



Fayette Regional Health System

FINANCIAL STATEMENTS

SEPTEMBER 30, 2014 AND 2013



FAYETTE REGIONAL HEALTH SYSTEM

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Fayette Regional Health System
Connersville, Indiana

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Fayette Regional Health System (the System), which comprise the statements of financial position as of September 30, 2014 and 2013, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

Board of Trustees
Fayette Regional Health System
Connersville, Indiana

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the System as of September 30, 2014 and 2013 and its results of operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Blue & Co., LLC

Indianapolis, Indiana
May 19, 2015

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF FINANCIAL POSITION SEPTEMBER 30, 2014 AND 2013

	ASSETS	<u>2014</u>	<u>2013</u>
Current assets			
Cash and cash equivalents		\$ 3,166,869	\$ 1,922,212
Accounts receivable			
Patient services, net		9,176,342	10,368,492
Other		812,734	1,052,160
Inventories		852,954	908,280
Prepaid expenses and other current assets		444,178	565,618
Trustee held assets		-0-	727,516
		<u>14,453,077</u>	<u>15,544,278</u>
Investments		20,013,236	17,367,012
Property and equipment			
Land		1,244,594	1,244,594
Land improvements		606,043	553,626
Buildings and building equipment		55,246,510	53,070,241
Major movable equipment		24,773,019	24,225,509
Construction in progress		171,557	1,594,823
Total property and equipment		<u>82,041,723</u>	<u>80,688,793</u>
Less accumulated depreciation and amortization		<u>(54,202,007)</u>	<u>(52,029,079)</u>
Net property and equipment		27,839,716	28,659,714
Interest in net assets of foundation		957,304	970,245
Other assets		<u>334,595</u>	<u>345,396</u>
		<u>\$ 63,597,928</u>	<u>\$ 62,886,645</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF FINANCIAL POSITION SEPTEMBER 30, 2014 AND 2013

LIABILITIES AND NET ASSETS

	<u>2014</u>	<u>2013</u>
Current liabilities		
Line-of-credit	\$ 6,991,723	\$ 1,051,181
Current maturities of long-term debt	706,443	705,725
Current maturities of capital leases	929,358	825,849
Accounts payable	2,121,259	1,739,699
Accrued salaries, wages, and payroll taxes	1,450,661	1,327,165
Other accrued liabilities	556,597	451,497
Estimated third-party settlements	504,496	1,174,195
Total current liabilities	<u>13,260,537</u>	<u>7,275,311</u>
Derivative liabilities	2,558,666	2,641,669
Long-term debt, less current maturities	20,569,258	20,613,865
Long-term capital leases, less current maturities	1,923,790	2,508,922
Total liabilities	<u>38,312,251</u>	<u>33,039,767</u>
Net assets		
Unrestricted	24,328,373	28,876,633
Temporarily restricted - interest in foundation's net assets	957,304	970,245
Total net assets	<u>25,285,677</u>	<u>29,846,878</u>
Total liabilities and net assets	<u>\$ 63,597,928</u>	<u>\$ 62,886,645</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF OPERATIONS YEARS ENDED SEPTEMBER 30, 2014 AND 2013

