current and noncurrent assets	(3,269,900)	544,296
Accounts payable and other current liabilities	805,374	(1,492,740)
Salaries, wages and related liabilities	2,563,041	1,459,684
Other long-term liabilities	(3,965,631)	905,998
Estimated third-party payor settlements	3,683,588	1,839,465
Accrued interest	(27,136)	2,100,624
Deferred revenue	(100,325)	(106,273)
Net cash flows from operating activities	50,851,983	30,231,249
<b>Investing activities</b>		
Purchases of property and equipment	(26,296,982)	(14,462,312)
Proceeds from sale of equipment and land	52,284	345,581
Payments of intangible asset	(900,000)	-0-
Change in trustee held investments	11,507,331	(17,060,747)
Change in board designated funds and other	(17,548,875)	3,962,770
Net cash flows from investing activities	(33,186,242)	(27,214,708)
<b>Financing activities</b>		
Repayments on long-term debt	(3,867,216)	(36,361,338)
Payment of bond original issue discount	-0-	(1,050,947)
Proceeds from long-term debt	261,735	55,067,659
Other changes in receivable from Union Hospital Foundation, Inc.	391,906	381,873
Transfers to Union Health System	(12,071,545)	(12,062,285)
Net cash flows from financing activities	(15,285,120)	5,974,962
Change in cash and cash equivalents	2,380,621	8,991,503
<b>Cash and cash equivalents</b>		
Beginning of year	30,851,734	21,860,231
End of year	\$ 33,232,355	\$ 30,851,734
<b>Noncash investing activities</b>		
Issuance of capital leases	\$ 601,591	\$ 215,991
Capital acquisitions included in accounts payable	\$ 956,000	\$ -0-

See accompanying notes to consolidated financial statements.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### 1. ORGANIZATION

#### Nature of Operations

Union Hospital, Inc. (Corporation) is an Indiana not-for-profit corporation which owns and operates Union Hospital (the Hospital), a 318 staffed-beds, and regional referral center hospital located in Terre Haute, Indiana. The Hospital is a full-service, acute-care hospital with medical-surgical, obstetric, pediatric, coronary care, post-coronary care, intensive care, maximum care, and medical rehabilitation units. Additionally, as the largest hospital in west central Indiana, the Hospital is a referral center for such services as its newborn intensive care unit (Level II), open heart surgery, cardiac rehabilitation clinic, radiology, cardiopulmonary services, and radiation therapy. The Hospital and its related consolidated entities provide comprehensive health care services to the residents of Terre Haute and the surrounding communities, west central Indiana, and east central Illinois through its acute and specialty care facilities and physician medical practices. Union Hospital, Inc. is exempt from federal income taxes on related function income pursuant to Section 501(c) (3) and Section 501(a) of the Internal Revenue Code.

The consolidated financial statements include the accounts of the Hospital, Union Hospital Clinton (UHC), IPACS, Inc. (IPACS), and the Center for Occupational Health (COH) (collectively, the Corporation and subsidiaries). UHC, wholly owned by the Corporation, is a designated Medicare critical access hospital operating as a division of the Corporation. UHC is a 25-bed general, acute care hospital located in Clinton, Indiana. IPACS is a wholly owned, taxable subsidiary engaged in providing collection services to hospitals, hospital physicians, and other health care providers. COH, wholly owned by the Corporation, provides work related injury care and other occupational medicine services. All material intercompany accounts and transactions have been eliminated.

During 2010, the Corporation became part of an affiliated group. Union Health System, Inc (UHS), an Indiana not-for-profit corporation, is the sole member of Union Associated Physicians Clinic, LLC (UAPC) and the Corporation. Certain physicians who were members or employees of Associated Physicians and Surgeons (AP&S), an outside and unrelated party (physician practice), became employees of UAPC. AP&S continues to provide certain personnel, equipment, supplies and other administrative support to UAPC. The Corporation has entered into transactions with the affiliated group as is disclosed in Note 3. The Corporation is consolidated into the affiliated group financial statements. These financial statements reflect only the financial position, results of operations, changes in net assets and cash flows of the Corporation.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Corporation is also related to various organizations principally through overlapping board membership which does not constitute control. These organizations include Union Hospital Foundation, Inc., Union Hospital Health Services, Inc., and Visiting Nurse Association of the Wabash Valley, Inc. In addition, a majority of all fund-raising activities are conducted by Union Hospital Foundation, Inc. (the Foundation).

Accordingly, unrestricted gifts and bequests received directly by the Corporation are recorded as nonoperating gains, and restricted gifts and bequests received by the Foundation for the benefit of the Corporation are recorded by the Corporation as temporarily restricted net assets until expended by the Corporation for their intended purpose.

### Charity Care and Community Benefit

Patients are provided care regardless of their ability to pay in accordance with charity care policies of the Corporation. These policies define charity care services as those services for which no or reduced payment is anticipated and are based on federal poverty income levels and certain other factors. Because collection of amounts determined to qualify as charity care is not pursued, such amounts are not reported as revenue. The Corporation's charity care policies also extend to services provided by physicians, although records are not maintained for such services provided by the physicians.

Of the Corporation's total expenses reported (approximately \$403,831,000 and \$374,893,000 during 2012 and 2011, respectively), an estimated \$12,512,000 and \$11,333,000 arose from providing services to charity patients during 2012 and 2011, respectively. The estimated costs of providing patient assistance services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Corporation's cost-to-charge ratio provided on the Medicare cost reports.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Corporation also provides programs and services to address the needs of the communities it serves, generally at no, or low, cost to those being served. Specific community needs being addressed by the Corporation include, among others, low-weight births and infant mortality, high incidence of, and deaths from, certain diseases and chronic illnesses, underserved populations, adequacy of the supply of physicians and other health care providers, and certain behavioral risk factors. The Corporation's programs and services include, among others, services to low-income women in need of prenatal care, health screenings for underserved women, wellness and injury prevention programs, chronic disease management assistance, educational programs, rural health care access and availability initiatives, transportation services for elderly and low-income patients, and access to support groups for critically and chronically ill patients and their families. Assistance is also provided to senior citizens and other patients and their families for the submission of forms for insurance, financial counseling, and application to the Medicare and Medicaid programs for health service coverage. The Corporation periodically reviews, modifies, and reports on its Community Health Assessment and Plan of Action for the communities served.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

All significant intercompany balances and transactions have been eliminated in consolidation.

### Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the allowance for estimated uncollectible accounts and estimated third-party payor settlements, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period and could differ from actual results.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### New Accounting Pronouncements

Effective September 1, 2011, the Corporation adopted Accounting Standards Update (ASU) 2010-23, Healthcare Entities (Topic 954) "Measuring Charity Care for Disclosure" which requires certain healthcare entities to disclose the cost of providing charity care. All periods presented have been reclassified to conform to this presentation. The Corporation's adoption of this standard had no net impact on financial position, results of operations, or cash flows. Also ASU 2011-7 "Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities", effective for the first annual period ending after December 15, 2012, has been adopted early by the Corporation. This additional requirement of Topic 954 moves the provision for bad debts from an operational expense to a deduction to arrive at net patient service revenue less provision of bad debts. ASU 2010-24 "Presentation of Insurance Claims and Related Insurance Recoveries", effective for fiscal years beginning after December 15, 2010, has been adopted by the Corporation to properly record health insurance claims and any related recoveries separately on the balance sheet.

### Net Patient Service Revenue and Other

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

*Medicare:* Physician services, inpatient acute care services, and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Critical access hospital services are reimbursed based on cost reimbursement methodologies. Cost reimbursable services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary.

