

CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

Beacon Health System, Inc. and Affiliated Corporations  
Years Ended December 31, 2014 and 2013  
With Reports of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Financial Statements  
and Supplementary Information

Years Ended December 31, 2014 and 2013

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## Report of Independent Auditors

The Board of Directors  
Beacon Health System, Inc. and Affiliated Corporations

We have audited the accompanying consolidated financial statements of Beacon Health System, Inc. and Affiliated Corporations (the Corporation), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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



## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Beacon Health System, Inc. and Affiliated Corporations at December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst + Young LLP*

March 5, 2015

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Balance Sheets  
(In Thousands)

	December 31	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 96,532	\$ 85,863
Short-term investments	85,919	71,884
Patient accounts receivable, less allowances for doubtful accounts (2014 – \$26,375; 2013 – \$23,123)	140,259	138,950
Due from third-party payors	18,253	7,230
Other receivables	11,884	10,299
Inventories	22,868	21,641
Prepaid expenses	12,088	11,146
Total current assets	<u>387,803</u>	<u>347,013</u>
Assets limited as to use:		
Internally designated investments	570,198	558,918
Restricted cash	6,144	5,194
Externally designated investments – insurance trust	2,619	2,582
Board-designated endowment	20,801	20,968
Endowment and temporarily restricted investments	6,610	6,278
	<u>606,372</u>	<u>593,940</u>
Property and equipment:		
Land	43,597	45,955
Buildings and improvements	614,625	595,141
Furniture and equipment	408,363	375,603
Construction-in-progress	63,954	32,060
	<u>1,130,539</u>	<u>1,048,759</u>
Less allowances for depreciation and amortization	554,795	505,566
	<u>575,744</u>	<u>543,193</u>
Unamortized bond issuance costs, net	2,188	2,474
Deferred charges and other assets	30,695	26,411
Total assets	<u>\$ 1,602,802</u>	<u>\$ 1,513,031</u>

	<b>December 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 60,246	\$ 53,531
Accrued salaries and benefits	48,204	43,942
Accrued expenses	4,961	4,971
Due to third-party payors	9,737	10,753
Current maturities of long-term debt	8,693	6,899
Total current liabilities	<u>131,841</u>	120,096
Non-current liabilities:		
Long-term debt, less current maturities	249,797	256,237
Pension and other liabilities	97,245	65,484
Interest rate and basis swaps	27,752	36,761
	<u>374,794</u>	358,482
Total liabilities	<u>506,635</u>	478,578
Net assets:		
Unrestricted:		
Undesignated	1,059,437	1,000,532
Board-designated endowment	20,801	20,968
Total unrestricted	<u>1,080,238</u>	1,021,500
Temporarily restricted	15,338	12,362
Permanently restricted	591	591
Total net assets	<u>1,096,167</u>	1,034,453
Total liabilities and net assets	<u><u>\$ 1,602,802</u></u>	<u><u>\$ 1,513,031</u></u>

*See accompanying notes.*

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Statements of Operations  
and Changes in Net Assets  
(In Thousands)

	<b>Year Ended December 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Unrestricted revenue, gains, and other support</b>		
Net patient service revenue	\$ 938,468	\$ 840,408
Provision for bad debts	(68,927)	(62,724)
Net patient service revenue less provision for bad debts	<b>869,541</b>	777,684
Other revenue	43,902	42,726
Net assets released from restrictions used for operations	322	458
	<b>913,765</b>	820,868
<b>Expenses</b>		
Salaries and wages	361,661	329,320
Employee benefits	93,030	90,072
Supplies and other	232,821	192,834
Professional fees and purchased services	113,630	107,094
Depreciation and amortization	50,547	44,169
Interest	5,925	6,594
	<b>857,614</b>	770,083
Income from operations	<b>56,151</b>	50,785
<b>Non-operating</b>		
Investment income, net	29,672	49,466
Unrealized gains (losses) on swap transactions, net	9,008	(6,744)
Loss on bond refunding	-	(3,734)
Revenue and gains in excess of expenses	<b>94,831</b>	89,773

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Statements of Operations  
and Changes in Net Assets (continued)

(In Thousands)

	<b>Year Ended December 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Unrestricted net assets</b>		
Revenue and gains in excess of expenses	\$ 94,831	\$ 89,773
Net assets released from restrictions used for capital purposes	392	529
Net assets released from board-designated endowment	(771)	(690)
Other	-	(53)
Postretirement benefit adjustments other than periodic costs	(35,714)	44,838
Increase in unrestricted net assets	<u>58,738</u>	134,397
<b>Temporarily restricted net assets</b>		
Contributions temporarily restricted for use	3,334	2,182
Investment income	356	1,193
Net assets released from restrictions used for operating and capital purposes	(714)	(987)
Increase in temporarily restricted net assets	<u>2,976</u>	2,388
Increase in net assets	61,714	136,785
Net assets at beginning of year	1,034,453	897,668
Net assets at end of year	<u>\$ 1,096,167</u>	<u>\$ 1,034,453</u>

See accompanying notes.

# Beacon Health System, Inc. and Affiliated Corporations

## Consolidated Statements of Cash Flows (In Thousands)

	<b>Year Ended December 31</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating activities</b>		
Change in net assets	\$ 61,714	\$ 136,785
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	50,547	44,169
Provision for bad debts	68,927	62,724
Unrealized gains on swap transactions, net	(9,008)	6,744
Loss on early extinguishment of debt	–	3,734
Postretirement benefit adjustments other than periodic costs	35,713	(44,838)
Realized gains on investments	(21,061)	(8,670)
Restricted contributions and investment income	(3,690)	(3,375)
Changes in operating assets and liabilities:		
Patient accounts receivable	(70,236)	(64,232)
Other receivables, inventories, and prepaid expenses	(3,754)	(3,581)
Other assets	(3,998)	3,452
Restricted cash	(950)	(1,096)
Investments – trading	(4,456)	(86,151)
Accounts payable, accrued salaries and benefits, and accrued expenses	10,966	5,054
Due to/from third-party payors, net	(12,039)	16,033
Other long-term liabilities	(3,952)	(12,071)
Net cash provided by operating activities	94,723	54,681
<b>Investing activities</b>		
Net additions to property and equipment	(83,098)	(86,423)
Net cash used in investing activities	(83,098)	(86,423)
<b>Financing activities</b>		
Principal payments on long-term debt and other debt obligations	(7,452)	(149,505)
Net proceeds from issuance of long-term debt and other debt obligations	3,876	191,337
Payment of bond issue costs	(1,070)	(1,820)
Restricted contributions and investment income	3,690	3,375
Net cash (used in) provided by financing activities	(956)	43,387
Increase in cash and cash equivalents	10,669	11,645
Cash and cash equivalents at beginning of year	85,863	74,218
Cash and cash equivalents at end of year	\$ 96,532	\$ 85,863
<b>Supplemental disclosure of cash flow information</b>		
Interest paid	\$ 5,974	\$ 5,748

See accompanying notes.

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements

*(In Thousands)*

December 31, 2014

### **1. Organization and Basis of Consolidation**

The accompanying consolidated financial statements represent the accounts of Beacon Health System, Inc. (the Corporation) and its various affiliated corporations under the control of the Corporation (collectively, BHS). The Corporation is an Indiana not-for-profit corporation exempt from federal income tax under Internal Revenue Code (the Code) Section 501(a) as an organization described in Section 501(c)(3) and a public charity as described in Section 509(a)(3). The Corporation is the sole corporate member of the following entities:

- Elkhart General Hospital, Inc. (EGH)
- Memorial Hospital of South Bend, Inc. (MHSB)
- Memorial Health Foundation, Inc. (MHF)
- Beacon Medical Group, Inc. (BMG), formerly Memorial Health System, Inc.
- Beacon Health Ventures, Inc. (BHV)
- Community Occupational Medicine, Inc. (COM)

EGH, MHSB, BMG, and MHF are also exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) and as public charities described in Sections 509(a)(1) and 509(a)(2). BHV and COM are Indiana for-profit corporations. EGH is a 365-licensed-bed (270 available) acute care community hospital located in Elkhart, Indiana. MHSB is a 657-licensed-bed (409 available) acute care trauma center located in South Bend, Indiana. EGH and MHSB (collectively, the Hospitals) provide inpatient, outpatient, and 24-hour emergency care services for residents of Elkhart and South Bend, Indiana, and the surrounding communities. MHF is organized primarily to promote and encourage philanthropic activities for the support of the Corporation and its affiliates. BHV manages the taxable operations of the Corporation, including home care and other non-acute health care services. COM primarily promotes population health management. BMG operates the physician enterprise of the Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

### **1. Organization and Basis of Consolidation (continued)**

The Corporation owns a less than majority ownership or controlling interest in the following:

- 50% interest in Community Health Alliance LLC, an Indiana physician hospital organization
- 40% interest in Skyway Limited Partnership, a professional medical building venture
- 50% interest in Memorial Spine and Neuroscience Center, LLC, an outpatient surgery center specializing in neurologic, spine, and pain control procedures
- 46% interest in LaPorte Medical Group Surgery Center, LLP, an outpatient surgery center
- 35% interest in Physicians Hospital LLC, a long-term acute care facility
- 50% interest in Valparaiso Medical Development, LLC, a professional medical building venture
- 25% interest in Magnetic Resonance Imaging, LLC, an imaging and radiology center
- 33% interest in Michiana Information Health Network, Inc., a health information exchange
- 40% interest in Northern Indiana Ambulatory Surgery Center, LLC, an ambulatory surgery center
- 42% interest in Wakarusa Medical Clinic, LLC, a medical clinic
- 50% interest in Wa Nee Walk-in Clinic, LLC, a medical clinic

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

(In Thousands)

### 1. Organization and Basis of Consolidation (continued)

Aggregate financial information relating to these investments is as follows:

	<u>2014</u>	<u>2013</u>
Assets	\$ 32,536	\$ 42,419
Liabilities	17,033	20,746
Net income	5,843	8,236

### 2. Summary of Significant Accounting Policies

#### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ from those estimates.

#### Cash Equivalents

All investments that are not limited as to use with a maturity of three months or less at the time of acquisition are reflected as cash equivalents. Cash equivalents include checking accounts, money market accounts, corporate credit card accounts, and petty cash. The carrying value of cash equivalents approximates fair value.

#### Short-Term Investments

Short-term investments include cash reinvested on a daily basis, accrued interest on investments, and money expected to be used in less than a year as part of BHS' community benefit. Also included in short-term investments are restricted and unrestricted investment donations that are in the process of being liquidated.

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

#### **Accounts Receivable**

The Corporation evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for doubtful accounts when they are deemed uncollectible.

#### **Assets Limited as to Use**

Assets limited as to use include assets set aside by the Board of Directors (the Board) for future capital improvements and community health enhancement initiatives that the Board, at its discretion, may subsequently use for other purposes. In addition, assets limited as to use also include assets held by trustees under self-funded insurance agreements, and investments externally designated under indenture or donor restriction.

#### **Investments**

The Corporation classifies substantially all of its investments as trading. Under a trading classification, all unrestricted realized and unrealized gains and losses are included in revenue and gains in excess of expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Dividend and interest income, realized gains and losses, and changes to fair values of investments are reported as non-operating investment income in the consolidated statements of operations and changes in net assets.

