Consolidated Financial Statements and Supplementary Information

Beacon Health System, Inc. and Affiliated Corporations
Year Ended December 31, 2012
With Reports of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Financial Statements
and Supplementary Information

Year Ended December 31, 2012

Contents

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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 sheet as of December 31, 2012, and the related consolidated statements of operations and changes in net assets, and cash flows for the year 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 audit. We conducted our audit 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, 2012, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 7, 2013

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Balance Sheet
(In Thousands)

December 31, 2012

Assets	
Current assets:	
Cash and cash equivalents	$ 78,316
Short-term investments	7,305
Patient accounts receivable, less allowances for doubtful accounts (2012 – $19,393)	137,442
Due from third-party payors	18,573
Other receivables	8,844
Inventories	21,316
Prepaid expenses	9,345
Total current assets	281,141
Assets limited as to use:	
Internally designated investments	531,354
Externally designated investments – insurance trust	2,584
Board-designated endowment	19,332
Endowment and temporarily restricted investments	5,235
	558,505
Property and equipment:	
Land	38,347
Buildings and improvements	573,562
Furniture and equipment	338,814
Construction in progress	24,751
	975,474
Less allowances for depreciation and amortization	478,597
	496,877
Unamortized bond issuance costs, net	1,995
Deferred charges and other assets	30,243
	$ 1,368,761

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Liabilities and net assets	
Current liabilities:	
Accounts payable	$ 45,915
Accrued salaries and benefits	46,161
Accrued expenses	5,314
Due to third-party payors	6,063
Current maturities of long-term debt	6,920
Total current liabilities	110,373
Noncurrent liabilities:	
Long-term debt, less current maturities	208,140
Pension and other liabilities	122,563
Interest rate and basis swaps	30,017
	360,720
Total liabilities	471,093
Net assets:	
Unrestricted:	
Undesignated	867,771
Board-designated endowment	19,332
Total unrestricted	887,103
Temporarily restricted	9,974
Permanently restricted	591
Total net assets	897,668
	$ 1,368,761

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2012

Unrestricted revenue, gains, and other support	
Net patient service revenue	$ 897,737
Provision for bad debts	(51,950)
Net patient service revenue less provision for bad debts	845,787
Other revenue	39,670
Net assets released from restrictions used for operations	620
	886,077
Expenses	
Salaries and wages	302,454
Employee benefits	94,783
Supplies and other	208,416
Professional fees and purchased services	107,310
Depreciation and amortization	46,858
Interest	6,228
	766,049
Income from operations	120,028
Nonoperating	
Investment income, net	50,178
Unrealized gains on swap transactions, net	12,333
Realized loss on swap termination	(290)
Revenue and gains in excess of expenses	182,249

Beacon Health System, Inc. and Affiliated Corporations

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

(In Thousands)

Year Ended December 31, 2012

Unrestricted net assets	
Revenue and gains in excess of expenses	$ 182,249
Net assets released from restrictions used for capital purposes	304
Other	122
Capital contributions	257
Postretirement benefit adjustments other than periodic costs	(10,239)
Increase in unrestricted net assets	172,693
Temporarily restricted net assets	
Contributions temporarily restricted for use	1,502
Investment income	649
Net assets released from restrictions used for operating and capital purposes	(924)
Increase in temporarily restricted net assets	1,227
Permanently restricted net assets	
Contributions permanently restricted for use	–
Increase in permanently restricted net assets	–
Increase in net assets	173,920
Net assets at beginning of year	723,748
Net assets at end of year	$ 897,668

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Statement of Cash Flows

(In Thousands)

Year Ended December 31, 2012

Operating activities	
Change in net assets	$ 173,920
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation and amortization	46,858
Provision for bad debts	51,950
Unrealized gains on swap transactions, net	(12,333)
Realized loss on swap termination	290
Loss on disposal of assets	105
Postretirement benefit adjustments other than periodic costs	10,239
Realized gains on investments	(1,498)
Restricted contributions and investment income	(2,151)
Changes in operating assets and liabilities:	
Patient accounts receivable	(71,901)
Other receivables, inventories, and prepaid expenses	535
Other assets	(3,694)
Investments – trading	(118,226)
Accounts payable, accrued salaries and benefits, and accrued expenses	12,786
Due to/from third-party payors, net	(11,023)
Other long-term liabilities	(9,704)
Net cash provided by operating activities	66,153
Investing activities	
Net additions to property and equipment	(47,938)
Cash used in investing activities	(47,938)
Financing activities	
Principal payments on long-term debt and other debt obligations	(6,806)
Net proceeds from issuance of long-term debt and other debt obligations	55
Restricted contributions and investment income	2,151
Net cash used in financing activities	(4,600)
Increase in cash and cash equivalents	13,615
Cash and cash equivalents at beginning of year	64,701
Cash and cash equivalents at end of year	$ 78,316
Supplemental disclosure of cash flow information	
Interest paid	$ 6,312

See accompanying notes.

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. 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). In December 2011, the Corporation became 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); Memorial Health System, Inc. (MHS); and Beacon Health Ventures, Inc. (BHV). EGH, MHSB, MHS, 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 of 509(a)(1) and 509(a)(2), respectively. BHV is an Indiana for-profit corporation. All significant intercompany accounts and transactions have been eliminated in the consolidation. 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. MHS operates the physician enterprise of the Corporation.

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
- 50% interest in LaPorte Medical Group Surgery Center, LLP, an outpatient surgery center
- 35% interest in Physicians Hospital LLC, a long-term acute care facility

1. Organization and Basis of Consolidation (continued)

- 50% interest in Valparaiso Medical Development, LLC, a professional medical building venture
- 40% interest in Magnetic Resonance Imaging, LLC, an imaging and radiology center
- 40% interest in Northern Indiana Ambulatory Surgery Center, LLC, an ambulatory surgery center
- 26% interest Community Occupational Medicine, LLC, an occupational health care facility
- 42% interest in Wakarusa Medical Clinic, LLC, a medical clinic
- 50% interest in Wanee Walk in Clinic, LLC, a medical clinic

Aggregate financial information relating to these investments is as follows (in thousands):

	2012
Assets	$ 40,292
Liabilities	24,096
Net income	8,149

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, petty cash, and prepaid vendor accounts. The carrying value of cash equivalents approximates fair value.