*Medicaid:* Reimbursement for services rendered to Medicaid program beneficiaries are at prospectively determined rates per discharge for inpatient hospital services. Other services are reimbursed based on a combination of cost reimbursement methodologies and prospectively determined rates.

*Other:* Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, preferred provider organizations, and other payors, based on prospectively determined rates per discharge or discount of charges for inpatient hospital services and discount of charges for outpatient services.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated settlements could change by a material amount in the near term.

Management believes that adequate provisions have been made for any adjustments which may result from such final settlements. Differences between prior estimates and subsequent actual settlements are immaterial to these financial statements for 2012 and 2011.

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets follows:

	<u>2012</u>	<u>2011</u>
Inpatient revenue	\$ 517,090,741	\$ 505,831,476
Outpatient revenue	606,605,537	550,762,004
Physician revenue	<u>53,626,628</u>	<u>43,444,326</u>
Gross patient revenue	1,177,322,906	1,100,037,806
Charity care revenue foregone	38,737,421	33,138,608
Bad debt expense	41,305,687	41,961,395
Contractual adjustments	<u>676,050,226</u>	<u>652,954,706</u>
Total adjustments	<u>756,093,334</u>	<u>728,054,709</u>
Net patient service revenue	<u>\$ 421,229,572</u>	<u>\$ 371,983,097</u>

A summary of gross patient service revenue at established rates by payor source for 2012 and 2011, respectively, is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	46%	47%
Medicaid	16%	16%
Commercial insurance	3%	3%
Other managed care	27%	26%
Self-pay and other	<u>8%</u>	<u>8%</u>
	<u>100%</u>	<u>100%</u>

There is a single insurance provider that constituted 17% of patient service revenue at established rates for the years ended August 31, 2012 and 2011.

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding investments limited as to use. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate fair value.

### Patients Accounts Receivable, Estimated Third Party Settlements, and Net Patient Service Revenue

Patients accounts receivable and net patient service revenue are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered. Net patient service revenue includes estimated retroactive adjustments under reimbursement agreements with certain third-party payors (principally for the Medicare program). Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, adjusted in future periods as final settlements are determined, and are included with estimated receivables from third-party payors.

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Corporation analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Corporation analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Corporation records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

During 2012, the Corporation's allowance for uncollectible accounts stayed consistent at approximately \$19,100,000. As of August 31, 2012, the allowance for uncollectible accounts of \$19,100,000 was comprised of approximately \$11,884,000 reserved for self-pay balances and approximately \$7,204,000 reserved for third-party payor balances. As of August 31, 2011, the allowance for uncollectible accounts of \$19,100,000 was comprised of approximately \$10,433,000 reserved for self-pay balances and approximately \$8,702,000 reserved for third-party payor balances.

The Corporation grants credit to patients, substantially all of whom are local residents of the communities served. The Corporation does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The Corporation has not changed its charity care or uninsured discount policies during 2012 or 2011.

At August 31, 2012 and 2011, net accounts receivable from patients and third party were comprised of the following:

	<u>2012</u>	<u>2011</u>
Medicare	32%	38%
Medicaid	13%	10%
Commercial insurance	7%	6%
Other managed care	28%	34%
Self-pay and other	20%	12%
	<u>100%</u>	<u>100%</u>

The allowance for doubtful accounts is based on management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy for uncollectible receivables based upon the payor composition and aging of receivables as of the reporting date with consideration of the historical write-off experience by payor category. The results of these reviews are then used to make any modifications to the provision for uncollectible receivables to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the Corporation follows established guidelines for placing past-due patient accounts with collection agencies.

### Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost or market and principally valued using the average cost method.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### Investments Limited as to Use

Investments limited as to use are stated at fair value. The fair value of assets is based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The cost of securities sold is based on the specific identification method. Dividends and interest income and realized gains and losses on sales of investments are recorded as nonoperating gains (losses). Unrealized appreciation and temporary depreciation (temporary losses) of investments are reported as other changes in net assets in the consolidated statements of operations and changes in net assets.

Investments are generally commingled for investment purposes and consist of short-term investments (principally money market mutual funds), U.S. government and governmental agency obligations, mutual and common trust funds, corporate obligations, marketable equity securities, and guaranteed investment contracts. Fair values for investments, with the exception of guaranteed investment contracts, are based on quoted market prices. Guaranteed investment contracts are valued at fair value as reported by the custodian.

Investments limited as to use include investments set aside by the Board of Directors for future capital improvements and retirement of debt over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes; investments held by trustees under bond indenture agreements; and donor-restricted funds. Amounts that are required for obligations classified as current liabilities, and other amounts previously paid from operating cash that are to be reimbursed by the applicable funds held by trustee project fund, are reported in current assets.

### Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows: land improvements 3 to 30 years, buildings 5 to 40 years, and equipment 3 to 25 years. The Corporation's policy is to designate certain available unrestricted net assets for expansion and renovation.

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs are capitalized as a component of the cost of constructing the assets. In addition, interest earnings on unexpended borrowed project funds related to tax-exempt financings are netted against capitalized interest. Net interest costs capitalized approximated \$1,528,000 in 2012 and \$754,000 in 2011. Repair and maintenance costs are expensed when incurred.

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Corporation periodically evaluates whether circumstances have occurred that would indicate whether the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, an estimate is made of the undiscounted cash flows over the remaining life of the assets in measuring whether the asset is recoverable in accordance with accounting standards.

### Intangible Assets

Intangible assets arising from the purchase of physician practices (primarily medical records and non-compete provisions) are carried at cost. Amortization is computed using the straight-line method based on the assets' estimated useful lives.

### Unamortized Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt are amortized using the bonds outstanding method, which approximates the amortization under the effective interest rate method, and are included in depreciation and amortization in the accompanying consolidated statements of operations and changes in net assets.

### Medical Malpractice Insurance

The Corporation and its employed physicians with active Indiana medical licenses are qualified as health providers under the Indiana Medical Malpractice Act (the Medical Malpractice Act). The Medical Malpractice Act limits liability for malpractice claims against qualified health care providers such as the Corporation. The law provides for a mandatory State Patient's Compensation Fund (the Compensation Fund) to which qualified health care providers contribute a surcharge. The amount of the surcharge is established by the Indiana Department of Insurance on an actuarial basis. The amount contributed by each hospital must be sufficient to cover, but may not exceed, the actuarial risk posed to the Compensation Fund by such hospital and its employed physicians with active Indiana medical licenses. For malpractice incidents occurring after December 31, 1989, and before July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of \$750,000 per claim (\$3,000,000 annual aggregate); the related health care provider is liable for up to \$100,000 of the recovery. For malpractice incidents occurring on or after July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per claim (\$7,500,000 annual aggregate); the related health care provider is liable for up to \$250,000 of the recovery.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

Effective December 31, 2003, the Corporation became a member in a Vermont captive insurance company, Indiana Healthcare Reciprocal Risk Retention Group, Inc., to fund the Corporation's required portion of the insurance coverage pursuant to the Medical Malpractice Act, as well as its general liability insurance.

The Corporation also provides medical malpractice insurance for its employed physicians who practice in the state of Illinois with limits of \$1,000,000 per occurrence and \$3,000,000 in the aggregate.

Malpractice insurance coverage provided through the Compensation Fund and the captive insurance company is provided on a claims-made basis. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured.