Investments in alternative investments, primarily hedge fund of funds, that invest in marketable securities and derivative products are reported using the equity method. The estimated fair values are provided by the respective fund managers and are based on historical costs, appraisals, and other estimates that require varying degrees of judgment. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and may differ from the value that would have been used had a ready market for such investments existed. Resulting

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

differences could be material. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in non-operating investment income. The Corporation's holding reflects net contributions to the hedge fund and an allocated share of realized and unrealized investment income and expense.

#### **Inventories**

Inventories are stated at the lower of cost (average cost method) or market.

#### **Unamortized Bond Issuance Costs**

Costs incurred in connection with the issuance of long-term debt are deferred and amortized over the term of the related financing, which approximates the effective interest method.

#### **Fair Value of Financial Instruments**

The Corporation's carrying amount for its financial instruments, which include cash and cash equivalents, investments and assets limited as to use, and accounts receivable, at December 31, 2014 and 2013, approximates fair value. The estimated fair value amounts have been determined by the Corporation using available market information and appropriate valuation methodologies.

#### **Property and Equipment**

Property and equipment are carried at cost, except for donated assets, which are recorded at fair value at the date of donation. Allowances for depreciation and amortization are computed primarily utilizing the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years.

#### **Asset Impairment**

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine whether the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating expenses at the time the impairment is identified. There was no impairment of long-lived assets in 2014 or 2013.

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

The carrying value of goodwill amounted to approximately \$10,281 and \$7,853 at December 31, 2014 and 2013, respectively, and is included in deferred charges and other assets in the consolidated balance sheets. Goodwill is assessed for impairment on an annual basis at the reporting unit level. If the fair value of the reporting unit is less than the carrying value, an impairment loss equal to the difference between the implied fair value of the reporting unit goodwill and the carrying value of the reporting unit goodwill is recognized. There was no impairment of goodwill in 2014 or 2013.

#### **Deferred Charges and Other Assets**

Included in deferred charges and other assets are intangible assets, goodwill, and investments in unconsolidated affiliates.

The acquisition of a business entity can result in the recording of intangible assets. Acquired definite-lived intangible assets (excluding goodwill) are amortized over the useful life of the assets. Goodwill is carried at acquisition value, less any impairment reductions.

The Corporation accounts for its investments in less than majority owned and controlled affiliates using either the cost basis or the equity method of accounting. Income from these investments is reflected in other revenue in the consolidated statements of operations and changes in net assets.

#### **Endowment Investments**

Income is received directly by MHF from MHF board-designated endowment investments and is included in investment income within temporarily restricted net assets. EGH receives a portion of the income from investments in endowments directly as they are released from restriction. These endowment investments have perpetual existence.

#### **Contributions**

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received to the extent estimated to be collectible by the Corporation. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a stipulated

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

#### **Temporarily Restricted Net Assets**

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Corporation. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Assets released from restrictions that are used for the purchase of property and equipment or capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Resources restricted by donors for specific operating purposes are reported in unrestricted revenue, gains, and other support to the extent expended within the period.

#### **Permanently Restricted Net Assets**

Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. In accordance with the restriction, a majority of the investment income and investment gains or losses from permanently restricted net assets are restricted by the donor for a specific purpose and are therefore temporarily restricted. A specified portion of income earned by the temporarily restricted net assets is released from restriction and used for operations each year and, therefore, is included in the consolidated statements of operations and changes in net assets as other revenue.

#### **Net Patient Service Revenue**

Net patient service revenue is recorded in the period in which services are rendered, based upon estimated amounts due from patients and third-party payors. Third parties include Medicare, Medicaid, managed health care plans, and other commercial plans. BHS has agreements with various third-party payors that provide for payments to BHS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts received or due from patients, third-party

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

payors, and others for services rendered. These amounts include estimated adjustments under certain reimbursement agreements with third-party payors, which are subject to audit by the applicable administering agency. These adjustments are accrued on an estimated basis and are adjusted in future periods as final settlements are determined (see Note 3). The Hospitals provide care to all patients regardless of their ability to pay. Charity care provided is excluded from net patient service revenue (see Note 4).

#### **Performance Indicator**

The consolidated statements of operations and changes in net assets include a performance indicator, revenue and gains in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess of expenses, consistent with industry practice, include contributions of long-lived assets, including assets acquired using contributions, which, by donor restrictions, were to be used for the purpose of acquiring such assets, and pension-related changes other than net periodic costs.

#### **Allocation of Costs**

The Corporation's ability to exercise control over consolidated entities could result in the entities having a financial position or operating results that are significantly different from those that would have been obtained if the entities were autonomous. The manner of allocating certain shared and centralized costs, such as accounts payable processing, information technology support, and other Corporation-managed administration costs, is determined by the Corporation utilizing Internal Revenue Service transfer pricing guidance. Alternate methods of accounting for these cost allocations may produce significantly different operating results for each of the consolidated entities.

#### **Interest Rate and Basis Swaps**

All interest rate and basis swaps are measured at fair value based on techniques consistent with the market approach. None of the swaps are designated as hedging instruments; therefore, the unrealized gains or losses on the fair value of the swaps are included in revenue and gains in excess of expenses in the consolidated statements of operations and changes in net assets.

# Beacon Health System, Inc. and Affiliated Corporations

## Notes to Consolidated Financial Statements (continued)

(In Thousands)

### 2. Summary of Significant Accounting Policies (continued)

#### Asset Retirement Obligations

The Corporation accounts for the fair value of legal obligations associated with long-lived asset retirements by recognizing an expense and accreting a liability over the life of the asset to cover potential legal obligations at the end of the asset's useful life. The asset retirement obligation primarily relates to future asbestos remediation related to buildings on MHSB's campus, as well as ground/soil remediation associated with the removal of underground fuel tanks. The carrying value of the obligation amounted to approximately \$4,536 and \$4,343 at December 31, 2014 and 2013, respectively, and is reflected in pension and other liabilities on the consolidated balance sheets.

#### New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance related to recognizing revenue from contracts with customers. This new guidance dictates that the standard be applied either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the revenue recognition standard recognized at the date of initial application. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. The Corporation is evaluating the effect this guidance will have on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern*, that requires management to evaluate whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern. This standard is not effective for the Corporation until December 31, 2016.

#### Reclassifications

Certain reclassifications were made to the 2013 consolidated financial statements to conform with classifications made in 2014. The reclassifications had no effect on the changes in net assets or on net assets previously reported.

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### 3. Contractual Arrangements With Third-Party Payors and Uncollectible Accounts

The Medicare and Medicaid programs reimburse the Corporation for inpatient and outpatient services at predetermined rates based on diagnosis and treatment. Changes in the Medicare and Medicaid programs or reduction in funding of the programs could have an adverse effect on future amounts recognized as net patient service revenue.

The laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Managed care reimbursement agreements provide for payment of patient services at a fixed percentage of covered charges. The Corporation has also entered into contractual arrangements with various health maintenance and preferred provider organizations, the terms of which call for the Corporation to be paid for covered services at predetermined rates, including percentage of charges, per diem, and case rate.

Estimated amounts due are calculated from contractually obligated terms of payment for each payor, as well as uninsured discounts applied for patients with no insurance coverage. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the years ended December 31 from these major payor sources is as follows (in thousands):

<b>Payor</b>	<b>2014</b>	<b>2013</b>
Anthem	\$ 203,479	\$ 180,080
Commercial	265,230	249,960
Medicare	253,610	237,436
Medicaid	151,949	77,446
Self-pay	64,200	95,486
Net patient service revenue	938,468	840,408
Provision for bad debt	(68,927)	(62,724)
Net patient service revenue less provision for bad debt	\$ 869,541	\$ 777,684

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**3. Contractual Arrangements With Third-Party Payors and Uncollectible Accounts  
(continued)**

Net patient service revenues related to the Medicare program are 27% and 28% for the years ended December 31, 2014 and 2013, respectively. Net patient service revenues related to the Medicaid program are 16% and 9% for the years ended December 31, 2014 and 2013, respectively. Amounts reported under the Anthem payor contract account for 22% and 21% of net patient service revenue for the years ended December 31, 2014 and 2013, respectively. Credit is granted without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Major components of net patient accounts receivable include 26% from Medicare and 22% from Anthem at December 31, 2014, and 30% from Medicare and 20% from Anthem at December 31, 2013.

The provision for bad debts is based upon management's assessment of historical and expected net collections taking into consideration the trends in health care coverage, historical economic trends, and other collection indicators. Management assesses the adequacy of the allowances periodically throughout the year based upon historical write-off experience by major payor category. The results of the review are then utilized to make modifications, as necessary, to the provision for bad debts to provide for an appropriate allowance for uncollectible accounts. A significant portion of the Corporation's uninsured patients will be unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided. The allowance for doubtful accounts recognized at December 31 by major payor source is as follows:

<b>Payor</b>	<b>2014</b>	<b>2013</b>
Third-party payors	\$ 14,363	\$ 13,550
Self-pay	12,012	9,573
	<u>\$ 26,375</u>	<u>\$ 23,123</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**3. Contractual Arrangements With Third-Party Payors and Uncollectible Accounts  
(continued)**

Adjustments arising from reimbursement arrangements with third-party payors are accrued for on an estimated basis in the period in which the services are rendered, with the exception of Indiana Medicaid Disproportionate Share (DSH) reimbursement. DSH payments by the state of Indiana, if eligible, are paid according to the fiscal year of the state, which ends on June 30 of each year, and are based on the cost of uncompensated care provided by the DSH providers during their respective fiscal year ended during the state fiscal year. DSH payments are recorded after eligibility is determined, and payments are probable and reasonably estimable. In 2012, MHSB qualified for the State DSH program for State Fiscal Years (SFY) 2012 and 2013. In 2014, MHSB qualified for the State DSH program for SFYs 2014 and 2015. MHSB recorded net patient service revenue of \$10,700 for the year ended December 31, 2014, related to SFY 2014 and 2013 DSH payments. MHSB recorded net patient service revenue of \$23,071 for the year ended December 31, 2013, related to SFY 2013 and 2012 DSH payments.

In May 2012, the Indiana Hospital Assessment Fee program (HAF) was approved by the Centers for Medicare & Medicaid Services (CMS) for the period July 1, 2011 through June 30, 2013. The State of Indiana approved HAF effective July 2013 through June 2017. CMS ratified the HAF program retroactively to July 1, 2013 in April 2014. Under HAF, Indiana hospitals receive additional federal Medicaid funds for the state's health care system, administered by the Indiana Family and Social Services Administration. HAF includes both a payment to the Hospitals from the state (included in net patient service revenue) and an assessment (included in supplies and other expenses) against the Hospitals, which is paid to the state the same year. BHS recognized revenues and assessments as follows:

	<u>Year Recognized</u>		<u>Total</u>
	<u>2013</u>	<u>2014</u>	
2014 HAF revenue	\$ —	\$ <b>49,490</b>	\$ 49,490
2014 HAF assessments	—	<b>(25,203)</b>	(25,203)
2013 HAF revenue	28,954	<b>28,863</b>	57,817
2013 HAF assessments	(14,486)	<b>(13,358)</b>	(27,844)
	<u>\$ 14,468</u>	<u>\$ <b>39,792</b></u>	<u>\$ 54,260</u>

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **3. Contractual Arrangements With Third-Party Payors and Uncollectible Accounts (continued)**

HAF revenue is included in net patient service revenue and HAF assessments are included in supplies and other expenses in the consolidated statements of operations and changes in net assets.