	2014	2013
Net revenues		
Net patient service revenue	\$ 57,829,139	\$ 58,462,594
Provision for bad debts	<u>(7,113,388)</u>	<u>(5,797,561)</u>
Net patient service revenue less provision for bad debts	50,715,751	52,665,033
Other revenue including investment income	<u>4,506,164</u>	<u>4,328,072</u>
Total revenue	55,221,915	56,993,105
Expenses		
Salaries and wages	24,764,437	25,257,953
Fringe benefits	5,767,307	5,570,690
Supplies and drugs	6,120,548	5,679,840
Purchased services	12,523,517	10,694,113
Professional fees	481,617	446,101
Utilities	1,555,927	1,312,634
Depreciation and amortization	3,066,785	2,943,943
Interest	1,257,729	1,474,457
Hospital assessment fee	2,419,169	1,085,850
Other	<u>1,220,120</u>	<u>1,124,517</u>
Total expenses	<u>59,177,156</u>	<u>55,590,098</u>
Operating income	(3,955,241)	1,403,007
Nonoperating revenues (expenses)		
Unrealized gain on derivatives	83,003	1,420,545
Loss on extinguishment of debt	<u>-0-</u>	<u>(493,369)</u>
Total nonoperating gain, net	83,003	927,176
Excess revenues over expenses	(3,872,238)	2,330,183
Other changes in unrestricted net assets		
Contributions of property and equipment	-0-	355,891
Net unrealized loss on investments	<u>(676,022)</u>	<u>(196,330)</u>
Change in unrestricted net assets	<u>\$ (4,548,260)</u>	<u>\$ 2,489,744</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF CHANGES IN NET ASSETS YEARS ENDED SEPTEMBER 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
Unrestricted net assets		
Excess revenues over expenses	\$ (3,872,238)	\$ 2,330,183
Contributions of property and equipment	-0-	355,891
Net unrealized loss on investments	<u>(676,022)</u>	<u>(196,330)</u>
Change in unrestricted net assets	(4,548,260)	2,489,744
Temporarily restricted net assets		
Change in interest in net assets of foundation	<u>(12,941)</u>	<u>(308,654)</u>
Change in net assets	(4,561,201)	2,181,090
Net assets		
Beginning of year	29,846,878	27,665,788
End of year	<u>\$ 25,285,677</u>	<u>\$ 29,846,878</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2014 AND 2013

	2014	2013
Operating activities		
Change in net assets	\$ (4,561,201)	\$ 2,181,090
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Change in interest in net assets of the Foundation	12,941	308,654
Unrealized gain on derivatives	(83,003)	(1,420,545)
Depreciation and amortization	3,066,785	2,943,943
Bad debts	7,113,388	5,797,561
Net realized and unrealized gain on investments	(1,191,629)	(1,602,003)
Loss on disposal of property and equipment	(7,315)	13,033
Contributions of property and equipment	-0-	(355,891)
Changes in operating assets and liabilities:		
Accounts receivable	(5,681,812)	(7,462,068)
Inventories, prepaid expenses and other current	176,766	(4,979)
Accounts payable and other current liabilities	610,156	819,567
Estimated third-party settlements	(669,699)	937,537
Net cash flows from operating activities	(1,214,623)	2,155,899
Investing activities		
Purchases of property and equipment	(1,810,671)	(2,439,708)
Proceeds from disposal of property and equipment	20,945	9,567
Purchase of trustee held assets	-0-	(727,516)
Proceeds from sale of trustee held assets	727,516	-0-
Purchase of investments	(28,127,901)	(13,272,464)
Proceeds from sale of investments	26,673,306	13,398,177
Change in other assets, net	(26,440)	205,927
Net cash flows from investing activities	(2,543,245)	(2,826,017)
Financing activities		
Contributions of property and equipment	-0-	355,891
Proceeds from long-term debt	-0-	21,106,000
Payments on long-term debt	(43,889)	(19,811,501)
Payments on capital leases	(894,128)	(829,638)
Change in line-of-credit	5,940,542	290,908
Net cash flows from financing activities	5,002,525	1,111,660
Net change in cash and cash equivalents	1,244,657	441,542
Cash and cash equivalents		
Beginning of year	1,922,212	1,480,670
End of year	\$ 3,166,869	\$ 1,922,212
Supplemental disclosures of cash flow information		
Cash paid for interest	\$ 1,257,729	\$ 1,474,457
Non-cash investing activities		
Property acquired through capital leases	\$ 412,505	\$ 3,052,830
Non-cash financing activities		
Bond issuance costs	\$ -0-	\$ 290,198

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

1. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Organization

Fayette Memorial Hospital Association, Inc. d/b/a Fayette Regional Health System (the System) is located in Connerville, Indiana, and includes a not-for-profit acute care hospital. The System provides inpatient, outpatient, emergency and other ancillary services for residents of east central Indiana.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits and investments in highly liquid debt instruments with maturities of three months or less from the date of purchase. The System maintains its cash in bank deposit accounts, which, at times, may exceed the federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Patient Accounts Receivable and Net Patient Service Revenue

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

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the System analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