2. Summary of Significant Accounting Policies (continued)

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 the Corporation's community benefit. Also included in short-term investments are restricted and unrestricted investment donations that are in the process of being liquidated.

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.

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 revenues, gains, and other support 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 nonoperating investment income in the consolidated statement of operations and changes in net assets.

2. Summary of Significant Accounting Policies (continued)

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 differences could be material. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in nonoperating 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, 2012, 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 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.

2. Summary of Significant Accounting Policies (continued)

Asset Impairment

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine if 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 2012.

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 2012.

Deferred Charges and Other Assets

Included in deferred charges and other assets are intangible assets 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 statement 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.

2. Summary of Significant Accounting Policies (continued)

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 time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement 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 statement 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 statement of operations and changes in net assets as other revenue.

2. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

The Corporation has agreements with various third-party payors that provide for payments to the Corporation 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 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).

Community Commitment

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).

Revenue and Gains in Excess of Expenses

The consolidated statement of operations and changes in net assets includes 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.

2. Summary of Significant Accounting Policies (continued)

Interest Rate and Basis Swaps

All interest rate and basis swaps are measured at fair value based on quoted market interest rates. 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 statement of operations and changes in net assets.

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 $4,512,000 at December 31, 2012, and is reflected in pension and other liabilities on the consolidated balance sheet.

Recent Accounting Pronouncement

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirement in U.S. GAAP and IFRSs*. ASU 2011-04 changes the wording used to describe many of the requirements in U.S. generally accepted accounting principles (GAAP) for measuring fair value and for disclosing information about fair value measurements. This update was issued to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). ASU 2011-04 includes amendments that clarify the FASB's intent about the application of existing measurement and disclosure and changes certain principles and requirements for measuring fair value and for disclosing information about fair value measurements. The Corporation adopted the new guidance on January 1, 2012, and has made the required disclosures in the notes to the consolidated financial statements.

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 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 percent of charges, per diem, and case rate.

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. 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 period from these major payor sources is as follows (in thousands):

	2012 Net Revenue
Payor:	
Anthem	$ 174,833
Commercial	239,119
Medicare	230,485
Medicaid	169,295
Self-pay	84,005
Revenues before provision for bad debts	897,737
Provision for bad debts	(51,950)
Net patient service revenue	$ 845,787

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

Revenues related to the Medicare program, Medicaid program, and Anthem Payor Contract account for 26%, 19%, and 19%, respectively, of net patient service revenue for the year ended December 31, 2012. 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 24% from Medicare and 19% from Blue Cross at December 31, 2012.

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 unable or 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 in the period by major payor source is as follows (in thousands):

	2012 Allowance for Doubtful Accounts
Payor:	
Third party	$ 10,203
Self-pay	9,190
	$ 19,393

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. Estimates

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

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. In June 2012, MHSB completed a successful appeal with the state of Indiana in regards to qualification for DSH reimbursement for state fiscal years 2010 and 2011. As a result, MHSB recorded net patient service revenue of $52,953,000 in 2012 related to the prior year appeal settlement.

In May 2012, the Indiana Hospital Assessment Fee program (HAF) was approved by the Federal Centers for Medicare and Medicaid Services for the period July 1, 2011 through June 30, 2013. 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 and an assessment (included in other expenses) against the Hospitals, which is paid to the state the same year. Since HAF was retroactive to July 1, 2011, prior period claims were reprocessed with a higher payment rate. The bulk of the reprocessing occurred in June 2012. The December 31, 2012, consolidated financial statements therefore include six months of prior period HAF payments totaling $28,283,000 and assessments of $10,942,000 related to the period July 1, 2011 through December 31, 2011. Payments received for the 12-month period covering January 1, 2012 through December 31, 2012, totaled $57,535,000 and assessments for the same period were $21,884,000. HAF payments are included in net patient service revenue and HAF assessments are included in supplies and other expenses in the consolidated statement of operations and changes in net assets.

During 2012, the Corporation recognized $5,400,000 as part of net patient service revenue for the Medicare Rural Floor Budget Neutrality Act settlement. This settlement with the Centers for Medicare & Medicaid Services involved approximately 2,200 hospitals nationwide and was made to resolve a challenge made by the plaintiff for underpayment of Medicare services dating back to 1999.

Estimates for cost report settlements and contractual allowances can differ from actual reimbursement based on the results of subsequent reviews and cost report audits. For the year ended December 31, 2012, net patient service revenue has been decreased by approximately $42,000 for third-party payor settlements related to prior years.

4. Community Commitment

Community commitment represents charity care and/or 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 community commitment provided was approximately $8,862,000 for the year ended December 31, 2012, 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 $169,000 during the year ended December 31, 2012.

In addition, the Corporation reinvests funds into the community to improve the health status of community members, in particular underserved populations. Each year, the Corporation tithes based on the Corporation's income from operations plus certain investment earnings in a separate unrestricted current asset account. The estimated amount of tithing funds expended was approximately $2,176,000 during the year ended December 31, 2012.

5. Pension Plans

The Corporation maintains a defined-contribution employee retirement and savings plan for MHSB, MHS, MHF, and BHV 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. Contributions were approximately $5,498,000 for the year ended December 31, 2012, included in employee benefits expense.

The Corporation maintains a defined-contribution employee retirement and savings plan for all employees of EGH. The Corporation's contributions are based on 100% of the employee's contributions, up to 4% of the employee's salary. Contributions were approximately $2,162,000 for the year ended December 31, 2012, included with employee benefits expense.