Estimates for DSH, cost report settlements, and contractual allowances can differ from actual reimbursement based on the results of subsequent reviews, government regulatory changes, and cost report audits. For the years ended December 31, 2014 and 2013, net patient service revenue has been decreased by approximately \$3,971 and \$259, respectively, for changes in estimates of third-party payor settlements related to prior years.

#### **4. Charity Care**

Charity care represents unreimbursed costs for services rendered at a reduced fee, or no fee, due to the inability of the patient to pay for services. The amount of the charity care provided was approximately \$12,328 and \$12,092 for the years ended December 31, 2014 and 2013, respectively, at estimated cost. The Corporation utilized a cost to charge ratio methodology for the cost analysis. The only reimbursement for financial assistance care received by the Corporation is determined through a settlement process in the Hospitals' annual Medicare cost report filing. Financial assistance care reimbursement was approximately \$968 and \$340 for the years ended December 31, 2014 and 2013, respectively.

#### **5. Retirement Plans**

The Corporation maintains a defined-contribution employee retirement and savings plan for all employees who have attained 21 years of age and have completed 12 months of continuous service. The Corporation's contributions are based on 100% of the employee's contributions, up to 4% of the employee's salary. Both employee and corporation contributions are subject to certain limitations. Included in employee benefits on the statement of operations are contributions of approximately \$9,508 and \$8,972 for the years ended December 31, 2014 and 2013, respectively.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
*(In Thousands)*

**5. Retirement Plans (continued)**

The Corporation also has a noncontributory, defined-benefit pension plan (the MEM Plan), which includes MHSB, BMG, MHF, and BHV with a final average pay plan and a cash balance plan. The cash balance plan was frozen for new participants and accrual of benefits as of December 31, 2007, and the much smaller grandfathered final average pay plan, with fewer participants, remains frozen and has not been altered. The assets in the cash balance plan will continue to earn interest, but service credits are frozen.

The Corporation also has a noncontributory, defined-benefit pension plan (the EGH Plan) for EGH. As of December 31, 2007, the EGH Plan was frozen for all participants who had not attained the age of 50 and accumulated 15 years of vesting service as of December 31, 2007. No new participants are allowed into the plan as of December 31, 2007. Participants who were at least 50 years old and had accumulated 15 years of service at December 31, 2007, continued to accrue benefits under the terms of the EGH Plan until it was frozen effective January 1, 2013. Additionally, a lump-sum payout option was effective for all participants on July 1, 2012.

The Corporation's defined-benefit plan expense was as follows:

	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
December 31, 2014	\$ 878	\$ 1,445	\$ 2,324
December 31, 2013	2,659	2,201	4,860

The Corporation's expected plan expense for the year ending December 31, 2015, is as follows:

	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Plan expense	\$ 4,574	\$ 2,662	\$ 7,236

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**5. Retirement Plans (continued)**

The measurement date of December 31 is utilized for both plans. The summary of the changes in the benefit obligation and plan assets and the resulting funded status of the plans are as follows:

	<b>December 31, 2014</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Accumulated benefit obligation	\$ 158,120	\$ 144,094	\$ 302,214
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	\$ 140,205	\$ 129,976	\$ 270,181
Service cost	—	1,406	1,406
Interest cost	5,947	5,560	11,507
Actuarial gain	20,683	13,216	33,899
Benefits and administrative expenses paid	(5,159)	(4,224)	(9,383)
Lump-sum benefits paid	(3,556)	(1,840)	(5,396)
Projected benefit obligation at end of year	\$ 158,120	\$ 144,094	\$ 302,214
Change in plan assets:			
Fair value of plan assets at beginning of year	\$ 113,654	\$ 102,216	\$ 215,870
Actual return on plan assets	4,968	3,806	8,774
Employer contributions	3,000	3,870	6,870
Benefits and administrative fees paid	(5,159)	(4,224)	(9,383)
Lump-sum benefits paid	(3,556)	(1,840)	(5,396)
Fair value of plan assets at end of year	\$ 112,907	\$ 103,828	\$ 216,735
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheet	\$ (45,213)	\$ (40,266)	\$ (85,479)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**5. Retirement Plans (continued)**

	<b>December 31, 2013</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Accumulated benefit obligation	\$ 140,205	\$ 129,976	\$ 270,181
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	\$ 162,292	\$ 143,213	\$ 305,505
Service cost	–	1,386	1,386
Interest cost	5,506	4,892	10,398
Actuarial gain	(18,490)	(12,847)	(31,337)
Benefits and administrative expenses paid	(4,985)	(6,668)	(11,653)
Lump-sum benefits paid	(4,118)	–	(4,118)
Projected benefit obligation at end of year	\$ 140,205	\$ 129,976	\$ 270,181
Change in plan assets:			
Fair value of plan assets at beginning of year	\$ 106,512	\$ 96,953	\$ 203,465
Actual return on plan assets	11,245	9,181	20,426
Employer contributions	5,000	2,750	7,750
Benefits and administrative fees paid	(4,985)	(6,668)	(11,653)
Lump-sum benefits paid	(4,118)	–	(4,118)
Fair value of plan assets at end of year	\$ 113,654	\$ 102,216	\$ 215,870
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheet	\$ (26,551)	\$ (27,760)	\$ (54,311)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**5. Retirement Plans (continued)**

Included in unrestricted net assets are the following amounts that have not been recognized in net periodic pension cost:

	<b>At December 31, 2014</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Prior service cost	\$ —	\$ 9	\$ 9
Actuarial net loss	<b>61,549</b>	<b>44,389</b>	<b>105,938</b>
	<b>\$ 61,549</b>	<b>\$ 44,398</b>	<b>\$ 105,947</b>

	<b>At December 31, 2013</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Prior service cost	\$ —	\$ 5	\$ 5
Actuarial net gain	(40,766)	(29,463)	(70,229)
	<b>\$ (40,766)</b>	<b>\$ (29,458)</b>	<b>\$ (70,224)</b>

The estimated prior service cost and actuarial net losses that will be amortized into expense over the next fiscal year are as follows:

	<b>At December 31, 2014</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Prior service cost	\$ —	\$ (2)	\$ (2)
Actuarial net loss	(4,574)	(3,331)	(7,905)
Estimated benefit cost amortizations in the next fiscal year	<b>\$ (4,574)</b>	<b>\$ (3,333)</b>	<b>\$ (7,907)</b>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**5. Retirement Plans (continued)**

Changes in the plan's assets and benefit obligations recognized in unrestricted net assets include the following:

	<b>Year Ended December 31, 2014</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Current year actuarial loss	\$ 20,783	\$ 14,930	\$ 35,713
Current year amortization prior service cost	–	9	9
	<u>\$ 20,783</u>	<u>\$ 14,939</u>	<u>\$ 35,722</u>

	<b>Year Ended December 31, 2013</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Current year actuarial gain	\$ (26,888)	\$ (17,957)	\$ (44,845)
Current year amortization prior service cost	–	7	7
	<u>\$ (26,888)</u>	<u>\$ (17,950)</u>	<u>\$ (44,838)</u>

The components of net periodic benefit cost for the defined-benefit pension plans were as follows:

	<b>Year Ended December 31, 2014</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Service cost	\$ –	\$ 1,406	\$ 1,406
Interest cost	5,947	5,560	11,507
Expected return on plan assets	(7,743)	(7,070)	(14,813)
Prior service credit recognized	–	(4)	(4)
Amortization of recognized losses	2,675	1,553	4,228
Benefit cost	<u>\$ 879</u>	<u>\$ 1,445</u>	<u>\$ 2,324</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**5. Retirement Plans (continued)**

	<b>Year Ended December 31, 2013</b>		
	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
Service cost	\$ —	\$ 1,386	\$ 1,386
Interest cost	5,506	4,892	10,398
Expected return on plan assets	(7,990)	(7,144)	(15,134)
Prior service credit recognized	—	(6)	(6)
Amortization of recognized losses	5,143	3,073	8,216
Benefit cost	<u>\$ 2,659</u>	<u>\$ 2,201</u>	<u>\$ 4,860</u>

Assumptions used to determine benefit obligations at the measurement date are as follows:

	<b>December 31, 2014</b>	
	<b>EGH</b>	<b>MEM</b>
Discount rates	<b>3.60%</b>	<b>3.60%</b>
Expected return on plan assets	<b>7.00</b>	<b>7.00</b>
Rate of compensation increase	<b>N/A</b>	<b>3.00</b>

  

	<b>December 31, 2013</b>	
	<b>EGH</b>	<b>MEM</b>
Discount rates	4.40%	4.40%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

In 2014, the mortality assumptions for the plans' were updated to the RP-2014 mortality tables.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
*(In Thousands)*

**5. Retirement Plans (continued)**

Assumptions used to determine net pension expense for the fiscal years are as follows:

	<b>December 31, 2014</b>	
	<b>EGH</b>	<b>MEM</b>
Discount rates	<b>4.40%</b>	<b>4.40%</b>
Expected return on plan assets	<b>7.00</b>	<b>7.00</b>
Rate of compensation increase	<b>N/A</b>	<b>3.00</b>

  

	<b>December 31, 2013</b>	
	<b>EGH</b>	<b>MEM</b>
Discount rates	3.50%	3.50%
Expected return on plan assets	7.50	7.50
Rate of compensation increase	N/A	3.00

The following is a summary of the pension plan asset actual allocations:

<b>Asset Category</b>	<b>EGH/MEM Target</b>	<b>2014</b>		<b>2013</b>	
		<b>EGH</b>	<b>MEM</b>	<b>EGH</b>	<b>MEM</b>
Equity securities	38%	<b>37%</b>	<b>31%</b>	51%	31%
Debt securities	33	<b>28</b>	<b>29</b>	27	11
Other	29	<b>35</b>	<b>40</b>	22	58
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	100%	100%

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**5. Retirement Plans (continued)**

The following table sets forth by level, within the fair value hierarchy (see Note 11), the combined MEM and EGH plan assets carried at fair value as of December 31, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Short-term investment funds <sup>(a)</sup>	\$ 6,035	\$ —	\$ —	\$ 6,034
Mutual funds <sup>(a)</sup>				
Large cap equity	10,467	—	—	10,467
International equity	53,061	2,595	—	55,656
Blended fund	61,535	—	—	61,535
Total mutual funds	125,063	2,595	—	127,658
Common stocks <sup>(a)</sup>	8,643	—	—	8,643
Master limited partnership <sup>(c)</sup>	—	—	12,749	12,749
REIT <sup>(c)</sup>	—	—	7,180	7,180
Long/short funds: <sup>(b), (c)</sup>				
Long/short	—	249	—	249
Commingled	—	—	3,769	3,769
Hedge funds: <sup>(c)</sup>				
Multi-strategy	—	16,703	—	16,703
Long/short hedge	—	5,217	—	5,217
International	—	9,700	—	9,700
Global	—	2,800	—	2,800
Other	—	10,893	—	10,893
Fund of funds <sup>(c)</sup>	—	5,139	—	5,139
	<u>\$ 139,741</u>	<u>\$ 53,296</u>	<u>\$ 23,698</u>	<u>\$ 216,735</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**5. Retirement Plans (continued)**