### Pension Plans

A noncontributory, defined-benefit pension plan covers substantially all employees. Plan benefits are based on years of service and the employee's compensation. Contributions to the plan include amortization of prior service costs plus interest thereon and are funded currently. During 2010, the Corporation froze the defined benefit plan and initiated a discretionary match component to the 403b defined contribution plan. During 2011, the Corporation offered a voluntary early retirement program for eligible employees to receive monthly annuities, removal of early retirement penalties and reductions, and health benefits for eighteen months per COBRA requirements for the employee and dependents.

### Financial Statement Presentation

The Corporation is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets) based upon the existence or absence of donor imposed restrictions.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### Net Assets

Temporarily restricted net assets are those assets whose use by the Corporation has been limited by donors primarily for a specified time period or purpose. When a donor restriction expires or is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released for property and equipment. Temporarily restricted net assets include \$4,495,347 and \$5,334,560 of funds held by the Foundation for the benefit of the Corporation at August 31, 2012 and 2011, respectively. Due from Union Hospital Foundation, Inc. represents contributions received on behalf of the Corporation by the Foundation and other amounts the Foundation has granted to the Corporation. Other miscellaneous funds are held as temporarily restricted net assets. Permanently restricted net assets are those that the donor has requested to be held in perpetuity. In accordance with donor stipulations, certain investment income earned on permanently restricted net assets is unrestricted. Accordingly such income is recorded in the unrestricted net asset class as it is earned.

### Deferred Income

Deferred revenue represents amounts received in advance for services to be rendered. Revenue will be recognized as the services are provided.

### Health Insurance

The Corporation's employee health care insurance is provided through a combination of self-insurance and purchased re-insurance coverage from a commercial carrier. The Corporation maintains an estimated liability for the amount of claims incurred but not reported. Substantially all employees are covered for major medical benefits. The specific annual attachment point for an individual is \$325,000 with a life-time maximum of \$1,200,000. There is no aggregate limit on claims.

### Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were \$378,268,842 and \$354,910,823 in 2012 and 2011, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to \$25,562,526 and \$19,981,776 in 2012 and 2011, respectively.

### Income Taxes

The Corporation is organized as a not-for-profit corporation under Section 501(c) (3) of the United States Internal Revenue Code. As such, the Corporation is generally exempt from income taxes. However, the Corporation is required to file Federal Form 990 and 990T.

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Corporation and recognize a tax liability if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Corporation, and has concluded that as of August 31, 2012 and 2011, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying financial statements. The Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Filings are current through 2011. The impact of the subsidiaries tax consequences is immaterial to these financial statements.

### Operating Indicator

The Corporation's operating indicator (income from operations) includes all unrestricted net income, gains and support, and expenses from Corporation operations directly related to recurring and ongoing health care operations during the reporting period. The operating indicator excludes interest, dividend, and realized gains and losses on sales of investments, contributions, and gains and losses deemed by management not to be directly related to providing health care services.

### Advertising Costs

Advertising costs are expensed as incurred. Total expense for 2012 and 2011 was \$443,239 and \$504,200, respectively.

### Performance Indicator

The Corporation's performance indicator (excess of revenue over (under) expenses) includes all changes in unrestricted net assets other than net unrealized appreciation and temporary losses on investments, investment returns restricted by donors, changes in pension plan funded status, contributions of property and equipment, and equity transactions.

### Subsequent Events

The Corporation has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is November 13, 2012.

### Reclassifications

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation. These reclassifications had no impact on net assets and changes in net assets for 2011, as previously reported.

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### Electronic Health Records (EHR) Incentive Payments

The Corporation receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, the Corporation must meet "meaningful use" criteria that become more stringent over time. The Corporation periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30<sup>th</sup>). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Corporation's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, Medicare and Medicaid utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Corporation recognizes EHR incentive payments as grant income when there is reasonable assurance that the Corporation will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2012 and 2011, the Corporation recognized approximately \$1,200,000 and \$-0-, respectively, in EHR incentive payments as grant income using the ratable recognition method. Under the ratable recognition method, the Corporation recognizes income ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

EHR incentive income is included in other revenue in the statement of operations. EHR incentive income recognized is based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

Receipt of these funds is subject to the fulfillment of certain obligations by the Corporation as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

### 3. AFFILIATED ENTITY AND RELATED PARTY TRANSACTIONS

As part of the affiliation with UHS and UAPC, the Corporation purchased certain intangible assets, including medical records and other assets, from AP&S in the amount of \$7,345,000. The intangible assets are being amortized over 5 years with accumulated amortization of \$4,162,156 and \$2,693,152 at August 31, 2012 and 2011, respectively. The Corporation transferred \$12,071,545 and \$12,062,285 during 2012 and 2011, respectively, to UHS. The arrangement with UHS and UAPC contemplates that the Corporation will continue to transfer approximately \$1,000,000 dollars per month to UHS for on-going operational support to the affiliated group.

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Corporation purchased the CT and MRI service line of UAPC for \$3,600,000 which is to be paid \$100,000 monthly. As of August 31, 2012, the Corporation has paid \$900,000 under this agreement with a balance remaining of \$2,700,000. This liability is included under other long-term liabilities on the statement of financial position.

The Corporation provided management and other services for the Foundation and other related organizations in the amount of \$495,146 in 2012 and \$646,732 in 2011. At August 31, 2012 and 2011, \$345,706 and \$163,212, respectively, remained unpaid.

The Corporation received approximately \$946,000 and \$1,781,000 in contributions from the Foundation for the years ended August 31, 2012 and 2011, respectively.

The Corporation collaborates with physicians and physician groups including UAPC, to improve the quality of services, eliminate duplication of services, and to improve standards of care by entering into certain contractual agreements. While certain of the agreements are amended and/or terminated from time to time, the Corporation has had agreements for chemotherapy, ambulatory surgery, cardiac catheterization, laboratory, and radiation oncology therapy services. The costs for these services are included in contracted services in the statement of operations totaling \$42,135,993 and \$43,364,312 for August 31, 2012 and 2011, respectively.

#### 4. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at August 31, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
UH West renovation	\$ 10,288,768	\$ 10,478,055
Cardiovascular 1 - West	3,404,732	137,706
Other renovations and upgrades	2,430,462	1,266,846
	<u>\$ 16,123,962</u>	<u>\$ 11,882,607</u>

The Corporation is in the process of renovating Union West facilities with expected completion during 2013. Commitments for all remaining construction project costs total \$17,645,000 at August 31, 2012.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

### 5. INVESTMENTS

The Corporation does not engage in trading activities for investment purposes. The composition of investments, at fair value, is set forth in the following table:

	2012	2011
Cash and short-term investments	\$ 65,121,340	\$ 56,499,010
US Government and government agency obligations	2,564,308	5,688,845
Mutual funds	1,558,769	1,421,407
Marketable equity securities	7,619,789	6,409,084
Corporate obligations	722,825	683,829
Collective trusts	398,224	395,715
	77,985,255	71,097,890
Less current portion of:		
Debt service	9,357,980	9,495,137
Board designated	11,931,261	1,920,497
	\$ 56,696,014	\$ 59,682,256

Investment income included in the consolidated statements of operations and changes in net assets is primarily comprised of interest income.

	2012	2011
Investment income included with non-operating gains and net investment income on permanently restricted net assets:		
Interest and dividend income	\$ 601,621	\$ 601,569
Other changes in net assets:		
Unrealized appreciation of investments	845,821	739,114
	\$ 1,447,442	\$ 1,340,683

The following schedule summarizes the fair value of securities included in investments by board designated and held by trustee that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of August 31, 2012 and 2011. The schedule further segregates the securities that have been in a gross unrealized position as of August 31, 2012 and 2011, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to several securities which industry experts expect recovery in the short-term future.