Effective January 1, 2013, the defined-contribution plans were rolled into one plan under the Corporation. There were no changes to the contributions from the previous defined-contribution plans.

5. Pension Plans (continued)

The Corporation also has a noncontributory, defined-benefit pension plan (the MEM Plan), which includes MHSB, MHS, 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 plan expense for the year ended December 31, 2012, was as follows:

	EGH	MEM	Total
Plan expense	$ 4,034,000	$ 2,518,000	$ 6,552,000

The Corporation's expected plan expense for the year ended December 31, 2013, is as follows:

	EGH	MEM	Total
Plan expense	$ 2,658,000	$ 1,556,000	$ 4,214,000

5. Pension 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 (in thousands):

	December 31, 2012		
	EGH	**MEM**	**Total**
Accumulated benefit obligation	$ 162,292	$ 140,640	$ 302,932
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$ 149,018	$ 131,413	$ 280,431
Service cost	806	1,332	2,138
Interest cost	6,237	5,444	11,681
Actuarial loss	14,768	11,764	26,532
Benefits and administrative expenses paid	(4,605)	(6,740)	(11,345)
Lump-sum benefits paid	(849)	–	(849)
Curtailment	(3,083)	–	(3,083)
Projected benefit obligation at end of year	$ 162,292	$ 143,213	$ 305,505
Change in plan assets:			
Fair value of plan assets at beginning of year	$ 88,598	$ 90,581	$ 179,179
Actual gain on plan assets	11,868	8,602	20,470
Employer contributions	11,500	4,510	16,010
Benefits and administrative fees paid	(4,605)	(6,740)	(11,345)
Lump-sum benefits paid	(849)	–	(849)
Fair value of plan assets at end of year	$ 106,512	$ 96,953	$ 203,465
Funded status:			
Funded status of the plan and amounts recognized as noncurrent liabilities in the consolidated balance sheet	$ (55,780)	$ (46,260)	$ (102,040)

5. Pension Plans (continued)

Included in unrestricted net assets are the following amounts that have not been recognized in net periodic pension cost at December 31, 2012 (in thousands):

	EGH	MEM	Total
Prior service cost	$ –	$ (1)	$ (1)
Actuarial net loss	67,654	47,420	115,074
	$ 67,654	$ 47,419	$ 115,073

	EGH	MEM	Total
Prior service cost	$ –	$ (6)	$ (6)
Actuarial net loss	5,142	3,073	8,215
Estimated benefit cost amortizations in the next fiscal year	$ 5,142	$ 3,067	$ 8,199

Changes in the plan's assets and benefit obligations recognized in unrestricted net assets during 2012 include the following (in thousands):

	EGH	MEM	Total
Current year actuarial loss	$ 2,828	$ 7,414	$ 10,242
Current year amortization prior service cost	(9)	6	(3)
	$ 2,819	$ 7,420	$ 10,239

5. Pension Plans (continued)

The components of net periodic benefit cost for the defined-benefit pension plan for the year ended December 31, 2012, was as follows (in thousands):

	EGH	MEM	Total
Service cost	$ 806	$ 1,332	$ 2,138
Interest cost	6,237	5,444	11,681
Expected return on plan assets	(8,003)	(6,699)	(14,702)
Prior service credit recognized	–	(6)	(6)
Amortization of recognized losses	4,994	2,447	7,441
Benefit cost	$ 4,034	$ 2,518	$ 6,552

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

	December 31, 2012	
	EGH	MEM
Discount rates	3.50%	3.50%
Expected return on plan assets	7.50	7.50
Rate of compensation increase	N/A	3.00

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

	December 31, 2012	
	EGH	MEM
Discount rates	4.25%	4.25%
Expected return on plan assets	8.50	7.50
Rate of compensation increase	3.00	3.00

5. Pension Plans (continued)

The following is a summary of the pension plan asset target and actual allocations at December 31, 2012:

Asset Category	EGH Strategic Target	MEM Strategic Target	Actual Asset Allocation at December 31, 2012 EGH	MEM
Equity securities	75%	40%	63%	38%
Debt securities	24	15	36	9
Other	1	45	1	53
Total	100%	100%	100%	100%

5. Pension 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, 2012 (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Short-term investment funds[a]	$ 7,172	$ –	$ –	$ 7,172
Mutual funds:[a]				
Large cap equity	61,790	–	–	61,790
International equity	22,952	–	–	22,952
Small cap equity	3,361	–	–	3,361
Total return fund	9,639	–	–	9,639
Blended fund	49,959	–	–	49,959
Total mutual funds	147,701	–	–	147,701
Common stocks[a]	2,993	–	–	2,993
Common/collective trust funds[b]	–	314	–	314
Long/short funds:[b,c]				
Long/short	–	15,986	–	15,986
Leveraged capital	–	6,067	–	6,067
Hedge funds:[c]				
Multi-strategy	–	10,608	–	10,608
Long/short hedge	–	813	–	813
Fixed and convertible arbitrage	–	1,830	–	1,830
Long commodities	–	5,317	–	5,317
Other	–	849	–	849
Fund of funds[c]	–	–	3,816	3,816
	$ 157,866	$ 41,784	$ 3,816	$ 203,466

5. Pension 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, 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 assets (in thousands):

Balance as of January 1, 2012	$	3,027
Sales		(863)
Realized gains		483
Unrealized gains		1,169
Balance as of December 31, 2012	$	3,816

5. Pension Plans (continued)

In addition to understanding fair value methodologies, the long/short, hedge, and other funds may be subject to redemption and/or liquidity restrictions. Restrictions of such funds by category are as follows (dollars in thousands):

Type of Fund	Fair Value at December 31, 2012	Redemption Restrictions	Liquidity Time Frame
Long/short funds			
Long/short	$ 8,189	None	Under 95 days
Long/short	7,797	None	Annual
Long/short leveraged capital	6,067	None	Under 95 days
Hedge funds			
Multi-strategy hedge funds	10,608	None	Under 95 days
Long/short hedge funds	813	None	Under 95 days
Fixed and convertible arbitrage hedge funds	1,830	None	Under 95 days
Long commodities	5,317	None	Under 95 days
Other hedge funds	849	None	Under 95 days
Fund of funds	3,816	None	Illiquid

The Corporation employs a total return investment approach, whereby a mix of equities and fixed-income investments are 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.