During 2014, the System's allowance for uncollectible accounts for patient and physician services increased approximately \$2,772,000 from approximately \$2,128,000 to approximately \$4,900,000. This increase is due to payor mix changes and an increase in the age of accounts receivable from 2013 to 2014, most notably related to self-pay. Consequently, management instituted additional allowance provisions related to the aging of the accounts receivable. As of September 30, 2014, the allowance for uncollectible accounts of \$4,900,000 was comprised of approximately \$4,571,000 reserved for self-pay balances and approximately \$329,000 reserved for third-party payor balances. As of September 30, 2013, the allowance for uncollectible accounts of \$2,128,000 was comprised of approximately \$1,767,000 reserved for self-pay balances and approximately \$361,000 reserved for third-party payor balances.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The System grants credit to patients, substantially all of whom are local residents of the communities served. The System does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Health Maintenance Organizations, and commercial insurance policies). The System has not changed its charity care or uninsured discount policies during 2014 or 2013.

Accounts Receivable Other

Other receivables consist primarily of amounts due under a pharmacy benefit management service agreement and other miscellaneous receivables.

Inventories

Inventories consist mainly of medical supplies and are valued at the lower of cost (first-in, first-out method) or market value.

Trustee Held Assets

Trustee held assets include assets held by trustee under an indenture agreement for future capital improvements. Amounts required to meet current liabilities of the System have been classified as current assets. These are included within the statement of financial position and consist of cash and cash equivalents.

Investments

Investments consist primarily of common stock, convertible securities, preferred securities, mutual funds, U.S. government securities, mortgage backed securities, and hedge funds. Investments are carried at fair value. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses as the investments are not considered trading securities and the System demonstrates the ability and intent to hold the securities until they recover.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Useful lives are 3 to 40 years for property and equipment.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the donated assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Other Assets

Deferred financing costs are recorded at cost. The costs are amortized over the life of the bonds. Amortization expense for 2014 and 2013 is approximately \$15,000. Amortization expense for the next five years is approximately \$15,000 per year.

Net Assets

Under the applicable Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topics, the System is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets) based upon the existence or absence of donor imposed restrictions.

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received and are included in other revenue if the promise to give is unrestricted. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. The System holds a beneficial interest in the net assets of Fayette Regional Health System Foundation that is adjusted to reflect that activity of the Foundation. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Indiana Hospital Assessment Fee Program

During 2012, the Indiana Hospital Assessment Fee (HAF) Program for the period July 1, 2011 through June 30, 2013 was approved by the Centers for Medicare & Medicaid Services (CMS) retroactive to July 1, 2011. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana hospitals. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. Under the HAF Program, the enhanced Medicaid payments follow the patients and are realized through increased Medicaid rates.

During 2014 and 2013, the System recognized HAF assessment fee expense of approximately \$2,419,000 and \$1,086,000, respectively, which resulted in increased Medicaid reimbursement.

The HAF Program was approved for extension in March 2014 by CMS for the period July 1, 2013 through June 30, 2017.

Charity Care and Community Benefit

The System provides charity care on a case-by-case basis for those patients who meet certain criteria of financial need. This care is provided without charge or at amounts less than established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy.

Of the System's total expenses reported (approximately \$59,177,000 and \$55,590,000 during 2014 and 2013, respectively), an estimated \$1,173,000 and \$679,000 arose from providing services to charity patients during 2014 and 2013, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the System's total expenses (less bad debt expense) divided by gross patient service revenue.

Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were approximately \$305,000 and \$326,000 in 2014 and 2013, respectively.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Pension Plans

The System maintains a defined contribution pension plan (the Plan) covering substantially all employees. The System made no discretionary profit sharing contributions during 2014 and 2013. The System matches 100% of employee deferral contributions up to 3% of the employees' salary, subject to certain eligibility requirements.

The System also maintains a 457(b) deferred compensation plan that provides for non-elective employer deferrals covering a select group of management or highly compensated individuals.

It is the System's policy to fund pension costs as accrued. Pension expense was approximately \$420,000 and \$442,000 in 2014 and 2013, respectively.

Operating Indicator

The statements of operations include an operating indicator, operating income. Operating income includes transactions that are pursuant to and used in the operations of the System which includes investment income (interest, dividends, and realized gain (losses)).

Performance Indicator

The statements of operations include a performance indicator, excess revenues over expenses. Changes in unrestricted net assets, which are excluded from excess revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments that are considered to be other than trading securities and contributions of long-lived assets.

Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act, which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries an occurrence basis insurance policy covering the System's \$250,000 of exposure per claim. Accordingly, the System has not recorded any provision for self-insured medical malpractice claims.

Federal and State Income Taxes

The System is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System and recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the System, and has concluded that as of September 30, 2014 and 2013, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying financial statements.

As such, the System is generally exempt from income taxes. However, the System is required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only. The System has filed its federal and state income tax returns for September 30, 2013.

The System is subject to routine audits by taxing jurisdictions; however, as of the date the financial statements were issued, there were no audits for any tax periods in progress.

Reclassification

Certain 2013 balances were reclassified to agree with the current year presentation.

Subsequent Events

The System has evaluated events or transactions occurring subsequent to the statement of financial position date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is May 19, 2015.

2. INVESTMENTS

The composition of investments at September 30, 2014 and 2013 follows:

	2014	2013
Common stocks	\$ 12,307,236	\$ 9,246,815
Convertible securities	-0-	784,007
Preferred securities	-0-	156,068
Mutual funds	4,484,924	1,960,820
U.S. government securities	-0-	1,271,246
Mortgage backed securities	-0-	919,696
Hedge funds	3,221,076	3,028,360
	<u>\$ 20,013,236</u>	<u>\$ 17,367,012</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Investment return for 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Investment income		
Interest and dividend income	\$ 472,519	\$ 476,256
Realized gain, net	<u>1,867,651</u>	<u>1,798,333</u>
	2,340,170	2,274,589
Net unrealized loss on investments	<u>(676,022)</u>	<u>(196,330)</u>
Investment return, net	<u>\$ 1,664,148</u>	<u>\$ 2,078,259</u>

Investment fees for 2014 and 2013 were approximately \$285,000 and \$208,000, respectively. The fees are offset against investment income included in the other revenue on the statements of operations.

The following schedule summarizes the fair value of securities included in investments that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of September 30, 2014 and 2013. The schedule further segregates the securities that have been in a gross unrealized loss position as of September 30, 2014 and 2013, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to several securities which industry experts expect recovery in the short-term future. These individual investments have projected recoveries in value in near term. The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of September 30, 2014 and 2013.

Description of securities	September 30, 2014					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 6,195,763	\$ (565,032)	\$ 233,800	\$ (56,345)	\$ 6,429,563	\$ (621,377)
Total temporarily impaired securities	<u>\$ 6,195,763</u>	<u>\$ (565,032)</u>	<u>\$ 233,800</u>	<u>\$ (56,345)</u>	<u>\$ 6,429,563</u>	<u>\$ (621,377)</u>
Description of securities	September 30, 2013					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 458,548	\$ (45,463)	\$ 1,020,970	\$ (102,682)	\$ 1,479,518	\$ (148,145)
Convertible securities	154,992	(10,000)	68,856	(4,257)	223,848	(14,257)
Preferred securities	1,955,305	(109,393)	-0-	-0-	1,955,305	(109,393)
Total temporarily impaired securities	<u>\$ 2,568,845</u>	<u>\$ (164,856)</u>	<u>\$ 1,089,826</u>	<u>\$ (106,939)</u>	<u>\$ 3,658,671</u>	<u>\$ (271,795)</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of September 30, 2014 and 2013:

- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Convertible securities*: Valued using pricing models based on a compilation of primarily observable inputs and imputed utilizing a conversion ratio.
- *Preferred securities*: Valued at the closing price reported on the active market on which the individual securities are traded.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

- *Mutual funds:* Valued at the daily closing price as reported by the fund. Mutual funds held by the System are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by the System are deemed to be actively traded.
- *Money market funds:* Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.
- *Mortgage-backed securities and U.S government securities:* Valued using pricing models maximizing the use of observable inputs for similar securities.
- *Hedge funds:* Valued at the net asset value (NAV) of units of the fund. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The hedge funds consist of investments in a variety of domestic and foreign equity and debt securities, managed accounts and other investment vehicles that employ diversified styles and strategies. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the net asset value of the fund and, consequently, the fair value of the System's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the System were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.
- *Derivative liability:* The derivative liability is an interest rate swap agreement that is valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The following tables set forth by level, within the hierarchy, the System's assets and liabilities measured at fair value on a recurring basis as of September 30, 2014:

	September 30, 2014			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents				
Money market funds	\$ 449,681	\$ -0-	\$ 449,681	\$ -0-
Investments				
Common stocks				
Consumer	2,480,320	2,480,320	-0-	-0-
Energy	713,729	713,729	-0-	-0-
Financial	2,174,359	2,174,359	-0-	-0-
Healthcare	1,550,482	1,550,482	-0-	-0-
Industrials	1,617,777	1,617,777	-0-	-0-
Materials	437,665	437,665	-0-	-0-
Information technology	1,859,170	1,859,170	-0-	-0-
Telecommunications	325,867	325,867	-0-	-0-
Utilities	368,791	368,791	-0-	-0-
Other	21,656	21,656	-0-	-0-
International	757,420	757,420	-0-	-0-
Fixed income mutual funds	4,484,924	4,484,924	-0-	-0-
Hedge funds				-0-
Multi-strategy	638,144	-0-	-0-	638,144
Diversified fund of funds	1,628,242	-0-	1,628,242	-0-
Managed futures	321,816	-0-	321,816	-0-
Equity long/short	632,874	-0-	632,874	-0-
	<u>\$ 20,013,236</u>	<u>\$ 16,792,160</u>	<u>\$ 2,582,932</u>	<u>\$ 638,144</u>
Long-term liabilities				
Derivative liability	<u>\$ 2,558,666</u>	<u>\$ -0-</u>	<u>\$ 2,558,666</u>	<u>\$ -0-</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The following tables set forth by level, within the hierarchy, the System's assets and liabilities measured at fair value on a recurring basis as of September 30, 2013:

	September 30, 2013			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents				
Money market funds	\$ 585,455	\$ -0-	\$ 585,455	\$ -0-
Investments				
Common stocks				
Consumer	1,965,396	1,965,396	-0-	-0-
Energy	1,435,546	1,435,546	-0-	-0-
Financial	1,219,884	1,219,884	-0-	-0-
Healthcare	1,254,017	1,254,017	-0-	-0-
Industrials	980,668	980,668	-0-	-0-
Materials	242,389	242,389	-0-	-0-
Information technology	1,620,215	1,620,215	-0-	-0-
Telecommunications	528,700	528,700	-0-	-0-
Convertible securities				
Consumer	20,921	-0-	20,921	-0-
Energy	12,578	-0-	12,578	-0-
Financial	19,822	-0-	19,822	-0-
Healthcare	167,569	-0-	167,569	-0-
Materials	151,601	-0-	151,601	-0-
Information technology	307,414	-0-	307,414	-0-
Services	104,102	-0-	104,102	-0-
Preferred securities	156,068	156,068	-0-	-0-
Fixed income mutual funds	1,960,820	1,960,820	-0-	-0-
Mortgage backed securities	919,696	-0-	919,696	-0-
US government securities	1,271,246	-0-	1,271,246	-0-
Hedge funds				
Multi-strategy	602,225	-0-	-0-	602,225
Diversified fund of funds	1,494,923	-0-	1,494,923	-0-
Managed futures	289,509	-0-	289,509	-0-
Equity long/short	641,703	-0-	641,703	-0-
	<u>\$ 17,367,012</u>	<u>\$ 11,363,703</u>	<u>\$ 5,401,084</u>	<u>\$ 602,225</u>
Long-term liabilities				
Derivative liability	<u>\$ 2,641,669</u>	<u>\$ -0-</u>	<u>\$ 2,641,669</u>	<u>\$ -0-</u>

The following is a reconciliation of activity for 2014 and 2013 for assets measured at fair value based upon significant unobservable (Level 3) inputs:

	Hedge Funds	
	2014	2013
Balance, beginning of year	\$ 602,225	\$ -0-
Interest and dividends credited	-0-	36
Purchases	-0-	606,000
Sales	-0-	-0-
Total realized and unrealized gains (losses)	35,919	(3,811)
Balance, end of year	<u>\$ 638,144</u>	<u>\$ 602,225</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The System's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2014 and 2013.

Realized gains and losses are reported in the statements of operations and changes in net assets as a component of investment income.

The System holds investments which are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying consolidated financial statements.

Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments measured at fair value based on net asset value per share as of September 30, 2014 and 2013, respectively.

September 30, 2014				
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Lockup
Hedge funds - multi-strategy	\$ 638,144	N/A	Quarterly	1 Year Soft Lock
Hedge funds - diversified fund of funds	1,628,242	N/A	Quarterly	Up to 90 days
Hedge funds - managed futures	321,816	N/A	Monthly	N/A
Hedge funds - equity long/short	632,874	N/A	Quarterly	N/A
	<u>\$ 3,221,076</u>			

September 30, 2013				
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Lockup
Hedge funds - multi-strategy	\$ 602,225	N/A	Quarterly	1 Year Soft Lock
Hedge funds - diversified fund of funds	1,494,923	N/A	Quarterly	Up to 90 days
Hedge funds - managed futures	289,509	N/A	Monthly	N/A
Hedge funds - equity long/short	641,703	N/A	Quarterly	N/A
	<u>\$ 3,028,360</u>			

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

- Cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements: The carrying amount reported in the statements of financial position for cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements approximate fair value based upon short term maturities.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

- Interest rate swap derivative: The fair value of the System's derivative liability is based on discounted cash flows and interest rate yield curves.
- Long-term debt: The carrying amount of the System's long-term debt approximates fair value based upon the variable nature of the primary debt.

4. RELATED PARTIES

The Fayette Memorial Hospital Foundation, Inc., d/b/a Fayette Regional Health System Foundation (the Foundation), which is a financially interrelated organization with Fayette Regional Health System was established to solicit contributions from the general public and to support the System activities. Funds are distributed to the System as determined by the Foundation's Board of Trustees and therefore all net assets are classified as temporarily restricted within the System's statement of financial position.

A summary of the Foundation assets, liabilities, and net assets for September 30, 2014 and 2013, follows.

	<u>2014</u>	<u>2013</u>
Financial position		
Assets, principally cash, investments and property	<u>\$ 1,062,331</u>	<u>\$ 991,029</u>
Liabilities	\$ 105,027	\$ 20,784
Net assets	<u>957,304</u>	<u>970,245</u>
Total liabilities and net assets	<u>\$ 1,062,331</u>	<u>\$ 991,029</u>

A summary of the Foundation results of operations and changes in net assets for September 30, 2014 and 2013, follows.

	<u>2014</u>	<u>2013</u>
Statement of activities		
Support, revenue and income	\$ 220,403	\$ 626,016
Expenses		
Contributions to Fayette Regional Health System	45,242	359,572
Other	<u>229,727</u>	<u>329,306</u>
Total expenses	<u>274,969</u>	<u>688,878</u>
Excess revenue over (under) expenses	(54,566)	(62,862)
Net unrealized gains on investments	11,884	40,223
Unrestricted net assets, beginning of year	<u>649,982</u>	<u>672,621</u>
Unrestricted net assets, end of year	607,300	649,982
Temporarily restricted net assets	350,004	320,263
Net assets, end of year	<u>\$ 957,304</u>	<u>\$ 970,245</u>
Change in temporarily restricted net assets	\$ 29,741	\$ (286,015)
Change in interest in Foundation	\$ (12,941)	\$ (308,654)

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The System provided accounting and financial management services to the Foundation of approximately \$141,000 during 2014 and 2013, respectively.

The System purchased services from organizations that employ board members related primarily to credit bureau services for 2014 and 2013 in the amount of approximately \$345,000 and \$295,000, respectively.

5. DERIVATIVE LIABILITIES

The System makes limited use of derivative financial instruments for the purpose of managing interest rate risk. In particular, interest rate swaps (which are designed as cash flow hedges) are used to manage risk associated with interest rates on variable-rate borrowings and to lower its overall borrowing costs.

At September 30, 2014, the System had outstanding two interest rate swap agreements with a commercial bank, having a total principal amount of \$18,825,000. Those agreements effectively change the System's interest rate exposure on its variable rate revenue bonds, series 2002A, due 2032 to a fixed 3.47% and its variable rate revenue bonds, series 2002B, due 2022 to a fixed 4.13%. The related bonds had been retired as of September 30, 2013, but the interest rate swap agreements remained in place. During 2014, a novation transaction served to replace the interest rate swap agreement on the series 2002B with a new agreement at a different commercial bank. The terms of the new agreement remained substantially unchanged from the old agreement. The interest rate swap on the series 2002A remained with the existing commercial bank.