The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of August 31, 2012 and 2011:

August 31, 2012						
Less than 12 Months			12 Months or Longer		Total	
Description of securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common Stock	\$ 231,072	\$ 11,408	\$ 1,282,119	\$ 218,140	\$ 1,513,191	\$ 229,548
Mutual Funds	33,824	9,706	139,690	18,126	173,514	27,832
Government Obligations	199,984	16	-0-	-0-	199,984	16
Certificates of Deposit	1,012,630	2,781	-0-	-0-	1,012,630	2,781
Total temporarily impaired securities	\$ 1,477,510	\$ 23,911	\$ 1,421,809	\$ 236,266	\$ 2,899,319	\$ 260,177

August 31, 2011						
Less than 12 Months			12 Months or Longer		Total	
Description of securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common Stock	\$ 345,473	\$ 47,794	\$ 1,762,948	\$ 369,364	\$ 2,108,421	\$ 417,158
Mutual Funds	80,948	4,883	290,132	22,572	371,080	27,455
Government Obligations	2,610,560	1,400	-0-	-0-	2,610,560	1,400
Corporate Bonds	60,412	699	29,739	261	90,151	960
Total temporarily impaired securities	\$ 3,097,393	\$ 54,776	\$ 2,082,819	\$ 392,197	\$ 5,180,212	\$ 446,973

## 6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Corporation's investments are reported at fair value in the accompanying balance sheets. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction, which requires an entity to maximize the use of observable inputs when measuring fair value.

The following provides a description of the three levels of inputs that may be used to measure fair value under the standard, the types of the Corporation's investments that fall under each category and the valuation methodologies used to measure these investments at fair value.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

### Level 1 Fair Value Measurements

Inputs to the valuation methodology are quoted prices available in the active markets for identical investments as of the reporting date.

The fair value of marketable equity securities is based on quoted share prices in active markets.

The fair value of mutual funds and exchange traded funds is based on quoted net asset values of the shares held by the Corporation at year-end. The net asset value is based on the value of the underlying assets owned by the fund, minus its liabilities and then divided by the number of shares outstanding. The net asset value is quoted in an active market.

### Level 2 Fair Value Measurements

Inputs to the valuation methodology are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date and fair value can be determined through the use of models or other valuation methodologies.

The fair value of corporate obligations is based on the expected value of discounted future cash flows from the underlying corporations issuing the obligation.

The fair value of collective trusts are based on the net asset value after adjustments to reflect all fund investments at fair value. The net asset value is quoted on a private market that is not active; however, the unit price is based on the underlying investments that are traded on an active market.

### Level 3 Fair Value Measurements

Inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability and the reporting entity makes estimates and assumptions related to the pricing of the asset or liability including assumptions regarding risk. The Corporation does not hold any level 3 investments.

The preceding methods used to measure fair value may produce an amount that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation 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.



# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

Cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements approximate fair value based on short term maturity.

Long-term debt: Fair value of the Corporation's long-term debt, based on current quoted market value of similar debt instruments, has an approximate fair value of \$239,991,000 and \$209,238,000 as of August 31, 2012 and 2011, respectively.

### 7. ENDOWMENT FUNDS

The Corporation's endowment consists of individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The objective is to meet or exceed the market index, or blended market index, selected and agreed upon by the Corporation or provide an acceptable return with lower volatility or credit risk. In order to meet its needs, the investment strategy of the Corporation is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income. Specifically, the primary objective in the investment management for endowment fund assets shall be long-term growth of capital and to emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated in as much as it is consistent with the volatility of a comparable market index. Endowment fund assets may be invested only in investment grade bonds rated BBB (or equivalent) or better. The board of directors has interpreted the relevant law as requiring prudent preservation of the fund and evaluates the amounts of unrestricted income and the unrealized gains and losses periodically.

The Corporation has a policy of appropriating for distribution the earned income.

The endowment net assets by type of fund as of August 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Donor-restricted endowment funds		
Permanently restricted	<u>\$ 976,358</u>	<u>\$ 958,445</u>
Total endowment funds	<u>\$ 976,358</u>	<u>\$ 958,445</u>

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

For 2012 and 2011, the Corporation had the following endowment-related activities:

	Permanently restricted	
	2012	2011
Endowment net assets, beginning of year	\$ 958,445	\$ 946,496
Net investment income and other changes	17,913	11,949
Endowment net assets, end of year	<u>\$ 976,358</u>	<u>\$ 958,445</u>

### 8. LONG-TERM DEBT

A Master Trust Indenture, as amended, provides for the issuance of long-term debt under an obligated group structure. The Obligated Group consists of the Corporation and subsidiaries. This Obligated Group is required to meet certain covenants under the Master Trust Indenture. The Obligated Group is subject to certain financial performance covenants, among other compliance requirements, that require the maintenance of debt service ratios. As of August 31, 2012, management of the Obligated Group believes that it is in compliance with all financial covenants.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

The following is a summary of long-term debt as of August 31, 2012 and 2011:

	2012	2011
Indiana Health and Educational Facility Financing Authority or Hospital Authority of Vigo County (Indiana):		
Series 2011, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2015 through 2041. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 7.5% to 8% and averages 7.77%. Includes bond discount of approximately \$1,000,000	\$ 54,072,030	\$ 54,016,712
Series 2007, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2027 through 2048. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 5.50% to 5.80% and averages 5.74%.	176,123,660	176,109,882
Series 2006B, taxable variable rate demand revenue bonds, payable in annual principal installments commencing in fiscal 2009 through fiscal 2037. Interest rate is set weekly (payable semiannually) and averages .50% in fiscal 2012.	12,545,000	12,645,000
Series 1993, tax-exempt fixed rate serial and term bonds, payable in annual principal installments commencing in fiscal 1996 through fiscal 2024. Interest (payable semiannually) ranges from 5.125% to 5.250% and averages 5.18% in fiscal 2012.	24,100,000	25,625,000
Loan payable in monthly principal installments commencing in fiscal 2010 through fiscal 2026. Fixed term with variable interest rate set monthly (payable monthly) using LIBOR based rates and averages 3.86% in 2012.	5,910,600	6,262,600
Capital leases and other	2,223,019	3,920,596
Total long-term debt	274,974,309	278,579,790
Less current portion	3,476,124	4,199,893
Long-term debt, less current portion	\$ 271,498,185	\$ 274,379,897

The scheduled maturities and mandatory redemptions of long-term debt are as follows:

Year	
2013	\$ 3,476,124
2014	3,408,919
2015	2,533,683
2016	3,348,710
2017	3,497,685
Thereafter	258,709,188
	\$ 274,974,309

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

In February 2011, the Corporation issued, through the Hospital Authority of Vigo County (Indiana), Hospital Revenue Bonds, Series 2011 (tax-exempt bonds) in the aggregate amount of \$55 million, net of bond discount, principally to finance, or reimburse the Corporation for, the costs of constructing, acquiring, equipping, or renovating certain capital assets of the Corporation, and to refund the Indiana Health Facility Financing Authority Variable Rate Demand Bonds, Series 2002 and the Indiana Health and Educational Facility Financing Authority Variable Rate Demand Revenue Bonds, Series 2006A, and for bond issuance cost, debt service reserve fund, and capitalized interest during the construction period. The interest rate is fixed and ranges from 7.5 to 8%. Term bonds expire in 2022 (\$10.4 million), 2031 (\$20.7 million), and 2041 (\$24.0 million) with principal payments beginning in 2015.