5. Pension Plans (continued)

Other assets, such as real estate, private equity, and 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 (in thousands):

	EGH	MEM	Total
2013	$ 9,960	$ 6,865	$ 16,825
2014	10,520	7,206	17,726
2015	9,709	7,384	17,093
2016	10,200	7,810	18,010
2017	10,435	8,373	18,808
2018 – 2022	49,352	43,739	93,091

The Corporation contributed the following to plan assets during 2012 from employer assets:

	EGH	MEM	Total
2012 contributions	$ 11,500,000	$ 4,510,000	$ 16,010,000

The Corporation contributed the following to plan assets from employer assets in January 2013 for the 2012 pension year:

	EGH	MEM	Total
January 2013 contributions for 2012	$ 1,000,000	$ 635,000	$ 1,635,000

The Corporation anticipates contributing the following to the plan assets from employer assets in 2013:

	EGH	MEM	Total
Anticipated 2013 total contributions	$ 10,000,000	$ 3,153,000	$ 13,153,000

6. Lease Obligations

The Corporation leases certain office space and equipment under noncancelable operating leases. At December 31, 2012, the minimum future rental payments under these leases are as follows (in thousands):

2013	$	4,492
2014		2,194
2015		1,973
2016		1,368
2017		1,013
Thereafter		3,838
	$	14,878

Rental expense for the year ended December 31, 2012, was approximately $5,084,000, which is included in supplies and other expense.

7. Long-Term Debt

Long-term debt consists of the following at December 31, 2012 (in thousands):

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 at 3.52% at December 31, 2012, due in varying annual installments on August 15 of each year through 2033	$	38,230
MHSB Revenue Bonds, Series 2008B, bearing interest at a variable rate of .14% at December 31, 2012, due in varying annual installments on August 15 of each year through 2034		36,370
MHSB Revenue Bonds, Series 2007, bearing interest at a variable rate of 1.08% at December 31, 2012, due in varying annual installments on August 15 of each year through 2046		1,000
MHSB Revenue Bonds, Series 1998A, interest ranging from 4.70% to 4.75%, due in varying annual installments on August 15 of each year through 2028		58,000
Tax-exempt bonds issued on behalf of EGH by the Hospital Authority of Elkhart County:		
EGH Revenue Bonds, Series 2008, bearing interest at a variable rate of 0.14% at December 31, 2012, due annually on May 1 of each year through 2033		44,685
EGH Revenue Bonds, Series 1998, bearing interest at a fixed rate of 5.25%, due annually on August 15 of each year through 2028		37,590
Mortgage-bearing interest at a variable rate of 2.46% at December 31, 2012, LIBOR plus 2.25%, due in varying annual installments on the last day of every month through 2015		1,419
Capital leases		275
		217,569
Less unamortized discount		2,509
		215,060
Less current portion		6,920
	$	208,140

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 $78,495,000. The interest rate for the Series 2008A and 2008B Bonds is a weekly interest rate determined by the remarketing agent. The 2008 bond issue is secured by two separate irrevocable direct-pay letters of credit issued by JPMorgan Chase Bank (JPMorgan). The JPMorgan letters of credit expire on October 12, 2015. 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 to, and including the year, 2033 in amounts sufficient to redeem the principal amounts. The Series 2008B Bonds are subject to mandatory redemption through the operation of a sinking fund on each August 15 that commenced with the year 2009 to, and including the year, 2034 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 $80,000,000 (the Series 2007 Bonds). MHSB purchased $27,000,000 par value of the Series 2007 Bonds for $13,230,000 in March 2009. In October 2008, MHSB purchased $52,000,000 par value of the Series 2007 Bonds for $29,640,000. The par value of the Series 2007 Bonds remains outstanding, with MHSB as owner of record. The consolidated balance sheet reflects these purchases as a reduction of long-term debt for the Series 2007 Bonds of $79,000,000 at par value. These bonds are available for reissuance.

In 1998, the Hospital Authority of St. Joseph County, on behalf of MHSB, issued revenue bonds in the principal amount of $97,365,000.

The Hospital Authority of Elkhart County issued $47,800,000 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 January 15, 2015, and decreases by the principal payments made by EGH on the Series 2008 Bonds. The Series 2008 Bonds

7. Long-Term Debt (continued)

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 (December 31, 2015).

The Hospital Authority of Elkhart County issued $49,330,000 of Series 1998 Hospital Revenue Bonds (the Series 1998 Bonds). EGH borrowed the proceeds of the sale of the Series 1998 Bonds and evidenced this loan with a loan agreement, issued under a Trust Indenture dated November 15, 1998, between the Hospital Authority of Elkhart County and Bank One, N.A., as trustee. A portion of the proceeds of the Series 1998 Bonds were issued to retire interest payments and principal payments of certain previously outstanding Series 1992 Bonds. The remaining are unsecured general obligations of EGH. The Series 1998 Bonds mature in August 2028.

As of the date of the issuance of the Series 2007 Bonds, under the terms of a Master Trust Indenture, the Corporation and MHSB formed 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 cancelled 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 2012 and at December 31, 2012.

Interest capitalized during the year ended December 31, 2012, was approximately $199,000.