The following table sets forth by level, within the fair value hierarchy (see Note 11), the combined MEM and EGH plan assets carried at fair value as of December 31, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Short-term investment funds <sup>(a)</sup>	\$ 34,082	\$ —	\$ —	\$ 34,082
Mutual funds: <sup>(a)</sup>				
Large cap equity	31,010	—	—	31,010
International equity	50,378	—	—	50,378
Small cap equity	4,481	—	—	4,481
Blended fund	41,850	—	—	41,850
Total mutual funds	127,719	—	—	127,719
Common stocks <sup>(a)</sup>	4,061	—	—	4,061
Common/collective trust funds <sup>(b)</sup>	—	334	—	334
Long/short funds: <sup>(b), (c)</sup>				
Long/short	—	18,326	—	18,326
Leveraged capital	—	6,386	—	6,386
Hedge funds: <sup>(c)</sup>				
Multi-strategy	—	16,425	—	16,425
Long/short hedge	—	880	—	880
Fixed and convertible arbitrage	—	1,979	—	1,979
Long commodities	—	4,761	—	4,761
Other	—	917	—	917
	<u>\$ 165,862</u>	<u>\$ 50,008</u>	<u>\$ —</u>	<u>\$ 215,870</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**5. Retirement Plans (continued)**

- (a) Pricing for common stocks, mutual funds, and short-term investments is based on the open market and is valued on a daily basis.
- (b) Pricing is based on the market value of the securities and is valued on a monthly basis. In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue to appropriately value the holding.
- (c) Investments in other funds, long/short funds, MLP, REIT, fund of funds and hedge funds are valued using the net asset value (NAV) provided by the administrator of the fund. These investments are not otherwise traded on a securities exchange. The NAV is based on the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding.

The table below sets forth a summary of changes in the fair value of Level 3 as follows:

Balance as of January 1, 2013	\$ 3,816
Sales	(4,075)
Realized gains	590
Unrealized gains	(331)
Balance as of December 31, 2013	—
Purchases	<b>24,628</b>
Sales	<b>(1,500)</b>
Realized gains	<b>1,405</b>
Unrealized gains	<b>(835)</b>
Balance as of December 31, 2014	<b><u>\$ 23,698</u></b>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**5. Retirement Plans (continued)**

In addition to understanding fair value methodologies, long/short funds, MLP, REIT, fund of funds, hedge funds, and other funds may be subject to redemption and/or liquidity restrictions. Those funds that have restrictions are summarized below, as follows:

Type of Fund	Fair Value at December 31		Redemption Restrictions	Liquidity Time Frame
	2014	2013		
<b>Mutual funds</b>				
International equities	\$ 2,595	\$ –	None	Under 95 days
<b>Long/short funds</b>				
Commingled	3,769	–	None	Under 95 days
Long/short	–	9,589	None	Under 95 days
Long/short	249	8,737	None	Annual
Long/short leveraged capital	–	6,386	None	Under 95 days
<b>Master limited partnership</b>	<b>12,749</b>	–	1 year lock redemption fee	Under 95 days
<b>REIT</b>	<b>7,180</b>	–	None	Under 95 days
<b>Hedge funds</b>				
Multi-strategy hedge funds	13,379	–	1 year lock varying redemption fees	Under 95 days
Multi-strategy hedge funds	3,324	16,425	None	Under 95 days
Long/short hedge funds	2,800	880	None	Under 95 days
Long/short hedge funds	2,417	–	1 year lock redemption fee	Under 95 days
International	2,055	–	1 year lock redemption fee	Under 95 days
International	7,645	–	None	Under 95 days
Fixed and convertible arbitrage hedge funds	–	1,979	None	Under 95 days
Long commodities	–	4,761	None	Under 95 days
Other hedge funds	4,868	917	None	Under 95 days
Other hedge funds	2,316	–	1 year lock redemption fee	Under 95 days
Other hedge funds	1,358	–	18 month year lock redemption fee	Under 95 days
<b>Fund of funds</b>				
Fund of funds	3,144	–	1 year redemption restriction	Under 95 days
Fund of funds	1,995	–	None	Under 95 days

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
*(In Thousands)*

**5. Retirement Plans (continued)**

The Corporation employs a total return investment approach, whereby a mix of equities and fixed-income investments is used to maximize the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity, fixed-income, and alternative investments. Equity investments are diversified across U.S. and non-U.S. corporate stocks, as well as growth, value, and small and large capitalizations.

Other assets, such as hedge funds, are used to enhance long-term returns while improving portfolio diversification. The Corporation's external investment managers may use derivatives to gain market exposure in an efficient and timely manner. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements, and periodic asset/liability studies.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years ending December 31:

	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
2015	\$ 10,128	\$ 8,475	\$ 18,603
2016	10,632	8,524	19,156
2017	10,813	9,151	19,964
2018	10,810	9,102	19,912
2019	11,042	9,458	20,500
2020–2023	49,396	46,136	95,532

The Corporation contributed the following to plan assets for the years ended December 31, 2014 and 2013, from employer assets:

	<b>EGH</b>	<b>MEM</b>	<b>Total</b>
2014 contributions	\$ 3,000	\$ 3,870	\$ 6,870
2013 contributions	5,000	2,750	7,750

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**5. Retirement Plans (continued)**

The Corporation anticipates contributing the following to the plan assets from employer assets in 2015:

	<u>EGH</u>		<u>MEM</u>		<u>Total</u>
Anticipated 2015 total contributions	\$ 4,000	\$	4,000	\$	8,000

**6. Lease Obligations**

The Corporation leases certain office space and equipment under non-cancelable operating leases. At December 31, 2014, the minimum future rental payments under these leases are as follows:

2015	\$ 4,370
2016	1,821
2017	1,490
2018	1,560
2019	1,455
Thereafter	6,550
	<u>\$ 17,246</u>

Rental expense for the years ended December 31, 2014 and 2013, was approximately \$6,993 and \$5,671, respectively, which is included in supplies and other expense.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**7. Long-Term Debt**

Long-term debt consists of the following at December 31:

	<u>2014</u>	<u>2013</u>
Tax-exempt bonds issued on behalf of BHS by the Indiana Finance Authority:		
BHS Revenue Bonds, Series 2013A, bearing interest at fixed rates between 2.00% and 5.00%, due in varying annual installments on August 15 of each year through 2034	\$ 105,625	\$ 110,265
BHS Revenue Note, Series 2013B, bearing interest at a fixed rate of 1.17%, at December 31, 2014, due in monthly installments through 2020	5,764	6,805
Tax-exempt bonds issued on behalf of BHS by the Hospital Authority of St. Joseph County:		
BHS Revenue Bonds, Series 2013C, bearing interest at fixed rates between 3.75% and 5.00%, due in varying annual installments on August 15 of each year through 2044	46,130	46,130
Tax-exempt bonds issued on behalf of MHSB by the Hospital Authority of St. Joseph County:		
MHSB Revenue Bonds, Series 2008A, bearing interest at variable rates retaining the hedge from Series 2006 with a floating fixed interest rate swap of 3.52% at December 31, 2014 and 2013, due in varying annual installments on August 15 of each year through 2033	37,865	38,065

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**7. Long-Term Debt (continued)**

	<u>2014</u>	<u>2013</u>
Tax-exempt bonds issued on behalf of EGH by the Hospital Authority of Elkhart County:		
EGH Revenue Bonds, Series 2008, bearing interest at variable rates of 0.04% and 0.05% at December 31, 2014 and 2013, respectively, due annually on May 1 of each year through 2033	\$ 42,970	\$ 43,790
Mortgage – bearing interest at a variable rates of 2.41% and 2.42% at December 31, 2014 and 2013, respectively, London Interbank Offered Rate (LIBOR) plus 2.25%, due in varying annual installments on the last day of every month through 2015	1,014	1,217
Capital leases	3,104	11
	<u>242,472</u>	<u>246,283</u>
Unamortized premium	16,018	16,853
	<u>258,490</u>	<u>263,136</u>
Less current portion	8,693	6,899
	<u>\$ 249,797</u>	<u>\$ 256,237</u>

In May 2013, the Indiana Finance Authority, on behalf of BHS, issued revenue refunding bonds Series 2013A (2013A) in the principal amount of \$116,705. The interest rate for 2013A is a fixed rate varying between 2.00% and 5.00%. The proceeds from 2013A were utilized to refund the MHSB Revenue Bonds, Series 2008B; MHSB Revenue Bonds, Series 1998A; and the EGH Revenue Bonds, Series 1998.

In May 2013, the Indiana Finance Authority, on behalf of BHS, issued a revenue note Series 2013B (2013B) in the principal amount of \$7,492. The interest rate for 2013B is a fixed rate of 1.17%. Proceeds from the bond were utilized for the purchase of a helicopter.

In May 2013, the Hospital Authority of St. Joseph County, on behalf of BHS, issued revenue bonds Series 2013C (2013C) in the principal amount of \$46,130. The interest rate for 2013C is a fixed rate varying between 3.75% and 5.00%. The proceeds from 2013C were utilized to refund the MHSB Revenue Bonds, Series 2007. The remaining proceeds are set aside in externally designated investments for future projects.

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **7. Long-Term Debt (continued)**

In August 2008, the Hospital Authority of St. Joseph County, on behalf of MHSB, issued revenue refunding bonds in the principal amount of \$78,495. The interest rate for the Series 2008A is a weekly interest rate determined by the remarketing agent. The 2008 bond issue is secured by an irrevocable direct-pay letter of credit issued by JPMorgan Chase Bank (JPMorgan). The JPMorgan letters of credit expire on July 31, 2018. As long as no default has occurred, draws on the direct-pay letter of credit made for failed remarketing will be required to be repaid in 12 equal quarterly installments commencing 12 months after the date of draw.

The Series 2008A Bonds are subject to mandatory redemption through the operation of a sinking fund on each August 15 commencing with the year 2011 up to and including the year 2033 in amounts sufficient to redeem the principal amounts.

In May 2007, the Hospital Authority of St. Joseph County, on behalf of MHSB, issued revenue bonds in the principal amount of \$80,000 (the Series 2007 Bonds). MHSB purchased \$27,000 par value of the Series 2007 Bonds for \$13,230 in March 2009. In October 2008, MHSB purchased \$52,000 par value of the Series 2007 Bonds for \$29,640. The par value of the Series 2007 Bonds remains outstanding, with MHSB as owner of record. The consolidated balance sheets reflect these purchases as a reduction of long-term debt for the Series 2007 Bonds of \$79,000 at par value. These bonds were refunded and reissued in May 2013 under the Series 2013C bonds.

The Hospital Authority of Elkhart County issued \$47,800 of Series 2008 Hospital Revenue Bonds (the Series 2008 Bonds). EGH borrowed the proceeds of the sale of the Series 2008 Bonds and evidenced this loan with a loan agreement, issued under a Trust Indenture dated December 1, 2008.