As part of the refunding of the Series 2002 and 2006A bonds, the Corporation wrote off deferred financings costs associated with the 2002 and 2006A issuances in the amount of approximately \$230,000 during 2011.

During July 2007, the Corporation issued, through the Hospital Authority of Vigo County (Indiana), Hospital Revenue Bonds, Series 2007 (tax-exempt bonds) in the aggregate amount of \$176.5 million principally to finance, or reimburse the Corporation for, the costs of acquisition, construction, furnishing, and equipping of a new 500,000 square-foot hospital building, and certain renovations of the existing hospital facility, bond issuance cost, debt service reserve fund, and capitalized interest during the construction period. The interest rate is fixed and ranges from 5.50% to 5.80%. Term bonds expire in 2027 (\$7.4 million), 2037 (\$52.2 million), 2042 (\$50.3 million), and 2047 (\$66.6 million) with principal payments beginning in 2024.

In July 2006, the Corporation opened a letter of credit for a maximum of \$19,000,000 attached to the Series 2006A tax-exempt Bonds to cover noncompliance with principal and interest payments. There were no draws on the letter during fiscal year 2012 and 2011, and there are no outstanding amounts under this arrangement at August 31, 2012 and 2011. During 2011, the Corporation paid off the remaining balance of the Series 2006A bonds with the issuance of the 2011 Bonds.

The Corporation has a letter of credit for a maximum of \$13,000,000 attached to the Series 2006B taxable Bonds to cover noncompliance with principal and interest payments. There were no draws on the letter during fiscal year 2012 and 2011, and there are no outstanding amounts under this arrangement at August 31, 2012 and 2011. The letter of credit expires May 2, 2014. However in the event of a failed remarketing, the Corporation is subject to a 367 day period of interest only payments. After 367 days, the amount of the draws would be required to be repaid in accordance with the amortization payment dates stipulated in the agreement.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Series 1993 tax-exempt Bonds are secured by a security interest in unrestricted receivables (as defined in the bond agreements) of the Corporation. Payment of principal and interest on the Series 1993 Bonds is guaranteed under a municipal bond insurance policy. In February 2004, the Corporation made a tender offer to existing 1993 Bondholders for a 103% tender price, which was accepted. A bank purchased the tendered bonds for par value.

Certain of the debt instruments contain financial covenants and management believes they are in compliance.

The fair value of the 2011, 2007, and 1993 fixed rate tax exempt bonds approximated \$222,535,000 as of August 31, 2012. The fair value of the fixed rate obligations is estimated based on current quoted market value of similar debt instruments. The fair value of variable rate debt (Series 2006B) approximates its carrying value.

Total interest paid on long-term debt (net of amounts capitalized of approximately \$1,540,000 and \$780,000) for the years ended August 31, 2012 and 2011, aggregated approximately \$14,700,000 and \$11,800,000, respectively. Total investment income on borrowed funds held by trustee for the years ended August 31, 2012 and 2011, aggregated approximately \$24,000 and \$37,000, respectively. Capitalized interest costs net of associated investment income earnings aggregated approximately \$1,528,000 and \$754,000.

Substantially all assets and revenue serve as collateral on the aforementioned bonds and letters of credit.

The Corporation leases medical equipment and software under capital leases with various expiration dates. Cost and accumulated depreciation of the equipment under capital leases was approximately \$6,890,000 and \$8,160,000, respectively, and \$3,240,000 and \$3,360,000, respectively, at August 31, 2012 and August 31, 2011. The following is a schedule by year of future minimum lease payments under capital leases as of August 31, 2012, that have initial or remaining lease terms in excess of one year.

Year	
2013	\$ 1,294,544
2014	649,615
2015	288,179
2016	58,451
2017	24,072
	2,314,861
	Less imputed interest 132,848
Present value of minimum lease payments	\$ 2,182,013

---

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Corporation has operating leases for medical equipment and office space. Total rent and lease expense for 2012 and 2011 was \$12,068,132 and \$11,725,759, respectively. Future minimum lease payments under noncancelable operating leases as of August 31, 2012 that have initial or remaining lease terms in excess of one year are as follows:

<u>Year</u>	
2013	\$ 5,207,674
2014	3,252,746
2015	1,803,114
2016	477,568
2017	210,113
	<u>\$ 10,951,215</u>

### 9. PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

The Corporation has a noncontributory, defined-benefit plan (the Plan) covering substantially all of its employees who are at least 21 years old and have completed one year of service, and certain employees meeting those requirements of affiliated organizations. The Plan provides for retirement, survivor, and severance benefits. Employees with five or more years of service are entitled to monthly pension benefits beginning at normal retirement age (65) equal to their credited service multiplied by 1/60th of 1% of the total of their annual compensation for the five consecutive plan years which produce the highest total. The Corporation has agreed to contribute such amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members. Contributions include normal cost, interest on unfunded prior service cost, and amortization of prior service cost over a period not exceeding 30 years. The Plan has met the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The Corporation instituted a special voluntary early-retirement pension and health insurance benefit for eligible employees between the ages of 55 to 60 and above through multiple phases throughout 2011. Employees who applied and qualified under the program received monthly annuities based upon the value of their pension, as well as COBRA health benefits for up to 18th months at the current employee costs. Upon the 19th month and until reaching the age of 65, the Corporation will deposit \$500 a month into a benefits account per qualifying retiree to be used for the health benefits. Total costs for the special early-retirement benefit program in the statement of operations and changes in net assets totaling \$7,250,873, consisted of \$5,198,052 related to the pension termination benefit cost and \$2,052,821 related to the health insurance benefits for the year ending August 31, 2011.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

The Corporation recognizes the funded status of its defined-benefit pension plan in its consolidated balance sheets and the changes therein within its consolidated statements of operations and changes in net assets. Funded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Prior unrecognized net actuarial losses of \$12,519,095 and \$12,211,211 have been included in the unrestricted net assets at August 31, 2012 and 2011, respectively, and have not yet been recognized in net periodic pension cost. The adjustment to unrestricted net assets consisted primarily of the change in cumulative losses on the retirement plan in 2012 and 2011 and changes in the funded status.

Actuarial losses included in unrestricted net assets at August 31, 2012, and expected to be amortized in net periodic benefit cost during fiscal 2013 are \$327,053.