These derivatives are not designated as hedging instruments, and are marked-to-market on the statement of financial position at fair value at the end of each period. The related gains and loss are included in excess of revenues over expenses, the performance indicator, for the reporting period. Cash flows from interest rate swap contracts are classified as an operating activity on the statement of cash flows.

The derivatives are reported as derivative liabilities. At September 30, 2014 and 2013, the fair values of derivatives recorded in the statement of financial position are as follows:

	<u>2014</u>	<u>2013</u>
Interest rate swap agreements	<u>\$ 2,558,666</u>	<u>\$ 2,641,669</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

During 2014 and 2013, the amounts of gain or loss recognized in the statement of operations are as follows:

2014		
Financial instrument	Gain	Location
Interest rate swap agreements	\$ 83,003	Unrealized gain on derivatives

2013		
Financial instrument	Gain	Location
Interest rate swap agreements	\$ 1,420,545	Unrealized gain on derivatives

Additional information regarding fair value measurements of the interest rate swap agreements is disclosed in Note 3.

6. LONG-TERM DEBT AND LINE-OF-CREDIT

A summary of long-term debt at September 30, 2014 and 2013 follows:

	2014	2013
Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 1998, Adjustable interest rate every 5 years, based on the then current 5 year treasury rate, 0.66% at September 30, 2014 with principal maturing in varying monthly amounts of approximately \$3,100 to \$4,100 through 2018.	\$ 169,701	\$ 213,590
Indiana Finance Authority Health Facility Revenue and Refunding Bonds, Series 2013, variable interest rate, based on the LIBOR rate, 2.11% at September 30, 2014 with with principal maturing in varying annual amounts of \$663,000 to \$1,714,000 through 2032.	<u>21,106,000</u>	<u>21,106,000</u>
	<u>21,275,701</u>	<u>21,319,590</u>
Less current maturities	<u>706,443</u>	<u>705,725</u>
	<u><u>\$ 20,569,258</u></u>	<u><u>\$ 20,613,865</u></u>

On August 21, 2013, the System issued \$21,106,000 of Revenue and Refunding Bonds, Series 2013 through the Indiana Finance Authority Health Facility to refinance the 2002 Series A and B bonds and fund the construction of an addition to the System facilities. The bonds were a private placement with Comerica Bank and are not actively traded on the market.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

On October 16, 2014 and March 23, 2015, the Revenue and Refunding Bonds, Series was re-issued through the Indiana Finance Authority Health Facility to amend certain borrower covenants, the basis for the interest rate and to shorten the period of time between calls on the bonds. Pursuant thereto, Comerica Bank has agreed to hold the bonds until at least October 1, 2016 (Initial Purchase Date) in accordance with the related terms and conditions of the Trust Indenture.

On May 18, 1999, the System issued \$1,400,000 of Revenue bonds, Series 1998 through the Indiana Health Facility Financing Authority for the purchase of computer equipment and the construction of a new facility.

Principal repayments on long-term debt are as follows:

Year ending <u>September 30,</u>	
2015	\$ 706,443
2016	744,480
2017	783,802
2018	809,224
2019	818,000
Thereafter	<u>17,413,752</u>
	<u><u>\$ 21,275,701</u></u>

The debt instruments are secured by substantially all assets and require the System to comply with certain restrictive financial covenants. As of September 30, 2014, the System received a waiver for any noncompliance with the financial covenants.

As of September 30, 2014 and 2013, the System has borrowings of approximately \$6,992,000 and \$1,051,000 on its \$7,500,000 revolving line of credit, which bears interest at 1.25% above the 30 day LIBOR standard lending rate (2.1% at September 30, 2014 and 2013). The line of credit is secured by the System's investments with no stated expiration date as long as collateral is maintained.