The proceeds of the Series 2008 Bonds were issued to retire interest and principal payments of previously outstanding bonds. The Series 2008 Bonds require EGH to hold a letter of credit with JPMorgan. The letter of credit expires on July 31, 2018, and decreases by the principal payments made by EGH on the Series 2008 Bonds. The Series 2008 Bonds mature in May 2033.

As long as no default has occurred, draws on the direct-pay letter of credit made for failed remarketing will be required to be repaid in eight equal quarterly installments commencing on the last business day of the fourth calendar quarter after the stated expiration date of the letter of credit (July 31, 2018).

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

**7. Long-Term Debt (continued)**

As of the date of the issuance of the Series 2007 Bonds, under the terms of a Master Trust Indenture, BMG and MHSB formed the Obligated Group (the Obligated Group). MHF and BHV constitute designated affiliates under the terms of the Master Trust Indenture.

The MHSB Series 2008A, 2008B, 2007, and 1998A bonds were issued pursuant to the Master Trust Indenture, and the bonds are secured by pledged revenues of the Obligated Group and contain various covenants, including achievement of specified financial ratios and limitations on additional debt.

In December 2012, the Corporation was admitted into the Obligated Group and became the Obligated Group Agent. On December 31, 2012, EGH was admitted into the Obligated Group. The Series 2008 and 1998 EGH Bonds were substituted into the existing MHSB Master Trust Indentures, and the EGH Trust Indentures were canceled and released.

The loan agreements require maintenance of certain debt service coverage ratios, limit additional borrowings, and require compliance with various other restrictive covenants. The Corporation was in compliance with all covenants during 2014 and 2013.

Interest capitalized for the years ended December 31, 2014 and 2013, was approximately \$912 and \$645.

Maturities of long-term debt and capital lease obligations for each of the next five years are as follows:

2015	\$	8,693
2016		8,030
2017		8,416
2018		8,370
2019		7,812

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) *(In Thousands)*

#### **8. Lines of Credit**

MHSB has a \$2,000 revolving line of credit with 1st Source Bank. The line of credit was renewed and extended through May 31, 2015. Of the \$2,000 revolving line of credit, \$50 for the years ended December 31, 2014 and 2013, was segregated for the beneficiary of a self-insurance trust. Conversely, \$1,950 was available to be drawn upon at December 31, 2014 and 2013. No draws were taken by MHSB in either 2014 or 2013. The interest rate on the line of credit is the prime rate minus 0.5%. No amounts were outstanding on the line of credit as of December 31, 2014 or 2013.

MHSB has a \$7,000 revolving line of credit with Merrill Lynch. The line of credit is due on demand and can be terminated by either party with notice. Advances on the line can be made with a variable rate of LIBOR plus 1.25%, at a fixed rate as agreed upon by the parties for a 12-month period or at an agreed-upon term rate for periods greater than 12 months. At any time MHSB may request that variable rate advances be converted into fixed or term rates. No draws were taken by MHSB in either 2014 or 2013. No amounts were outstanding on the line of credit as of December 31, 2014 or 2013.

#### **9. Interest Rate and Basis Swaps**

MHSB has various derivative instruments to manage the exposure on interest rates and MHSB's interest expense. Through the use of derivative financial instruments, MHSB is exposed to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of the derivative contract is positive, the counterparty owes MHSB, which creates credit risk to MHSB. When the fair value of the derivative contract is negative, MHSB owes the counterparty, and there is no credit risk to MHSB at that point in time. MHSB minimizes the credit risk in derivative instruments by entering into transactions that require the counterparty to post collateral for the benefit of the fair value of the derivative contract. Market risk is the adverse effect on the value of the financial instrument that results from a change in interest rates. The management of market risk associated with interest rate changes is defined in MHSB's Swap Management Policy (the Policy). The Policy includes continuous monitoring of market conditions, emergent opportunities, and risks. Swap management is meant to be long term in nature, and any modifications to the program are reviewed for the long-term costs and benefits. Management also mitigates risk through periodic reviews of its derivative position in the context of its total blended cost of capital.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Interest Rate and Basis Swaps (continued)**

The derivative instruments require adherence to collateral posting thresholds. For the years ended December 31, 2014 and 2013, the mark-to-market valuation on the swap portfolio was below the required collateral posting threshold of \$30,000 with PNC Bank, \$25,000 with Morgan Stanley, \$25,000 with Wells Fargo, and \$25,000 with Deutsche Bank.

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2014:

<b>Origination Date</b>	<b>Notional Amounts</b>	<b>Corporation Receives</b>	<b>Corporation Pays</b>	<b>Maturity Date</b>
March 2006	\$ 37,865	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	8,350	65% of 30-day LIBOR plus 0.45%	3.8100	August 2034

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2013:

<b>Origination Date</b>	<b>Notional Amounts</b>	<b>Corporation Receives</b>	<b>Corporation Pays</b>	<b>Maturity Date</b>
March 2006	\$ 38,065	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	8,600	65% of 30-day LIBOR plus 0.45%	3.8100	August 2034

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Interest Rate and Basis Swaps (continued)**

The following is a summary of the outstanding basis rate swaps as of December 31, 2014 and 2013:

<b>Origination Date</b>	<b>Notional Amounts</b>	<b>Corporation Receives</b>	<b>Corporation Pays</b>	<b>Maturity Date</b>
January 2007	\$ 42,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.0715%	January 2041
August 2007	54,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index + 0.0715%	August 2041
March 2001	140,000	75.125% of 3M LIBOR	SIFMA tax-exempt index	March 2031
July 2009	63,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	81,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index + 0.17%	August 2041

Net interest paid or received under the above swap agreements is included in interest expense. The net differential for the Corporation as a result of the swap agreements amounted to payments of approximately \$306 and \$589 for the years ended December 31, 2014 and 2013, respectively, and is reflected as an increase to interest expense. The swap agreements do not qualify for hedge accounting; therefore, the change in the fair value of the swap agreements is recorded as an unrealized non-operating gain of approximately \$9,008 and loss of approximately \$6,743 for the years ended December 31, 2014 and 2013, respectively.

The fair value of derivative instruments at December 31 is as follows:

	<b>Balance Sheet</b>		
	<b>Location</b>	<b>2014</b>	<b>2013</b>
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate and basis swaps	<u>\$ 27,752</u>	<u>\$ 36,761</u>

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### 10. Investments

Total investment return for the years ended December 31 is summarized as follows:

	<u>2014</u>	<u>2013</u>
Investment return:		
Net unrealized gains on investments	\$ 3,404	\$ 17,455
Net realized gains on investments	25,708	20,493
Net equity earnings on alternative investments	916	12,711
	<u>\$ 30,028</u>	<u>\$ 50,659</u>
Reported as:		
Investment income, net (non-operating)	\$ 29,672	\$ 49,466
Investment income (temporarily restricted net assets)	356	1,193
	<u>\$ 30,028</u>	<u>\$ 50,659</u>

The Corporation's investments are exposed to various kinds and levels of risk. Equity mutual funds expose the Corporation to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is the risk associated with a company's operating performance. Fixed-income securities expose the Corporation to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Liquidity risk tends to be higher for equities related to small capitalization companies. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value, resulting in additional gains and losses in the near term.

#### 11. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **11. Fair Value of Financial Instruments (continued)**

The fair value of the Corporation's long-term debt, excluding capital leases and the mortgage, is approximately \$252,826 and \$246,103 at December 31, 2014 and 2013, respectively. The valuation for the estimated fair value of long-term debt is completed by a third-party service and takes into account a number of factors, including, but not limited to, any one or more of the following: (i) general interest rate and market conditions; (ii) macroeconomic and/or deal-specific credit fundamentals; (iii) valuations of other financial instruments that may be comparable in terms of rating, structure, maturity, and/or covenant protection; (iv) investor opinions about the respective deal parties; (v) size of the transaction; (vi) cash flow projections, which, in turn, are based on assumptions about certain parameters that include, but are not limited to, default, recovery, prepayment, and reinvestment rates; (vii) administrator reports, asset manager estimates, broker quotations, and/or trustee reports; and (viii) comparable trades, where observable. Based on the inputs in determining the estimated fair value of debt, this fair value measurement would be considered Level 2.

Accounting Standards Codification Topic (ASC) 820-10-50-2 establishes a three-level valuation hierarchy. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in an active market and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**11. Fair Value of Financial Instruments (continued)**

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried as of December 31, 2014 and 2013, by caption, on the consolidated balance sheets by the valuation hierarchy defined above for those instruments carried at fair value, as well as the alternative investments that are reported on the equity method of accounting. Deferred compensation investments are included in other assets on the consolidated balance sheets.

	December 31, 2014					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
<b>Assets</b>						
Short-term investments <sup>(a)</sup>	\$ 85,919	\$ —	\$ —	\$ 85,919	\$ —	\$ 85,919
Internally designated investments:						
Mutual funds <sup>(a)</sup>						
International equity	12,443	—	—	12,443	—	12,443
Blended fund	306,905	—	—	306,905	—	306,905
Total mutual funds	319,348	—	—	319,348	—	319,348
Common stock <sup>(a)</sup>	79,037	—	—	79,037	—	79,037
Bonds <sup>(b)</sup>	—	—	—	—	—	—
Alternatives:						
Fund of hedge funds	—	—	—	—	11,293	11,293
International equity	—	—	—	—	17,521	17,521
MLP	—	—	—	—	31,270	31,270
Private equity	—	—	—	—	22,699	22,699
Real estate	—	—	—	—	6,630	6,630
Real assets	—	—	—	—	17,492	17,492
Commingled funds	—	—	—	—	9,834	9,834
Other	—	—	—	—	18,918	18,918
Long/short hedge	—	—	—	—	10,138	10,138
Global	—	—	—	—	4,131	4,131
Multi-strategy	—	—	—	—	21,887	21,887
Total alternatives	—	—	—	—	171,813	171,813
Total internally designated investments	398,385	—	—	398,385	171,813	570,198

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**11. Fair Value of Financial Instruments (continued)**

	December 31, 2014					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
<b>Assets (continued)</b>						
Restricted cash <sup>(a)</sup>	\$ 6,144	\$ –	\$ –	\$ 6,144	\$ –	\$ 6,144
Ext. designated investment – insurance trust:						
Fixed income <sup>(a)</sup>	2,619	–	–	2,619	–	2,619
Board-designated endowment:						
Mutual funds: <sup>(a)</sup>						
Equities	1,147	–	–	1,147	–	1,147
Blended fund	11,949	–	–	11,949	–	11,949
Fixed income <sup>(a), (b)</sup>	174	250	–	424	–	424
Equities <sup>(a)</sup>	3,584	–	–	3,584	–	3,584
Alternatives	–	–	–	–	3,697	3,697
Total board-designated endowment	16,854	250	–	17,104	3,697	20,801
Endowment:						
Mutual funds: <sup>(a)</sup>						
Fixed income	491	–	–	491	–	491
Equities	1,236	–	–	1,236	–	1,236
Money market <sup>(a)</sup>	114	–	–	114	–	114
Common collective trust funds <sup>(d)</sup>	–	4,769	–	4,769	–	4,769
Total endowment	1,841	4,769	–	6,610	–	6,610
Total	\$ 511,762	\$ 5,019	\$ –	\$ 516,781	\$ 175,510	\$ 692,291
<b>Liabilities</b>						
Swaps <sup>(c)</sup>	\$ –	\$ –	\$ (27,752)	\$ (27,752)	\$ –	\$ (27,752)
Total	\$ –	\$ –	\$ (27,752)	\$ (27,752)	\$ –	\$ (27,752)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**11. Fair Value of Financial Instruments (continued)**