7. Long-Term Debt (continued)

Maturities of long-term debt and capital lease obligations, assuming remarketing of variable rate debt, for each of the next five years are as follows (in thousands):

2013	$	6,920
2014		6,860
2015		8,010
2016		7,285
2017		7,640

8. Line of Credit

MHSB has a $2,000,000 revolving line of credit with 1st Source Bank. The line of credit was renewed and extended through May 31, 2013. Of the $2,000,000 revolving line of credit, $300,000 for the year ended December 31, 2012, was segregated for the beneficiary of a self-insurance trust. Conversely, $1,700,000 was available to be drawn upon at December 31, 2012. The interest rate on the line of credit is prime rate minus one-half percent. No amounts were outstanding on the line of credit as of December 31, 2012.

MHSB has a $7,000,000 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 amounts were outstanding on the line of credit as of December 31, 2012.

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

9. Interest Rate and Basis Swaps (continued)

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 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. In November 2012, MHSB terminated four PNC bank swaps with notional amounts of $30,000,000, $30,000,000, $77,150,000, and $56,000,000. MHSB realized a net loss of $290,000, which is included in nonoperating income on the consolidated statement of operations and changes in net assets.

The derivative instruments require adherence to collateral posting thresholds. As of December 31, 2012, the mark to market valuation on the swap portfolio was below the required collateral posting threshold of $30,000,000 with PNC Bank, $25,000,000 with Morgan Stanley, $25,000,000 with Wells Fargo, and $25,000,000 with Deutsche Bank.

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2012:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
March 2006	$38,230,000	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	$8,800,000	65% of 30-day LIBOR plus 0.45%	3.8100%	August 2034

9. Interest Rate and Basis Swaps (continued)

The following is a summary of the outstanding basis rate swaps as of December 31, 2012:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
January 2007	$42,000,000	74.6% of 1M LIBOR	SIFMA tax-exempt index +.0715%	January 2041
August 2007	$54,000,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index +.0715%	September 2041
March 2001	$140,000,000	75.125% of 3M LIBOR	SIFMA tax-exempt index	March 2031
July 2009	$63,000,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	$81,000,000	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 $368 for the year ended December 31, 2012, 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 nonoperating gain of approximately $12,333,000 and a realized nonoperating loss of $290,000 for the year ended December 31, 2012.

The fair value of derivative instruments at December 31 is as follows (in thousands):

	Balance Sheet Location	2012
Derivatives not designated as hedging instruments:		
Interest rate contracts	Interest rate and basis swaps	$ 30,017

10. Investments

Total investment return for the year ended December 31, 2012, is summarized as follows (in thousands):

Investment return:		
Net unrealized gains on investments	$	26,332
Net realized gains on investments		16,859
Net equity earnings on alternative investments		6,987
	$	50,178
Reported as:		
Investment income, net	$	50,178

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.

The fair value of the Corporation's long-term debt, excluding capital leases and the mortgage, is approximately $216,824,000 at December 31, 2012. 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

11. Fair Value of Financial Instruments (continued)

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 (ASC) Topic 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 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.

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, 2012, by caption, on the consolidated balance sheet 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. Deferred compensation investments are included in other assets on the consolidated balance sheet.

	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
			(In Thousands)			
Assets						
Short-term investments[a]	$ 7,305	$ –	$ –	$ 7,305	$ –	$ 7,305
Internally designated investments:						
Mutual funds:[a]						
Large cap equity	47,297	–	–	47,297	–	47,297
International equity	104,668	–	–	104,668	–	104,668
Small cap equity	5,631	–	–	5,631	–	5,631
Long/short equity	4,359	–	–	4,359	–	4,359
Total return fund	81,112	–	–	81,112	–	81,112
Blended fund	167,143	–	–	167,143	–	167,143
Total mutual funds	410,210	–	–	410,210	–	410,210
Common stock[a]	9,490	–	–	9,490	–	9,490
Bonds[b]	–	1,590	–	1,590	–	1,590
Alternatives:						
Fixed income	–	–	–	–	14,372	14,372
Fund of hedge funds	–	–	–	–	33,101	33,101
Long/short credit	–	–	–	–	6,068	6,068
Long/short equity	–	–	–	–	38,432	38,432
Private equity	–	–	–	–	12,027	12,027
Real estate	–	–	–	–	6,064	6,064
Total alternatives	–	–	–	–	110,064	110,064
Total internally designated investments	419,700	1,590	–	421,290	110,064	531,354

11. Fair Value of Financial Instruments (continued)

	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
			(In Thousands)			
Assets						
Ext. designated investment – insurance trust:						
Fixed income[a]	$ 2,584	$ –	$ –	$ 2,584	$ –	$ 2,584
Board-designated endowment:						
Mutual funds:[a]						
Equities	8,422	–	–	8,422	–	8,422
Fixed income[a,b]	6,262	259	–	6,521	–	6,521
Long/short equity	1,323	–	–	1,323	–	1,323
Equities[a]	882	–	–	882	–	882
Alternatives	–	–	–	–	2,184	2,184
Total board-designated endowment	16,889	259	–	17,148	2,184	19,332
Endowment:						
Mutual funds:[a]						
Fixed income	397	–	–	397	–	397
Equities	879	–	–	879	–	879
Money market[a]	181	–	–	181	–	181
Common collective trust funds[d]	–	3,778	–	3,778	–	3,778
Total endowment	1,457	3,778	–	5,235	–	5,235
Other long-term assets[a]						
Cash[a]	4,415	–	–	4,415	–	4,415
Fixed-income mutual fund[a]	2,965	–	–	2,965	–	2,965
Total	$ 455,315	$ 5,627	$ –	$ 460,942	$ 112,248	$ 573,190
Liabilities						
Swaps[c]	$ –	$ –	$ (30,017)	$ (30,017)	$ –	$ (30,017)
Total	$ –	$ –	$ (30,017)	$ (30,017)	$ –	$ (30,017)

(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.

(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.