7. LEASE OBLIGATIONS

Operating Leases

The System leases equipment under non-cancelable operating leases expiring in various years through 2019. Total rental expense amounted to approximately \$645,000 and \$1,017,000 for 2014 and 2013, respectively.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Future minimum payments under the operating leases with initial terms in excess of one year are as follows:

Year ending September 30,	
2015	\$ 219,760
2016	219,760
2017	219,760
2018	66,301
2019	913
	\$ 726,494

Capital Leases

The System has various capital lease arrangements for medical equipment expiring through 2018. Interest rates range from approximately 1% to 12% with monthly payments ranging from approximately \$350 to \$23,500. The leases are secured by property and equipment.

The following is the cost and accumulated depreciation on capital lease assets as of September 30, 2014 and 2013:

	2014	2013
Equipment	\$ 5,485,186	\$ 5,054,123
Accumulated depreciation	2,592,884	1,575,293
	\$ 2,892,302	\$ 3,478,830

Future payments under all capital lease obligations are as follows:

Year Ending September 30,	
2015	\$ 1,308,756
2016	984,370
2017	811,232
2018	140,337
	3,244,695
Less interest	391,547
	\$ 2,853,148

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

8. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement arrangements with major third-party payors is as follows:

Medicare and Medicaid

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment System). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the Prospective Payment System and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization, which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided. Medicare cost reports have been settled through 2011.

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The System believes that it is in compliance with all applicable laws and regulations and has provided for settlement of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

Other Payors

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

A summary of net patient service revenue, contractual adjustments and charity care for the years ended September 30, 2014 and 2013 follows:

	<u>2014</u>	<u>2013</u>
Patient service revenue		
Inpatient		
Routine services	\$ 14,151,448	\$ 13,033,037
Ancillary services	14,508,404	16,181,175
Outpatient		
Ancillary services	71,538,367	70,973,652
Physician services	16,519,735	17,468,419
Patient service revenue	<u>116,717,954</u>	<u>117,656,283</u>
Deductions		
Charity care	(2,313,375)	(1,427,881)
Contractual adjustments	(56,575,440)	(57,765,808)
Provisions for bad debts	(7,113,388)	(5,797,561)
Deductions	<u>(66,002,203)</u>	<u>(64,991,250)</u>
Net patient service revenue	<u>\$ 50,715,751</u>	<u>\$ 52,665,033</u>

9. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS

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

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

The System recognizes EHR incentive payments as grant income when there is reasonable assurance that the System will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2014 and 2013, the System recognized approximately \$1,063,000 and \$913,000, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the System records income at the end of EHR reporting period in which compliance is achieved.

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

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

10. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of who are local residents and are generally insured under third-party payor agreements. Accounts receivable as of September 30, 2014 and 2013 and gross patient service revenue from patients and third-party payors for 2014 and 2013 is as follows:

	Receivable		Revenue	
	2014	2013	2014	2013
Medicare	26%	26%	46%	47%
Medicaid	14%	16%	21%	26%
Blue Cross	6%	8%	11%	10%
Commercial insurance	15%	15%	15%	15%
Patients	39%	35%	7%	2%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

11. AFFILIATION AGREEMENTS

The System has an affiliation agreement with a health system located in central Indiana to identify areas of collaboration in providing clinical services. No change in control of the System occurred as a result of the agreement. However, neither of the parties is allowed to enter into another affiliation agreement without prior approval of the other party.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2014 AND 2013

12. FUNCTIONAL EXPENSES

The System is an acute care facility providing inpatient, outpatient, emergency and other ancillary services to residents within its geographical location. Expenses related to providing these services approximate the following:

	<u>2014</u>	<u>2013</u>
Health care services	\$ 51,359,278	\$ 49,044,345
Administrative and general	7,817,878	6,545,753
	<u>\$ 59,177,156</u>	<u>\$ 55,590,098</u>

13. COMMITMENTS AND CONTINGENCIES

Self-Funded Health Plan

The System is committed to pay for employees' health care costs. A third-party administrator has been retained to process and present all benefit claims to the System for payment. The System has purchased excess loss insurance from Zurich American Insurance Company. The System is responsible for the funding of all claims and related administrative costs up to \$150,000 per individual per policy year and up to \$302,047 per month on the group as a whole as of September 30, 2014. Group health insurance expense for 2014 and 2013 totaled approximately \$3,537,000 and \$2,924,000, respectively.

Litigation

The System is involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, the effect if any on the Systems future position, results from operations, and cash flows for certain regulatory investigations is not determinable at this time.