	December 31, 2013					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
<b>Assets</b>						
Short-term investments <sup>(a)</sup>	\$ 71,884	\$ —	\$ —	\$ 71,884	\$ —	\$ 71,884
Internally designated investments:						
Mutual funds: <sup>(a)</sup>						
Large cap equity	59,188	—	—	59,188	—	59,188
International equity	115,387	—	—	115,387	—	115,387
Small cap equity	49,054	—	—	49,054	—	49,054
Total return fund	5,562	—	—	5,562	—	5,562
Blended fund	194,495	—	—	194,495	—	194,495
Total mutual funds	423,686	—	—	423,686	—	423,686
Common stock <sup>(a)</sup>	11,807	—	—	11,807	—	11,807
Bonds <sup>b</sup>	—	1,876	—	1,876	—	1,876
Alternatives:						
Fixed income	—	—	—	—	14,867	14,867
Fund of hedge funds	—	—	—	—	59,512	59,512
Long/short credit	—	—	—	—	6,386	6,386
Long/short equity	—	—	—	—	21,891	21,891
Private equity	—	—	—	—	12,468	12,468
Real estate	—	—	—	—	6,425	6,425
Total alternatives	—	—	—	—	121,549	121,549
Total internally designated investments	435,493	1,876	—	437,369	121,549	558,918

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**11. Fair Value of Financial Instruments (continued)**

	December 31, 2013					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
<b>Assets (continued)</b>						
Restricted cash <sup>(a)</sup>	\$ 5,194	\$ –	\$ –	\$ 5,194	\$ –	\$ 5,194
Ext. designated investment – insurance trust:						
Fixed income <sup>(a)</sup>	2,582	–	–	2,582	–	2,582
Board-designated endowment:						
Mutual funds: <sup>(a)</sup>						
Equities	10,431	–	–	10,431	–	10,431
Blended fund	5,866	–	–	5,866	–	5,866
Fixed income <sup>(a), (b)</sup>	194	322	–	516	–	516
Equities <sup>a</sup>	983	–	–	983	–	983
Alternatives	–	–	–	–	3,172	3,172
Total board-designated endowment	17,474	322	–	17,796	3,172	20,968
Endowment:						
Mutual funds: <sup>(a)</sup>						
Fixed income	518	–	–	518	–	518
Equities	847	–	–	847	–	847
Money market <sup>(a)</sup>	406	–	–	406	–	406
Common/collective trust funds <sup>(d)</sup>	–	4,507	–	4,507	–	4,507
Total endowment	1,771	4,507	–	6,278	–	6,278
Total	\$ 534,398	\$ 6,705	\$ –	\$ 541,103	\$ 124,721	\$ 665,824
<b>Liabilities</b>						
Swaps <sup>(c)</sup>	\$ –	\$ –	\$ (36,760)	\$ (36,760)	\$ –	\$ (36,760)
Total	\$ –	\$ –	\$ (36,760)	\$ (36,760)	\$ –	\$ (36,760)

(a) Pricing for mutual funds, short-term investments, equities, and government obligations is based on the open market and is valued on a daily basis.

(b) Pricing is based on the fair value of the securities and is valued on a monthly basis. Information used to value this account is provided by International Data Corp. (IDC). In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue from the IDC data to appropriately value the holding.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**11. Fair Value of Financial Instruments (continued)**

(c) Pricing is based on discounted cash flows to reflect a credit spread adjustment to the LIBOR discount curve in order to reflect “nonperformance” risk. The credit spread adjustment is derived from how other comparable entities’ bonds price and trade in the market. As the credit spread adjustment is a significant component of the swap valuation and is an unobservable input, the swaps have been classified as Level 3.

(d) Pricing is based on the market value of the securities and is valued on a monthly basis.

In addition to understanding fair value methodologies, the alternative investments may have redemption and/or liquidity restrictions. Restrictions of such funds by category are as follows as of December 31, 2014:

Type of Fund	Carrying Value	Redemption Restrictions	Liquidity Time Frame
Fund of hedge funds	\$ 5,383	Redemptions upon realization	Illiquid
Fund of hedge funds	6,534	None	Under 95 days
International equity	14,996	None	Under 95 days
International equity	2,524	1 year soft lock (redemption fee)	Under 95 days
MLP	31,270	1 year soft lock (redemption fee)	Under 95 days
Private equity	22,699	N/A	Illiquid
Real estate	6,630	None	Under 95 days
Real assets	17,794	None	Under 95 days
Commingled funds	9,834	None	Under 95 days
Other hedge	10,745	None	Holdback
Other hedge	6,566	None	Under 95 days
Other hedge	2,765	1 year soft lock (redemption fee)	Under 95 days
Other hedge	1,614	18 month soft lock (redemption fee)	Under 95 days
Long/short hedge	5,400	None	Under 95 days
Long/short hedge	4,738	1 year soft lock	Under 95 days
Global	4,131	None	Under 95 days
Multi-strategy	9,529	1 year soft lock (redemption fee)	Under 95 days
Multi-strategy	5,857	3 year soft lock	Under 95 days
Multi-strategy	6,500	1 year soft lock	Annual

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### 11. Fair Value of Financial Instruments (continued)

The table below sets forth a summary of changes in the fair value of the Corporation's Level 3 swaps for the years ended December 31:

	<b>2014</b>	<b>2013</b>
Balance, beginning of the year	\$ (36,760)	\$ (30,014)
Unrealized gains, net	<b>9,008</b>	(6,744)
Balance, end of the year	<b>\$ (27,752)</b>	<b>\$ (36,758)</b>

For the year ended December 31, 2014, the Corporation recorded approximately \$9,008 in non-operating gains, which relates to gains of \$11,684 due to the change in the swaps' value and loss of \$2,676 to reflect the fair value of the uncollateralized portion of the swap balance. For the year ended December 31, 2013, the Corporation recorded approximately \$6,744 in non-operating losses, which relates to losses of \$5,445 due to the change in the swaps' value and loss of \$1,299 to reflect the fair value of the uncollateralized portion of the swap balance.

#### 12. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to this and general and administrative functions for the years ended December 31 are as follows:

	<b>2014</b>	<b>2013</b>
Health care services	\$ <b>561,548</b>	\$ 544,610
Affiliated health services	<b>164,804</b>	103,417
General and administrative	<b>131,262</b>	122,056
	<b>\$ 857,614</b>	<b>\$ 770,083</b>

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **13. Commitments**

BMG is a guarantor for a portion of a loan of an unconsolidated joint venture, Valparaiso Medical Development, LLC, in which BMG records an equity interest. The portion of debt guaranteed by BMG is a maximum of \$5,520 and \$5,760 at December 31, 2014 and 2013, respectively. No amounts have been paid or accrued pursuant to this guarantee as of December 31, 2014 or 2013. The loan is collateralized by the assets, including the facility and land, held by Valparaiso Medical Development, LLC.

The Corporation has committed to investing \$40,000 in certain hedge funds and alternative investments. During the years ended December 31, 2014 and 2013, the Corporation invested approximately \$6,667 and \$4,497, respectively. The Corporation had a remaining unfunded commitment of approximately \$6,081 at December 31, 2014.

The Corporation has entered into various construction projects, including related commitments to construction managers, architects, and other vendors. The commitments under these agreements were approximately \$72,350, of which approximately \$37,819 was paid at December 31, 2014. The Corporation has made additional payments related to these projects subsequent to December 31, 2014, and through the date of this report of approximately \$3,391.

#### **14. Professional Liability Insurance**

The Corporation is a defendant in certain litigation arising in the ordinary course of business. MHSB and EGH have obtained separate professional liability insurance coverage under claims-made policies. MHSB terminated self-funding of its professional and general liability coverage on November 30, 2009. EGH terminated self-funding of its professional and general liability coverage on April 1, 2012. The Indiana Medical Malpractice Act has provided recovery up to \$1,250, per occurrence, with the first \$250 covered by the respective entity. MHSB maintains a trust fund for its self-insurance program, which it will continue to maintain until all claims have been settled. The fair value of the trust fund at December 31, 2014 and 2013, was approximately \$2,618 and \$2,582, respectively. The amount of malpractice and general liability claims, including a component for incurred but not reported claims, was approximately \$5,794 and \$6,043, gross of an insurance recoverable at December 31, 2014 and 2013, respectively, which is included in pension and other liabilities. The interest rate used to discount these claims was 3.0% at December 31, 2014 and 2013. In addition, at December 31, 2014 and 2013, the Corporation recognized a recoverable insurance asset of approximately \$4,080 and \$3,908, respectively, which is included in deferred charges and other assets.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**15. Income Taxes**

The Corporation and its related affiliates, except for BHV, have been determined to qualify as exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) of the Code.

Most of the income received by the Corporation and its related affiliates, except for BHV, is exempt from taxation, as the income is related to the mission of the organization. Accordingly, there is no material provision for income tax for these entities. However, some of the income received by exempt entities is subject to taxation as unrelated business income. The Corporation and its subsidiaries file federal and various state income tax returns in the United States.

**16. Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at December 31:

	<b>2014</b>	<b>2013</b>
Net assets currently available for:		
General – health care	\$ 7,869	\$ 7,907
Capital	5,833	2,821
Programs	260	259
Education	288	217
Other	1,088	1,158
	<b>\$ 15,338</b>	<b>\$ 12,362</b>

Permanently restricted net assets generate investment income, which is used to benefit the following purposes at December 31:

	<b>2014</b>	<b>2013</b>
Endowment investments providing income for health care educational purposes	\$ 191	\$ 191
Endowment for charity care at EGH	400	400
	<b>\$ 591</b>	<b>\$ 591</b>

## Beacon Health System, Inc. and Affiliated Corporations

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### **17. Board-Designated Endowment and Endowment Investments**

FASB Staff Position FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and additional disclosures about an organization's endowment funds. In 2007, the state of Indiana adopted UPMIFA. The adoption of UPMIFA had no effect on accounting for the Corporation's endowment. The following disclosures are made as required by FASB Staff Position FAS 117-1.

The Corporation's endowment consists of a donor-restricted endowment fund and a board-designated endowment fund. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Directors of the Corporation has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

MHF has a board-designated endowment. The Board provides direction to use the income and profits for support, betterment, improvement, upkeep, expansion, and replacement of BMG and its corporate affiliates.

MHF follows its Statement of Investment Objectives and Policy, which established formal yet flexible investment guidelines incorporating prudent risk parameters, appropriate asset guidelines, and realistic return goals. Per the policy, the primary objective is to meet commitments to employees at a reasonable cost to the company. Therefore, MHF will actively invest to achieve real growth of capital over inflation through appreciation of securities held and through the accumulation and reinvestment of dividends and interest income. MHF utilizes an investment consulting firm to assist in development of asset allocation targets, review investment performance to benchmarks, review investment strategies, and communicate this information to the MHF Investment Committee and management.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**17. Board-Designated Endowment and Endowment Investments (continued)**

EGH has a donor-restricted endowment established for patient care purposes. EGH has established an investment and spending policy related to the preservation and appreciation of this endowment. Should the underlying assets fall below this targeted amount, EGH pursues actions consistent with established policies to return the endowment to the targeted amount. Based upon these policies, the investment earnings on the endowment are temporarily restricted until the Board authorizes release of funds for patient care purposes. A portion of the endowment is held as permanently restricted based on the original restriction at the time of donation.