11. Fair Value of Financial Instruments (continued)

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, 2012:

Type of Fund	Carrying Value	Redemption Restrictions	Liquidity Time Frame
	(In Thousands)		
Fixed income	$ 4,258	None	Illiquid
Fixed income	10,114	2.5-year lock	Illiquid
Fund of hedge funds	933	None	Illiquid
Fund of hedge funds	12,031	Semiannual redemptions	Illiquid
Fund of hedge funds	741	None	Under 95 days
Fund of hedge funds	12,641	15% redemption gate	Under 95 days
Fund of hedge funds	5,308	Quarterly redemptions	Under 95 days
Fund of hedge funds	1,448	3-year lock	Illiquid
Long/short credit	6,067	2-soft lock (5% fee 1st year and 3% fee 2nd year)	Under 95 days
Long/short equity	21,720	None	Annual
Long/short equity	18,896	None	Under 95 days
Private equity	12,027	None	Illiquid
Real estate	6,064	None	Annual

The table below sets forth a summary of changes in the fair value of the Corporation's Level 3 swaps for the year ended December 31, 2012 (in thousands):

Balance, beginning of the year	$ (42,060)
Unrealized gains, net	12,333
Realized loss, net	(290)
Balance, end of the year	$ (30,017)

For the year ended December 31, 2012, the Corporation recorded approximately $12,043,000 in nonoperating gains, which relates to gains of $13,620,000 due to the change in the swaps' value, $290,000 in realized gain on the termination of swaps, and loss of $1,287,000 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 year ended December 31, 2012, are as follows (in thousands):

Health care services	$ 514,283
Affiliated health services	97,702
General and administrative	154,064
	$ 766,049

13. Commitments

MHS is a guarantor for a portion of a loan of an unconsolidated joint venture, Valparaiso Medical Development, LLC, in which MHS records an equity interest. The portion of debt guaranteed by MHS is a maximum of $6,000,000 at December 31, 2012. No amounts have been paid or accrued pursuant to this guarantee as of December 31, 2012. The loan is collateralized by the assets, including the facility and land, held by Valparaiso Medical Development, LLC.

The Corporation has committed to investing $40,000,000 in certain hedge funds and alternative investments. During the year ended December 31, 2012, the Corporation invested approximately $16,107,000. The Corporation had a remaining unfunded commitment of approximately $17,245,000 at December 31, 2012.

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 $1,250,000 per occurrence, with the first $250,000 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, 2012, was approximately $2,584,000. The amount of malpractice and general liability claims, including a

14. Professional Liability Insurance (continued)

component for incurred but not reported claims, was approximately $6,395,000, gross of an insurance recoverable at December 31, 2012, which is included in pension and other liabilities. The interest rate used to discount these claims was 3.0% at December 31, 2012. In addition, at December 31, 2012, the Corporation recognized a recoverable insurance asset of approximately $3,250,000, which is included in deferred charges and other assets.

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 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 or periods at December 31, 2012 (in thousands):

Net assets currently available for:		
General	$	6,561
Capital		1,906
Programs		301
Education		196
Other		1,010
	$	9,974

16. Restricted Net Assets (continued)

Permanently restricted net assets generate investment income, which is used to benefit the following purposes at December 31, 2012 (in thousands):

Endowment investments providing income for health care educational purposes	$	191
Endowment		400
	$	591

17. Board-Designated Endowment and Endowment Investments

In August 2008, the FASB issued ASC 958, *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,* which, among other things, 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 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 ASC 958.

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, profits for support, betterment, improvement, upkeep, expansion, and replacement of MHS and its corporate affiliates.

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

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.

EGH has donor-restircted 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.

	December 31, 2012		
	Unrestricted	**Permanently Restricted**	**Total**
		(In Thousands)	
Cash and cash equivalents	$ –	$ 191	$ 191
Board-designated endowment funds	19,332	–	19,332
Endowment and temporarily restricted investments	–	400	400
Total investment funds	19,332	400	19,732
Total funds	$ 19,332	$ 591	$ 19,923

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

	Unrestricted	Permanently Restricted	Total
		(In Thousands)	
Endowment and board-designated endowment funds and endowment investments, beginning of year (January 1, 2012)	$ 17,525	$ 400	$ 17,925
Investment return:			
Investment income	381	–	381
Net unrealized gains on investments	1,375	–	1,375
Net equity gains on investments	51	–	51
Total investment return	1,807	–	1,807
Endowment and board-designated endowment funds and endowment investments, end of year (December 31, 2012)	$ 19,332	$ 400	$ 19,732

18. Subsequent Events

The Corporation intends to refinance the existing tax-exempt bond issues into a consolidated bond issue.

MHSB has received notification of qualification for state DSH reimbursement for state fiscal years 2012 and 2013. As of March 7, 2013, MHSB is unable to determine the amount of DSH reimbursement related to this qualification. No amounts are recorded in the 2012 consolidated financial statements related to this notification.

The Corporation evaluated events and transactions occurring subsequent to December 31, 2012 through March 7, 2013, the date of issuance of the 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

We have audited the consolidated financial statements of Beacon Health System, Inc. and Affiliated Corporations as of and for the year ended December 31, 2012, and have issued our report thereon dated March 7, 2013, which contained an unmodified opinion on those consolidated financial statements.

Our audit was performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The following financial information for 2012 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 7, 2013

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet
(In Thousands)