The following table sets forth the defined-benefit pension plan's benefit obligations, fair value of the Plan's assets, and funded status at August 31, 2012 and 2011:

	2012	2011
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 90,741,573	\$ 82,432,540
Service cost	-0-	-0-
Interest cost	5,753,943	5,267,599
Benefits paid	(4,403,549)	(3,640,212)
Actuarial loss	393,703	1,483,594
Termination benefit cost	-0-	5,198,052
Effect of Settlement/Curtailment	-0-	-0-
Benefit obligation, end of year	92,485,670	90,741,573
Changes in plan assets		
Fair value of plan assets, beginning of year	80,525,011	67,969,947
Actual return on plan assets	5,143,998	9,165,267
Employer contributions	7,800,000	7,030,009
Benefits paid	(4,403,549)	(3,640,212)
Fair value of plan assets, end of year	89,065,460	80,525,011
Funded status		
Funded status of the plan, end of year	\$ (3,420,210)	\$ (10,216,562)

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

The following is a summary of the components of net periodic pension costs:

	2012	2011
Components of net benefit cost		
Service cost	\$ -0-	\$ -0-
Interest cost	5,753,943	5,267,599
Expected return on plan assets	(5,343,366)	(5,237,204)
Actuarial loss	285,187	641,243
Net periodic benefit cost	695,764	671,638
Termination benefit cost	-0-	5,198,052
Net benefit cost	\$ 695,764	\$ 5,869,690

The following is a schedule, by year, of expected benefit payments, which reflect expected future service:

Year Ending August 31,	
2013	\$ 4,868,248
2014	4,898,679
2015	4,949,697
2016	5,132,037
2017	5,441,658
2018-2022	31,036,804
	\$ 56,327,123

The weighted-average assumptions used to determine the Plan's projected benefit obligation (PBO) and net periodic benefit costs (NPBC) for the years ended August 31, 2012 and 2011 are as follows:

	2012	2011
Discount rate	6.5%	6.5%
Expected return on plan assets	6.5%	7.5%
Rate of compensation increase - NPBC	Not Applicable	Not Applicable

The principal long-term determinant of a portfolio's investment return is its asset allocation. The Plan's allocation includes growth assets (36%) and fixed income (61%) investments and other (3%). In addition, active management strategies have added value relative to passive benchmark returns. The expected long-term rate of return assumption is based on the mix of assets in the Plan, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

The Plan's weighted-average asset allocations at August 31, 2012 and 2011, by asset category, are as follows:

	2012	2011
Mutual funds - equity funds	36%	35%
Mutual funds - bond funds	61%	60%
Other	3%	5%
	100%	100%

The following is an analysis of fair value of the major classes of plan assets as of August 31, 2012 and 2011:

	Fair Value	
	2012	2011
Cash and equivalents	\$ 1,155,469	\$ 2,253,635
Mutual funds - equity funds	31,889,829	28,295,642
Mutual funds - bond funds	54,206,652	48,396,203
Private equity funds	1,813,510	1,579,531
Total	\$ 89,065,460	\$ 80,525,011

Fair value of cash and equivalents, equity funds, and bond funds are based on the basis of quoted prices in active markets (Level 1 inputs). The fair value of the private equity funds are based on valuation techniques (Level 3 inputs).

The following is a reconciliation of the fair value of plan assets as of August 31, 2012 and 2011 determined on the basis of valuation techniques:

	Private Equity Funds	
	2012	2011
Balance, beginning of year	\$ 1,579,531	\$ 1,270,745
Return on plan assets:		
Assets held at the end of the year	189,550	308,786
Net purchases	44,429	-0-
Balance, end of year	\$ 1,813,510	\$ 1,579,531

# UNION HOSPITAL INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2012 AND 2011

---

The Plan employs an investment advisor to monitor the Plan's investment managers and make investment recommendations to the Corporation. The Corporation invests fund balances in a structured portfolio of equity and bond mutual funds and alternative investments. The target allocation strategy for the Plan is to have its investment portfolio comprise approximately 60% to 70% growth investments, 25% to 32% fixed-income investments, and 0% to 8% in alternative investments. Within the growth investment classification, the Plan's asset strategy encompasses equity and equity-like instruments that are expected to represent approximately 60.0% of the Corporation's plan asset portfolio of both public and private market investments. The largest component of these equity and equity-like instruments is public equity securities that are well diversified and invested in U.S. and international companies.

Projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category.

The Corporation expects to contribute approximately \$7,800,000 to the pension plan in 2013 and will meet the required funding amounts for 2012. The Corporation elected to freeze the Plan in 2010, but will continue to fund the plan as required.

The Corporation also has a 403b discretionary defined contribution plan for which contributions during 2012 and 2011 were approximately \$5,075,000 and \$4,829,000, respectively.

### 10. COMMITMENTS AND CONTINGENCIES

During 2012, the Corporation received notice from Medicaid that there were possible overpayments based on free-standing facilities versus provider based payments. The outcome of this matter is uncertain and any amount assessed, if any, is unknown at this time.

The Corporation is involved in other litigation arising in the normal course of business. After consultation with legal counsel, it is management's opinion that these matters will be resolved without a material adverse effect on the Corporation's financial position or consolidated results of operations, changes in net assets, and cash flows.

**SUPPLEMENTARY INFORMATION**

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEETS AUGUST 31, 2012

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ 31,063,107	\$ 2,165,300	\$ 3,948	\$ -0-	\$ 33,232,355
Funds held by trustee, current portion	9,357,980	-0-	-0-	-0-	9,357,980
Board designated funds, current portion	11,931,261	-0-	-0-	-0-	11,931,261
Patient accounts receivable, net	51,029,921	-0-	188,271	-0-	51,218,192
Inventories	4,361,427	-0-	-0-	-0-	4,361,427
Prepaid expenses and other current assets	4,229,851	111,536	56,822	(121,966)	4,276,243
Total current assets	111,973,547	2,276,836	249,041	(121,966)	114,377,458
<b>Investments limited as to use, less current portion</b>					
Funds held by trustee	24,270,756	-0-	-0-	-0-	24,270,756
Board designated funds	31,448,900	-0-	-0-	-0-	31,448,900
Permanently restricted	976,358	-0-	-0-	-0-	976,358
Total investments limited as to use	56,696,014	-0-	-0-	-0-	56,696,014
<b>Property and equipment</b>					
Land and improvements	37,291,582	-0-	-0-	-0-	37,291,582
Buildings and fixed equipment	314,480,911	7,652	-0-	-0-	314,488,563
Movable equipment	119,362,238	56,850	49,894	-0-	119,468,982
	471,134,731	64,502	49,894	-0-	471,249,127
Less allowances for depreciation	191,786,439	14,485	36,849	-0-	191,837,773
	279,348,292	50,017	13,045	-0-	279,411,354
Construction in progress	16,123,962	-0-	-0-	-0-	16,123,962
Total property and equipment, net	295,472,254	50,017	13,045	-0-	295,535,316
<b>Other assets</b>					
Due from Union Hospital Foundation, Inc.	4,495,347	-0-	-0-	-0-	4,495,347
Deferred financing costs, net	3,090,878	-0-	-0-	-0-	3,090,878
Intangible assets, net	5,982,856	-0-	-0-	-0-	5,982,856
Other assets	3,980,230	-0-	-0-	(2,103,644)	1,876,586
	17,549,311	-0-	-0-	(2,103,644)	15,445,667
Total assets	\$ 481,691,126	\$ 2,326,853	\$ 262,086	\$ (2,225,610)	\$ 482,054,455

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEETS AUGUST 31, 2012

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Liabilities and net assets</b>					
<b>Current liabilities</b>					
Accounts payable and other current liabilities	\$ 22,386,923	\$ 445,011	\$ 15,238	\$ (121,966)	\$ 22,725,206
Salaries, wages and related liabilities	19,757,553	25,046	-0-	-0-	19,782,599
Estimated third party settlements	3,073,530	-0-	-0-	-0-	3,073,530
Accrued interest	7,842,998	-0-	-0-	-0-	7,842,998
Current portion of long-term debt	3,476,124	-0-	-0-	-0-	3,476,124
Total current liabilities	<u>56,537,128</u>	<u>470,057</u>	<u>15,238</u>	<u>(121,966)</u>	<u>56,900,457</u>
<b>Long-term liabilities</b>					
Long-term debt, less current portion	271,498,185	-0-	-0-	-0-	271,498,185
Deferred revenue	301,122	-0-	-0-	-0-	301,122
Pension liability	3,420,210	-0-	-0-	-0-	3,420,210
Other long-term liabilities	5,313,254	-0-	-0-	-0-	5,313,254
Total long-term liabilities	<u>280,532,771</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>280,532,771</u>
Total liabilities	337,069,899	470,057	15,238	(121,966)	337,433,228
<b>Net assets</b>					
Unrestricted	139,069,623	1,856,796	246,848	(2,103,644)	139,069,623
Temporarily restricted	4,575,246	-0-	-0-	-0-	4,575,246
Permanently restricted	976,358	-0-	-0-	-0-	976,358
Total net assets	<u>144,621,227</u>	<u>1,856,796</u>	<u>246,848</u>	<u>(2,103,644)</u>	<u>144,621,227</u>
Total liabilities and net assets	<u>\$ 481,691,126</u>	<u>\$ 2,326,853</u>	<u>\$ 262,086</u>	<u>\$ (2,225,610)</u>	<u>\$ 482,054,455</u>