	<b>December 31, 2014</b>		
	<b>Unrestricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Cash and cash equivalents	\$ —	\$ 191	\$ 191
Board-designated endowment funds	20,801	—	20,801
Endowment and temporarily restricted investments	—	400	400
Total investment funds	20,801	400	21,201
Total funds	\$ 20,801	\$ 591	\$ 21,392

  

	<b>December 31, 2013</b>		
	<b>Unrestricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Cash and cash equivalents	\$ —	\$ 191	\$ 191
Board-designated endowment funds	20,968	—	20,968
Endowment and temporarily restricted investments	—	400	400
Total investment funds	20,968	400	21,368
Total funds	\$ 20,968	\$ 591	\$ 21,559

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**17. Board-Designated Endowment and Endowment Investments (continued)**

	<b>Unrestricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment and board-designated endowment funds and endowment investments, beginning of year (January 1, 2013)	\$ 19,332	\$ 400	\$ 19,732
Investment return:			
Investment income	231	—	231
Net unrealized gains on investments	2,066	—	2,066
Net equity gains on investments	29	—	29
Released for use in operations	(690)	—	(690)
Total investment return	<u>1,636</u>	<u>—</u>	<u>1,636</u>
Endowment and board-designated endowment funds and endowment investments, end of year (December 31, 2013)	20,968	400	21,368
Investment return:			
Investment income	<b>551</b>	—	<b>551</b>
Net unrealized gains on investments	<b>238</b>	—	<b>238</b>
Net equity gains on investments	<b>(185)</b>	—	<b>(185)</b>
Released for use in operations	<b>(771)</b>	—	<b>(771)</b>
Total investment return	<u><b>(167)</b></u>	<u>—</u>	<u><b>(167)</b></u>
Endowment and board-designated endowment funds and endowment investments, end of year (December 31, 2014)	<u><b>\$ 20,801</b></u>	<u><b>\$ 400</b></u>	<u><b>\$ 21,201</b></u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

**18. Subsequent Events**

The Corporation evaluated events and transactions occurring subsequent to December 31, 2014, through March 5, 2015, the date of issuance of the accompanying consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements, other than those previously disclosed.

# Supplementary Information



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## Report of Independent Auditors on Supplementary Information

The Board of Directors  
Beacon Health System, Inc. and Affiliated Corporations

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The following financial information is presented for purposes of additional analysis and is 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. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Ernst & Young LLP*

March 5, 2015

# Beacon Health System, Inc. and Affiliated Corporations

## Details of Consolidated Balance Sheet (In Thousands)

December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Assets</b>								
Current assets:								
Cash and cash equivalents	\$ 96,532	\$ –	\$ 28,348	\$ 12,681	\$ 490	\$ 2,486	\$ 46,901	\$ 5,626
Short-term investments	85,919	–	51,005	–	1,088	–	1	33,825
Patient accounts receivable, net	140,259	(3,781)	79,539	14,646	–	7,286	42,339	230
Due from third-party payors	18,253	–	17,200	–	–	–	1,053	–
Other receivables	11,884	–	3,989	1,372	463	400	5,264	396
Inventories	22,868	–	14,162	–	–	1,314	7,392	–
Prepaid expenses	12,088	–	1,559	406	–	191	1,123	8,809
Due from affiliates	–	(14,249)	3,583	–	–	–	368	10,298
<b>Total current assets</b>	<b>387,803</b>	<b>(18,030)</b>	<b>199,385</b>	<b>29,105</b>	<b>2,041</b>	<b>11,677</b>	<b>104,441</b>	<b>59,184</b>
Assets limited as to use:								
Internally designated investments	570,198	–	–	–	–	–	–	570,198
Restricted cash	6,144	–	–	–	6,144	–	–	–
Externally designated investments – insurance trust	2,619	–	2,588	20	–	11	–	–
Board-designated endowment	20,801	–	–	–	20,801	–	–	–
Endowment and temporarily restricted investments	6,610	–	–	–	–	–	6,610	–
	606,372	–	2,588	20	26,945	11	6,610	570,198
Property and equipment:								
Land	43,597	–	21,923	2,430	–	–	4,105	15,139
Buildings and improvements	614,625	–	399,389	28,767	–	9,061	174,923	2,485
Furniture and equipment	408,363	–	273,487	17,044	425	7,715	78,909	30,783
Construction-in-progress	63,954	–	9,389	12,555	2	45	38,756	3,207
	1,130,539	–	704,188	60,796	427	16,821	296,693	51,614
Less allowances for depreciation and amortization	554,795	–	367,487	22,338	402	11,006	133,213	20,349
	575,744	–	336,701	38,458	25	5,815	163,480	31,265
Unamortized bond issuance costs, net	2,188	–	1,458	–	–	–	730	–
Deferred charges and other assets	30,695	(12,367)	4,738	17,008	1,570	7,526	4,378	7,842
Interest in net assets of recipient organization	–	(9,128)	9,128	–	–	–	–	–
<b>Total assets</b>	<b>\$ 1,602,802</b>	<b>\$ (39,525)</b>	<b>\$ 553,998</b>	<b>\$ 84,591</b>	<b>\$ 30,581</b>	<b>\$ 25,029</b>	<b>\$ 279,639</b>	<b>\$ 668,489</b>

# Beacon Health System, Inc. and Affiliated Corporations

## Details of Consolidated Balance Sheet (continued) (In Thousands)

December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Liabilities and net assets</b>								
Current liabilities:								
Accounts payable	\$ 60,246	\$ –	\$ 27,145	\$ 6,374	\$ 23	\$ 1,043	\$ 16,945	\$ 8,716
Accrued salaries and benefits	48,204	(3,781)	22,173	9,402	59	2,672	11,528	6,151
Accrued expenses	4,961	–	2,277	–	–	153	776	1,755
Due to third-party payors	9,737	–	5,900	–	–	–	3,837	–
Due to affiliates	–	(14,249)	–	293	–	13,956	–	–
Current maturities of long-term debt	8,693	–	6,107	70	–	–	2,516	–
<b>Total current liabilities</b>	<b>131,841</b>	<b>(18,030)</b>	<b>63,602</b>	<b>16,139</b>	<b>82</b>	<b>17,824</b>	<b>35,602</b>	<b>16,622</b>
Non-current liabilities:								
Long-term debt, less current maturities	249,797	–	168,613	274	–	–	80,910	–
Pension and other liabilities	97,245	–	8,288	40,295	–	15	47,211	1,436
Interest rate and basis swaps	27,752	–	27,752	–	–	–	–	–
	<b>374,794</b>	<b>–</b>	<b>204,653</b>	<b>40,569</b>	<b>–</b>	<b>15</b>	<b>128,121</b>	<b>1,436</b>
<b>Total liabilities</b>	<b>506,635</b>	<b>(18,030)</b>	<b>268,255</b>	<b>56,708</b>	<b>82</b>	<b>17,839</b>	<b>163,723</b>	<b>18,058</b>
Net assets:								
Unrestricted:								
Undesignated	1,059,437	(12,367)	276,615	27,883	379	7,190	109,306	650,431
Board-designated endowment	20,801	–	–	–	20,801	–	–	–
<b>Total unrestricted</b>	<b>1,080,238</b>	<b>(12,367)</b>	<b>276,615</b>	<b>27,883</b>	<b>21,180</b>	<b>7,190</b>	<b>109,306</b>	<b>650,431</b>
Temporarily restricted	15,338	(9,128)	9,128	–	9,128	–	6,210	–
Permanently restricted	591	–	–	–	191	–	400	–
<b>Total net assets</b>	<b>1,096,167</b>	<b>(21,495)</b>	<b>285,743</b>	<b>27,883</b>	<b>30,499</b>	<b>7,190</b>	<b>115,916</b>	<b>650,431</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,602,802</b>	<b>\$ (39,525)</b>	<b>\$ 553,998</b>	<b>\$ 84,591</b>	<b>\$ 30,581</b>	<b>\$ 25,029</b>	<b>\$ 279,639</b>	<b>\$ 668,489</b>

# Beacon Health System, Inc. and Affiliated Corporations

## Details of Consolidated Balance Sheet (In Thousands)

December 31, 2013

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Assets</b>								
Current assets:								
Cash and cash equivalents	\$ 85,863	\$ –	\$ 40,007	\$ 6,446	\$ 483	\$ 1,990	\$ 28,898	\$ 8,039
Short-term investments	71,884	–	65,427	–	1,057	–	5,400	–
Patient accounts receivable, net	138,950	–	81,897	8,172	–	7,082	41,535	264
Due from third-party payors	7,230	–	6,612	–	–	–	618	–
Other receivables	10,299	–	3,900	1,119	129	364	4,368	419
Inventories	21,641	–	13,332	–	–	1,760	6,549	–
Prepaid expenses	11,146	–	1,793	382	–	125	1,964	6,882
Due from affiliates	–	(8,303)	2,205	–	–	–	237	5,861
<b>Total current assets</b>	<b>347,013</b>	<b>(8,303)</b>	<b>215,173</b>	<b>16,119</b>	<b>1,669</b>	<b>11,321</b>	<b>89,569</b>	<b>21,465</b>
Assets limited as to use:								
Internally designated investments	558,918	–	326,980	–	–	–	231,938	–
Restricted cash	5,194	–	–	–	5,194	–	–	–
Externally designated investments – insurance trust	2,582	–	2,551	20	–	11	–	–
Board-designated endowment	20,968	–	–	–	20,968	–	–	–
Endowment and temporarily restricted investments	6,278	–	–	–	–	–	6,278	–
	593,940	–	329,531	20	26,162	11	238,216	–
Property and equipment:								
Land	45,955	–	21,923	2,390	–	–	3,507	18,135
Buildings and improvements	595,141	–	385,328	26,983	–	8,206	172,280	2,344
Furniture and equipment	375,603	–	255,103	11,677	417	7,113	75,759	25,534
Construction-in-progress	32,060	–	15,575	6,158	–	1,376	7,332	1,619
	1,048,759	–	677,929	47,208	417	16,695	258,878	47,632
Less allowances for depreciation and amortization	505,566	–	339,887	17,426	385	10,739	119,492	17,637
	543,193	–	338,042	29,782	32	5,956	139,386	29,995
Unamortized bond issuance costs, net	2,474	–	1,665	–	–	–	809	–
Deferred charges and other assets	26,411	(12,367)	4,576	16,826	279	7,912	2,384	6,801
Interest in net assets of recipient organization	–	(6,484)	6,484	–	–	–	–	–
<b>Total assets</b>	<b>\$ 1,513,031</b>	<b>\$ (27,154)</b>	<b>\$ 895,471</b>	<b>\$ 62,747</b>	<b>\$ 28,142</b>	<b>\$ 25,200</b>	<b>\$ 470,364</b>	<b>\$ 58,261</b>