December 31, 2012

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.
Assets							
Current assets:							
Cash and cash equivalents	$ 78,316	$ –	$ 36,774	$ 5,430	$ 4,165	$ 1,856	$ 30,091
Short-term investments	7,305	–	5,942	–	914	–	449
Patient accounts receivable, net	137,442	–	75,718	7,342	–	7,211	47,171
Due from third-party payors	18,573	–	15,419	–	–	–	3,154
Other receivables	8,844	–	1,269	1,236	25	695	5,619
Inventories	21,316	–	13,320	–	–	788	7,208
Prepaid expenses	9,345	(1,676)	1,214	4,584	–	74	5,149
Due from affiliates	–	(3,605)	2,643	902	–	–	60
Total current assets	281,141	(5,281)	152,299	19,494	5,104	10,624	98,901
Assets limited as to use:							
Internally designated investments	531,354	–	328,328	–	–	–	203,026
Externally designated investments – insurance trust	2,584	–	2,553	20	–	11	–
Board-designated endowment	19,332	–	–	–	19,332	–	–
Endowment and temporarily restricted investments	5,235	–	–	–	–	–	5,235
	558,505	–	330,881	20	19,332	11	208,261
Property and equipment:							
Land	38,347	–	20,935	15,798	–	–	1,614
Buildings and improvements	573,562	–	343,480	55,042	–	7,824	167,216
Furniture and equipment	338,814	–	228,354	43,797	417	6,228	60,018
Construction in progress	24,751	–	14,896	3,246	–	627	5,982
	975,474	–	607,665	117,883	417	14,679	234,830
Less allowances for depreciation and amortization	478,597	–	305,963	55,809	348	10,012	106,465
	496,877	–	301,702	62,074	69	4,667	128,365
Unamortized bond issuance costs, net	1,995	–	1,317	–	–	–	678
Deferred charges and other assets	30,243	(12,367)	4,044	26,141	115	7,191	5,119
Interest in net assets of recipient organization	–	(5,139)	5,139	–	–	–	–
	$ 1,368,761	$ (22,787)	$ 795,382	$ 107,729	$ 24,620	$ 22,493	$ 441,324

Beacon Health System, Inc. and Affiliated Corporations

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

December 31, 2012

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.
Liabilities and net assets							
Current liabilities:							
Accounts payable	$ 45,915	$ (1,676)	$ 18,600	$ 5,280	$ 1	$ 2,638	$ 21,072
Accrued salaries and benefits	46,161	–	21,420	9,736	91	2,560	12,354
Accrued expenses	5,314	–	2,575	1,195	54	521	969
Due to third-party payors	6,063	–	1,667	–	–	–	4,396
Due to affiliates	–	(3,605)	–	–	–	3,605	–
Current maturities of long-term debt	6,920	–	4,470	–	–	–	2,450
Total current liabilities	110,373	(5,281)	48,732	16,211	146	9,324	41,241
Noncurrent liabilities:							
Long-term debt, less current maturities	208,140	–	128,774	–	–	–	79,366
Pension and other liabilities	122,563	–	8,539	50,083	–	33	63,908
Interest rate and basis swaps	30,017	–	30,017	–	–	–	–
	360,720	–	167,330	50,083	–	33	143,274
Total liabilities	471,093	(5,281)	216,062	66,294	146	9,357	184,515
Net assets:							
Unrestricted:							
Undesignated	867,771	(12,367)	574,181	41,435	(188)	13,136	251,574
Board-designated endowment	19,332	–	–	–	19,332	–	–
Total unrestricted	887,103	(12,367)	574,181	41,435	19,144	13,136	251,574
Temporarily restricted	9,974	(5,139)	5,139	–	5,139	–	4,835
Permanently restricted	591	–	–	–	191	–	400
Total net assets	897,668	(17,506)	579,320	41,435	24,474	13,136	256,809
	$ 1,368,761	$ (22,787)	$ 795,382	$ 107,729	$ 24,620	$ 22,493	$ 441,324

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Statement of Operations and Changes in Net Assets

(In Thousands)

Year Ended December 31, 2012

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.
Unrestricted revenue, gains, and other support							
Net patient service revenue	$ 897,737	$ (1,451)	$ 515,807	$ 57,226	$ –	$ 31,508	$ 294,647
Provision for bad debts	(51,950)	–	(26,651)	(2,807)	–	(942)	(21,550)
Net patient service revenue less provision for bad debts	845,787	(1,451)	489,156	54,419	–	30,566	273,097
Other revenue	39,670	(2,137)	19,801	10,292	73	1,437	10,204
Net assets released from restrictions used for operations	620	–	392	214	14	–	–
	886,077	(3,588)	509,349	64,925	87	32,003	283,301
Expenses							
Salaries and wages	302,454	(153)	124,829	68,132	–	18,812	90,834
Employee benefits	94,783	(320)	40,708	18,395	53	4,770	31,177
Supplies and other	208,416	(3,115)	113,053	16,514	212	6,149	75,603
Management fees	–	–	21,136	(22,935)	286	1,513	–
Professional fees and purchased services	107,310	–	46,261	11,256	510	1,361	47,922
Depreciation and amortization	46,858	–	23,946	4,782	51	890	17,189
Interest	6,228	–	4,145	–	29	31	2,023
	766,049	(3,588)	374,078	96,144	1,141	33,526	264,748
Income (loss) from operations	120,028	–	135,271	(31,219)	(1,054)	(1,523)	18,553
Nonoperating							
Investment income, net	50,178	–	25,357	465	1,975	2	22,379
Unrealized gains on swap transactions	12,333	–	12,333	–	–	–	–
Realized loss on swap termination	(290)	–	(290)	–	–	–	–
Revenue and gains in excess of (less than) expenses	182,249	–	172,671	(30,754)	921	(1,521)	40,932

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, 2012

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.
Unrestricted net assets							
Revenue and gains in excess of (less than) expenses	$ 182,249	$ –	$ 172,671	$ (30,754)	$ 921	$ (1,521)	$ 40,932
Net assets released from restrictions used for capital purposes	304	–	302	2	–	–	–
Other	122	–	(41,660)	34,780	810	4,034	2,158
Capital contributions	257	–	–	–	–	–	257
Postretirement benefit adjustments other than periodic costs	(10,239)	–	–	(7,420)	–	–	(2,819)
Increase in unrestricted net assets	172,693	–	131,313	(3,392)	1,731	2,513	40,528
Temporarily restricted net assets							
Contributions temporarily restricted for use	1,502	–	–	–	1,502	–	–
Investment income	649	–	–	–	78	–	571
Net assets released from restrictions used for operating and capital purposes	(924)	–	–	–	(924)	–	–
Change in interest in recipient organization	–	(656)	656	–	–	–	–
Increase in temporarily restricted net assets	1,227	(656)	656	–	656	–	571
Permanently restricted net assets							
Contributions permanently restricted for use	–	–	–	–		–	–
Increase in permanently restricted net assets	–	–	–	–	–	–	–
Increase (decrease) in net assets	173,920	(656)	131,969	(3,392)	2,387	2,513	41,099
Net assets at beginning of year	723,748	(16,850)	447,351	44,827	22,087	10,623	215,710
Net assets at end of year	$ 897,668	$ (17,506)	$ 579,320	$ 41,435	$ 24,474	$ 13,136	$ 256,809