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEETS AUGUST 31, 2011

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ 28,919,312	\$ 1,928,474	\$ 3,948	\$ -0-	\$ 30,851,734
Funds held by trustee, current portion	9,495,137	-0-	-0-	-0-	9,495,137
Board designated funds, current portion	1,920,497	-0-	-0-	-0-	1,920,497
Patient accounts receivable, net	49,209,425	-0-	161,570	-0-	49,370,995
Other receivables	-0-	103,332	-0-	-0-	103,332
Third party settlements	610,058	-0-	-0-	-0-	610,058
Inventories	4,386,794	-0-	-0-	-0-	4,386,794
Prepaid expenses and other current assets	4,532,364	(5,834)	(23,516)	(136,627)	4,366,387
Total current assets	99,073,587	2,025,972	142,002	(136,627)	101,104,934
<b>Investments limited as to use, less current portion</b>					
Funds held by trustee	35,640,930	-0-	-0-	-0-	35,640,930
Board designated and temporarily restricted funds	23,082,881	-0-	-0-	-0-	23,082,881
Permanently restricted	958,445	-0-	-0-	-0-	958,445
Total investments limited as to use	59,682,256	-0-	-0-	-0-	59,682,256
<b>Property and equipment</b>					
Land and improvements	36,075,662	-0-	-0-	-0-	36,075,662
Buildings and fixed equipment	303,795,065	7,652	-0-	-0-	303,802,717
Movable equipment	108,703,442	25,504	49,894	-0-	108,778,840
	448,574,169	33,156	49,894	-0-	448,657,219
Less allowances for depreciation	170,135,124	7,560	29,905	-0-	170,172,589
	278,439,045	25,596	19,989	-0-	278,484,630
Construction in progress	11,882,607	-0-	-0-	-0-	11,882,607
Total property and equipment, net	290,321,652	25,596	19,989	-0-	290,367,237
<b>Other assets</b>					
Due from Union Hospital Foundation, Inc.	5,334,560	-0-	-0-	-0-	5,334,560
Deferred financing costs, net	3,260,902	-0-	-0-	-0-	3,260,902
Intangible assets, net	4,651,848	-0-	-0-	-0-	4,651,848
Other assets	2,090,693	-0-	-0-	(1,740,205)	350,488
	15,338,003	-0-	-0-	(1,740,205)	13,597,798
Total assets	\$ 464,415,498	\$ 2,051,568	\$ 161,991	\$ (1,876,832)	\$ 464,752,225

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING BALANCE SHEETS AUGUST 31, 2011

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Liabilities and net assets</b>					
<b>Current liabilities</b>					
Accounts payable and other current liabilities	20,649,482	\$ 434,981	\$ 15,996	\$ (136,627)	\$ 20,963,832
Salaries, wages and related liabilities	17,197,090	22,468	-0-	-0-	17,219,558
Accrued interest	7,870,134	-0-	-0-	-0-	7,870,134
Current portion of long-term debt	4,199,893	-0-	-0-	-0-	4,199,893
Total current liabilities	<u>49,916,599</u>	<u>457,449</u>	<u>15,996</u>	<u>(136,627)</u>	<u>50,253,417</u>
<b>Long-term liabilities</b>					
Long-term debt, less current portion	274,379,897	-0-	-0-	-0-	274,379,897
Deferred revenue	401,447	-0-	-0-	-0-	401,447
Pension liability	10,216,562	-0-	-0-	-0-	10,216,562
Other long-term liabilities	2,174,649	-0-	-0-	-0-	2,174,649
Total long-term liabilities	<u>287,172,555</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>287,172,555</u>
Total liabilities	337,089,154	457,449	15,996	(136,627)	337,425,972
<b>Net assets</b>					
Unrestricted	121,024,812	1,594,119	145,995	(1,740,205)	121,024,721
Temporarily restricted	5,343,087	-0-	-0-	-0-	5,343,087
Permanently restricted	958,445	-0-	-0-	-0-	958,445
Total net assets	<u>127,326,344</u>	<u>1,594,119</u>	<u>145,995</u>	<u>(1,740,205)</u>	<u>127,326,253</u>
Total liabilities and net assets	<u>\$ 464,415,498</u>	<u>\$ 2,051,568</u>	<u>\$ 161,991</u>	<u>\$ (1,876,832)</u>	<u>\$ 464,752,225</u>

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2012

	Union Hospital	Union Hospital Clinton	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Operating revenue</b>							
Net patient service revenue (net of contractual allowances and discounts including charity care provision of \$38,737,421)	\$ 431,391,216	\$ 30,081,940	\$ 461,473,156	\$ -0-	\$ 1,062,103	\$ -0-	\$ 462,535,259
Provision for bad debts	(36,602,544)	(4,703,143)	(41,305,687)	-0-	-0-	-0-	(41,305,687)
Net patient service revenue less provision for bad debts	394,788,672	25,378,797	420,167,469	-0-	1,062,103	-0-	421,229,572
Other revenue	9,034,243	373,091	9,407,334	1,604,900	-0-	(2,027,817)	8,984,417
Total operating revenue	403,822,915	25,751,888	429,574,803	1,604,900	1,062,103	(2,027,817)	430,213,989
<b>Operating expenses</b>							
Salaries and wages	116,694,652	9,206,004	125,900,656	344,051	-0-	-0-	126,244,707
Employee benefits	25,175,660	2,059,390	27,235,050	151,286	-0-	-0-	27,386,336
Supplies and drugs	64,771,572	2,655,238	67,426,810	-0-	121,182	-0-	67,547,992
Physician services	10,287,601	455,252	10,742,853	-0-	-0-	-0-	10,742,853
Contract services	62,740,357	812,521	63,552,878	3,224	112,945	-0-	63,669,047
Rent and leases	11,375,306	688,194	12,063,500	16,625	3,118	(15,111)	12,068,132
Utilities, supplies, and other	35,933,799	3,336,423	39,270,222	893,328	717,061	(2,012,690)	38,867,921
Hospital assessment fee	17,186,775	715,855	17,902,630	-0-	-0-	-0-	17,902,630
Depreciation and amortization	23,492,862	992,869	24,485,731	6,891	6,944	-0-	24,499,566
Interest	14,898,275	3,909	14,902,184	-0-	-0-	-0-	14,902,184
Total operating expenses	382,556,859	20,925,655	403,482,514	1,415,405	961,250	(2,027,801)	403,831,368
Income from operations	21,266,056	4,826,233	26,092,289	189,495	100,853	(16)	26,382,621
<b>Non-operating gains (losses)</b>							
Investment income	510,036	490	510,526	73,182	-0-	-0-	583,708
Other	1,817,563	(1,706)	1,815,857	-0-	-0-	(363,423)	1,452,434
Total non-operating revenues	2,327,599	(1,216)	2,326,383	73,182	-0-	(363,423)	2,036,142
Excess of revenue over expenses	\$ 23,593,655	\$ 4,825,017	\$ 28,418,672	\$ 262,677	\$ 100,853	\$ (363,439)	\$ 28,418,763