# Beacon Health System, Inc. and Affiliated Corporations

## Details of Consolidated Balance Sheet (continued)

(In Thousands)

December 31, 2013

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Liabilities and net assets</b>								
Current liabilities:								
Accounts payable	\$ 53,531	\$ –	\$ 20,836	\$ 4,038	\$ 16	\$ 1,261	\$ 24,845	\$ 2,535
Accrued salaries and benefits	43,942	–	19,600	3,882	36	2,448	12,952	5,024
Accrued expenses	4,971	–	2,538	837	31	341	831	393
Due to third-party payors	10,753	–	4,978	–	–	–	5,775	–
Due to affiliates	–	(8,303)	–	199	–	8,104	–	–
Current maturities of long-term debt	6,899	–	4,557	–	–	–	2,342	–
<b>Total current liabilities</b>	<b>120,096</b>	<b>(8,303)</b>	<b>52,509</b>	<b>8,956</b>	<b>83</b>	<b>12,154</b>	<b>46,745</b>	<b>7,952</b>
Non-current liabilities:								
Long-term debt, less current maturities	256,237	–	172,903	–	–	–	83,334	–
Pension and other liabilities	65,484	–	8,162	27,790	–	20	28,730	782
Interest rate and basis swaps	36,761	–	36,761	–	–	–	–	–
	<b>358,482</b>	<b>–</b>	<b>217,826</b>	<b>27,790</b>	<b>–</b>	<b>20</b>	<b>112,064</b>	<b>782</b>
<b>Total liabilities</b>	<b>478,578</b>	<b>(8,303)</b>	<b>270,335</b>	<b>36,746</b>	<b>83</b>	<b>12,174</b>	<b>158,809</b>	<b>8,734</b>
Net assets:								
Unrestricted:								
Undesignated	1,000,532	(12,367)	618,652	26,001	416	13,026	305,277	49,527
Board-designated endowment	20,968	–	–	–	20,968	–	–	–
<b>Total unrestricted</b>	<b>1,021,500</b>	<b>(12,367)</b>	<b>618,652</b>	<b>26,001</b>	<b>21,384</b>	<b>13,026</b>	<b>305,277</b>	<b>49,527</b>
Temporarily restricted	12,362	(6,484)	6,484	–	6,484	–	5,878	–
Permanently restricted	591	–	–	–	191	–	400	–
<b>Total net assets</b>	<b>1,034,453</b>	<b>(18,851)</b>	<b>625,136</b>	<b>26,001</b>	<b>28,059</b>	<b>13,026</b>	<b>311,555</b>	<b>49,527</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,513,031</b>	<b>\$ (27,154)</b>	<b>\$ 895,471</b>	<b>\$ 62,747</b>	<b>\$ 28,142</b>	<b>\$ 25,200</b>	<b>\$ 470,364</b>	<b>\$ 58,261</b>

## Beacon Health System, Inc. and Affiliated Corporations

### Details of Consolidated Statement of Operations and Changes in Net Assets (In Thousands)

Year Ended December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Unrestricted revenue, gains, and other support</b>								
Net patient service revenue	\$ 938,468	\$ (37)	\$ 496,271	\$ 99,221	\$ –	\$ 36,126	\$ 306,887	\$ –
Provision for bad debts	(68,927)	–	(35,599)	(4,604)	–	(1,613)	(27,111)	–
Net patient service revenue less provision for bad debts	869,541	(37)	460,672	94,617	–	34,513	279,776	–
Other revenue	43,902	(8,284)	25,507	6,728	796	2,443	13,652	3,060
Net assets released from restrictions used for operations	322	–	241	–	11	–	–	70
	913,765	(8,321)	486,420	101,345	807	36,956	293,428	3,130
<b>Expenses</b>								
Salaries and wages	361,661	(11)	138,415	99,571	–	23,340	80,012	20,334
Employee benefits	93,030	–	38,865	17,137	22	5,344	23,096	8,566
Supplies and other	232,821	(7,853)	126,232	18,228	280	9,390	78,441	8,103
Management fees	–	–	24,578	7,086	231	1,916	16,402	(50,213)
Professional fees and purchased services	113,630	(457)	47,555	8,736	670	1,447	37,741	17,938
Depreciation and amortization	50,547	–	27,565	3,022	17	1,356	15,875	2,712
Interest	5,925	–	4,801	2	–	–	1,122	–
	857,614	(8,321)	408,011	153,782	1,220	42,793	252,689	7,440
Income (loss) from operations	56,151	–	78,409	(52,437)	(413)	(5,837)	40,739	(4,310)
<b>Non-operating</b>								
Investment income, net	29,672	–	9,455	34	619	1	8,965	10,598
Unrealized gains on swap transactions	9,008	–	9,008	–	–	–	–	–
Loss on bond refunding	–	–	–	–	–	–	–	–
Revenue and gains in excess of (less than) expenses	94,831	–	96,872	(52,403)	206	(5,836)	49,704	6,288

## Beacon Health System, Inc. and Affiliated Corporations

### Details of Consolidated Statement of Operations and Changes in Net Assets (continued) (In Thousands)

Year Ended December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Unrestricted net assets</b>								
Revenue and gains in excess of (less than) expenses	\$ 94,831	\$ –	\$ 96,872	\$ (52,403)	\$ 206	\$ (5,836)	\$ 49,704	\$ 6,288
Net assets released from restrictions used for capital purposes	392	–	387	5	–	–	–	–
Net assets released from board-designated endowment	(771)	–	–	–	(771)	–	–	–
Other	–	–	(439,296)	69,211	361	–	(224,892)	594,616
Postretirement benefit adjustments other than periodic costs	(35,714)	–	–	(14,931)	–	–	(20,783)	–
Increase (decrease) in unrestricted net assets	58,738	–	(342,037)	1,882	(204)	(5,836)	(195,971)	600,904
<b>Temporarily restricted net assets</b>								
Contributions temporarily restricted for use	3,334	–	–	–	3,334	–	–	–
Investment income	356	–	–	–	24	–	332	–
Net assets released from restrictions used for operating and capital purposes	(714)	–	–	–	(714)	–	–	–
Change in interest in recipient organization	–	(2,644)	2,644	–	–	–	–	–
Increase (decrease) in temporarily restricted net assets	2,976	(2,644)	2,644	–	2,644	–	332	–
Increase (decrease) in net assets	61,714	(2,644)	(339,393)	1,882	2,440	(5,836)	(195,639)	600,904
Net assets at beginning of year	1,034,453	(18,851)	625,136	26,001	28,059	13,026	311,555	49,527
Net assets at end of year	<u>\$ 1,096,167</u>	<u>\$ (21,495)</u>	<u>\$ 285,743</u>	<u>\$ 27,883</u>	<u>\$ 30,499</u>	<u>\$ 7,190</u>	<u>\$ 115,916</u>	<u>\$ 650,431</u>

## Beacon Health System, Inc. and Affiliated Corporations

### Details of Consolidated Statement of Operations and Changes in Net Assets (In Thousands)

Year Ended December 31, 2013

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
<b>Unrestricted revenue, gains, and other support</b>								
Net patient service revenue	\$ 840,408	\$ (1,136)	\$ 462,446	\$ 58,424	\$ –	\$ 36,746	\$ 283,921	\$ 7
Provision for bad debts	(62,724)	–	(35,209)	(2,876)	–	(885)	(23,754)	–
Net patient service revenue less provision for bad debts	777,684	(1,136)	427,237	55,548	–	35,861	260,167	7
Other revenue	42,726	(6,007)	23,419	6,297	728	2,171	14,676	1,442
Net assets released from restrictions used for operations	458	–	322	17	4	1	–	114
	820,868	(7,143)	450,978	61,862	732	38,033	274,843	1,563
<b>Expenses</b>								
Salaries and wages	329,320	(104)	132,987	58,450	–	23,387	95,210	19,390
Employee benefits	90,072	(3)	36,994	10,806	1	5,052	29,998	7,224
Supplies and other	192,834	(6,579)	105,925	10,880	253	7,363	67,586	7,406
Management fees	–	–	24,332	3,036	181	1,535	17,964	(47,048)
Professional fees and purchased services	107,094	(457)	43,606	2,762	580	1,304	44,303	14,996
Depreciation and amortization	44,169	–	25,408	2,333	37	1,207	13,072	2,112
Interest	6,594	–	4,787	–	–	17	1,790	–
	770,083	(7,143)	374,039	88,267	1,052	39,865	269,923	4,080
Income (loss) from operations	50,785	–	76,939	(26,405)	(320)	(1,832)	4,920	(2,517)
<b>Non-operating</b>								
Investment income, net	49,466	–	25,527	6	2,403	2	21,156	372
Unrealized losses on swap transactions	(6,744)	–	(6,744)	–	–	–	–	–
Loss on bond refunding	(3,734)	–	(3,039)	–	–	–	(695)	–
Revenue and gains in excess of (less than) expenses	89,773	–	92,683	(26,399)	2,083	(1,830)	25,381	(2,145)

## Beacon Health System, Inc. and Affiliated Corporations

### Details of Consolidated Statement of Operations and Changes in Net Assets (continued) (In Thousands)

Year Ended December 31, 2013

	<b>Consolidated</b>	<b>Eliminations</b>	<b>Memorial Hospital of South Bend, Inc.</b>	<b>Beacon Medical Group, Inc.</b>	<b>Memorial Health Foundation, Inc.</b>	<b>Beacon Health Ventures, Inc.</b>	<b>Elkhart General Hospital, Inc.</b>	<b>Beacon Health System, Inc.</b>
<b>Unrestricted net assets</b>								
Revenue and gains in excess of (less than) expenses	\$ 89,773	\$ –	\$ 92,683	\$ (26,399)	\$ 2,083	\$ (1,830)	\$ 25,381	\$ (2,145)
Net assets released from restrictions used for capital purposes	529	–	499	30	–	–	–	–
Net assets released from board designated endowment	(690)	–	–	–	(690)	–	–	–
Other	(53)	–	(48,711)	(7,016)	845	1,720	1,437	51,672
Postretirement benefit adjustments other than periodic costs	44,838	–	–	17,951	–	–	26,887	–
Increase (decrease) in unrestricted net assets	134,397	–	44,471	(15,434)	2,238	(110)	53,705	49,527
<b>Temporarily restricted net assets</b>								
Contributions temporarily restricted for use	2,182	–	–	–	2,182	–	–	–
Investment income	1,193	–	–	–	152	–	1,041	–
Net assets released from restrictions used for operating and capital purposes	(987)	–	–	–	(987)	–	–	–
Change in interest in recipient organization	–	(1,345)	1,345	–	–	–	–	–
Increase (decrease) in temporarily restricted net assets	2,388	(1,345)	1,345	–	1,347	–	1,041	–
Increase (decrease) in net assets	136,785	(1,345)	45,816	(15,434)	3,585	(110)	54,746	49,527
Net assets at beginning of year	897,668	(17,506)	579,320	41,435	24,474	13,136	256,809	–
Net assets at end of year	<u>\$ 1,034,453</u>	<u>\$ (18,851)</u>	<u>\$ 625,136</u>	<u>\$ 26,001</u>	<u>\$ 28,059</u>	<u>\$ 13,026</u>	<u>\$ 311,555</u>	<u>\$ 49,527</u>

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