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Report of Independent Auditors on Unaudited Supplementary Information

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

We have audited the consolidated financial statements of Beacon Health System, Inc. and Affiliated Corporations as of and for the year ended December 31, 2012, and have issued our report thereon dated March 7, 2013, which contained an unmodified opinion on those consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The following finnaical information for 2011 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 not been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, accordingly, we express no opinion on it.

Ernst & Young LLP

March 7, 2013

Beacon Health System, Inc. and Affiliated Corporations

Unaudited Consolidated Balance Sheet

(In Thousands)

December 31, 2011

Assets	
Current assets:	
Cash and cash equivalents	$ 64,701
Short-term investments	34,884
Patient accounts receivable, less allowances for doubtful accounts of $24,619	117,491
Due from third-party payors	3,733
Other receivables	8,810
Inventories	20,881
Prepaid expenses	11,303
Total current assets	261,803
Assets limited as to use, less current portion:	
Internally designated investments	386,449
Externally designated investments under debt agreements	–
Externally designated investments – insurance trust	2,564
Board-designated endowment	17,525
Endowment and temporarily restricted investments	4,664
	411,202
Property and equipment:	
Land	38,588
Buildings and improvements	575,515
Furniture and equipment	384,988
Construction in progress	12,458
	1,011,549
Less allowances for depreciation and amortization	516,282
	495,267
Unamortized bond issuance costs, net	2,108
Deferred charges and other assets	25,760
Interest rate swap	123
	$ 1,196,263

Liabilities and net assets	
Current liabilities:	
Accounts payable	$ 40,280
Accrued salaries and benefits	39,071
Accrued expenses	5,253
Due to third-party payors	2,246
Current maturities of long-term debt	6,816
Total current liabilities	93,666
Noncurrent liabilities:	
Long-term debt, less current maturities	214,829
Pension and other long-term liabilities	121,836
Interest rate and basis swaps	42,184
	378,849
Total liabilities	472,515
Net assets:	
Unrestricted:	
Undesignated	696,885
Board-designated endowment	17,525
Total unrestricted	714,410
Temporarily restricted	8,747
Permanently restricted	591
Total net assets	723,748
	$ 1,196,263

Beacon Health System, Inc. and Affiliated Corporations

Unaudited Consolidated Statement of Operations and Changes in Net Assets

(In Thousands)

Year Ended December 31, 2011

Unrestricted revenue, gains, and other support	
Net patient service revenue	$ 719,730
Provision for bad debts	(63,390)
Net patient service revenue less provision for bad debt	656,340
Other revenue	32,157
Net assets released from restrictions used for operations	891
	689,388
Expenses	
Salaries and wages	282,791
Employee benefits	78,193
Supplies and other	167,659
Professional fees and purchased services	102,010
Depreciation and amortization	46,314
Interest	6,080
	683,047
Income from operations	6,341
Nonoperating	
Investment income, net	(322)
Unrealized losses on swap transactions, net	(5,745)
Gain on asset acquisition	16,410
Revenue and gains in excess of expenses	16,684

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2011

Unrestricted net assets	
Revenue and gains in excess of expenses	$ 16,684
Net assets released from restrictions used for capital purposes	290
Postretirement benefit adjustments other than periodic costs	(50,541)
Decrease in unrestricted net assets	(33,567)
Temporarily restricted net assets	
Contributions temporarily restricted for use	1,965
Investment loss	(392)
Net assets released from restriction used for operating and capital purposes	(1,181)
Increase in temporarily restricted net assets	392
Permanently restricted net assets	
Contributions permanently restricted for use	191
Increase in permanently restricted net assets	191
Decrease in net assets	(32,984)
Net assets at beginning of year	756,732
Net assets at end of year	$ 723,748

Beacon Health System, Inc. and Affiliated Corporations

Unaudited Consolidated Statement of Cash Flows
(In Thousands)

Year Ended December 31, 2011

Operating activities		
Change in net assets	$	(32,984)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization		46,249
Provisions for bad debts		63,388
Unrealized losses on swap transactions, net		5,745
Gain on disposal of fixed assets		(785)
Loss on early extinguishment of debt		86
Gain on asset acquisition		(16,410)
Postretirement benefit adjustments other than periodic costs		15,093
Realized gains (losses) on investments		17,048
Restricted contributions and investment income		(1,926)
Changes in operating assets and liabilities:		
Patient accounts receivable		(57,055)
Other receivables, inventories, due from afiliated corporations, and prepaid expenses		(1,937)
Other assets		(6,772)
Investments		(25,712)
Accounts payable, accrued expenses, and other current liabilities		12,327
Due to third-party payors		(2,676)
Other long-term liabilities		32,801
Net cash provided by operating activities		46,480
Investing activities		
Acquisitions		(19,418)
Net additions to property and equipment		(21,027)
Net cash used in investing activities		(40,445)
Financing activities		
Principal payments on long-term debt and other debt obligations		(7,254)
Proceeds from long-term debt		397
Restricted contributions and investment income		1,926
Net cash used in financing activities		(4,931)
Increase in cash and cash equivalents		1,104
Cash and cash equivalents at beginning of year		63,597
Cash and cash equivalents at end of year	$	64,701
Supplemental disclosure of cash flow information		
Interest paid	$	6,351

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