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2011

	Union Hospital	Union Hospital Clinton	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
<b>Operating revenue</b>							
Net patient service revenue (net of contractual allowances and discounts including charity care provision of \$33,138,608)	\$ 384,620,674	\$ 28,936,611	\$ 413,557,285	\$ -0-	\$ 974,421	\$ (587,214)	\$ 413,944,492
Provision for bad debts	(36,284,667)	(5,676,728)	(41,961,395)	-0-	-0-	-0-	(41,961,395)
Net patient service revenue less provision for bad debts	348,336,007	23,259,883	371,595,890	-0-	974,421	(587,214)	371,983,097
Other revenue	8,395,730	486,354	8,882,084	1,613,216	0	(1,398,646)	9,096,654
Total operating revenue	356,731,737	23,746,237	380,477,974	1,613,216	974,421	(1,985,860)	381,079,751
<b>Operating expenses</b>							
Salaries and wages	107,581,614	9,545,153	117,126,767	321,173	-0-	-0-	117,447,940
Employee benefits	25,644,934	2,203,471	27,848,405	133,315	-0-	-0-	27,981,720
Supplies and drugs	66,758,208	3,350,322	70,108,530	-0-	82,387	-0-	70,190,917
Physician services	9,719,988	640,640	10,360,628	-0-	-0-	-0-	10,360,628
Contract services	63,187,874	853,062	64,040,936	17,010	703,678	-0-	64,761,624
Rent and leases	11,038,190	668,693	11,706,883	16,185	2,691	-0-	11,725,759
Utilities, supplies, and other	31,267,284	3,256,944	34,524,228	890,301	100,992	(1,975,241)	33,540,280
Depreciation and amortization	23,991,201	956,933	24,948,134	3,045	9,799	-0-	24,960,978
Interest	13,916,229	6,524	13,922,753	-0-	-0-	-0-	13,922,753
Total operating expenses	353,105,522	21,481,742	374,587,264	1,381,029	899,547	(1,975,241)	374,892,599
Income (loss) from operations	3,626,215	2,264,495	5,890,710	232,187	74,874	(10,619)	6,187,152
<b>Special charge early retirement</b>	(6,326,718)	(924,155)	(7,250,873)	-0-	-0-	-0-	(7,250,873)
Income from operations after special charge	(2,700,503)	1,340,340	(1,360,163)	232,187	74,874	(10,619)	(1,063,721)
<b>Nonoperating gains</b>							
Investment income	595,389	2,430	597,819	66,676	-0-	(74,875)	589,620
Other	300,636	(1,344)	299,292	-0-	-0-	(288,352)	10,940
Total nonoperating revenues	896,025	1,086	897,111	66,676	-0-	(363,227)	600,560
Excess of revenue over (under) expenses	\$ (1,804,478)	\$ 1,341,426	\$ (463,052)	\$ 298,863	\$ 74,874	\$ (373,846)	\$ (463,161)

See Report of Independent Auditors on Page 1 and 2.

# UNION HOSPITAL INC. AND SUBSIDIARIES

## SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED AUGUST 31, 2012

Program	Grant ID #	CFDA Number	Federal Expenditures
<b>Major program</b>			
Telehealth Network Grant - Office of Advancement of Telemedicine (OAT)	G22RH22701-01	93.211	\$ 190,000
Grants for Training in Primary Care Medicine and Dentistry - Bureau of Health Professions (BHP)	D58HP23232-01	93.884	<u>227,715</u>
Total major programs			417,715
<b>Non-major programs</b>			
Department of Health and Human Services Affordable Care Act - Health Center Planning Grant	P04CS22769-01	93.527	80,000
Department of Health and Human Services Health Care and Other Facilities Grant	C76HF19877-01	93.887	38,400
Department of Health and Human Services Grants to States for Operation of Offices for Rural Health	6 H95 RH 00136-20-01	93.913	87,167
Department of Health and Human Services Substance Abuse Prevention and Treatment Block Grant Block Grant pass through the Indiana Division of Mental Health and Addictions	PSUP 245-2	93.959	<u>57,935</u>
Total non-major programs			<u>263,502</u>
Total federal expenditures			<u>\$ 681,217</u>

### Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Corporation under programs of the federal government for the year ended August 31, 2012. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The basic consolidated financial statement classifications may include other financial activity for reporting purposes. Therefore, some of the amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements.



Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282  
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED  
ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
*GOVERNMENT AUDITING STANDARDS*

Board of Directors  
Union Hospital  
Terre Haute, Indiana

We have audited the consolidated financial statements of Union Hospital, Inc. and Subsidiaries (the Corporation) as of and for the year ended August 31, 2012, and have issued our report thereon dated November 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Guidelines for Examination of Entities Receiving Financial Assistance from Governmental Sources issued by the Indiana State Board of Accounts.

Internal Control Over Financial Reporting

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis.

Board of Directors  
Union Hospital  
Terre Haute , Indiana

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Corporation in a separate letter dated November 13, 2012.

This report is intended solely for the information and use of the Board of Directors, management, the cognizant audit agencies, and other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Blue & Co., LLC*

November 13, 2012



Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282  
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH  
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT  
ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133 AND SCHEDULE OF  
EXPENDITURES OF FEDERAL AWARDS

Board of Directors  
Union Hospital  
Terre Haute, Indiana

Compliance

We have audited Union Hospital, Inc. and Subsidiaries' (the Corporation) compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Corporation's major federal programs for the year ended August 31, 2012. The Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Corporation's management. Our responsibility is to express an opinion on the Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Corporation's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Corporation's compliance with those requirements.

In our opinion, the Corporation complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended August 31, 2012.

Board of Directors  
Union Hospital  
Terre Haute , Indiana

### Internal Control Over Compliance

Management of the Corporation is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information of the board of directors, management, the cognizant audit agencies, other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Blue & Co., LLC*

November 13, 2012

# UNION HOSPITAL INC. AND SUBSIDIARIES

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED AUGUST 31, 2012

---

### Summary of Auditor's Results

#### *Financial Statements*

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified?  yes  none reported

Significant deficiency(ies) identified that are not considered to be material weakness(es)?  yes  none reported

Noncompliance material to financial statements noted?  yes  none reported

#### *Federal Awards*

Internal controls over major programs:

Material weakness(es) identified?  yes  none reported

Significant deficiency(ies) identified that are not considered to be material weakness(es)?  yes  none noted

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?  yes  no

#### Identification of major program:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
93.211	Telehealth Network Grant - Office of Advancement of Telemedicine (OAT)
93.884	Grants for Training in Primary Care Medicine and Dentistry - Bureau of Health Professions (BHP)

Dollar threshold used to distinguish between type A and B programs: \$300,000

Auditee qualified as low-risk auditee?  yes  no

### Section II – Findings related to financial statements reported in accordance with Government Auditing Standards:

No matters reported

### Section III – Findings and questioned costs relating to Federal awards:

No matters reported

### Section IV – Summary schedule of prior audit findings:

No matters reported

---

See report on compliance with OMB Circular A-133 on pages 40 and 42.