



**Community Health  
Network, Inc. and  
Affiliates**

**Consolidated Financial Statements  
December 31, 2013 and 2012**

# Community Health Network, Inc. and Affiliates

## Index

December 31, 2013 and 2012

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## Independent Auditor's Report

To the Board of Directors of Community Health Network, Inc.

We have audited the accompanying consolidated financial statements of Community Health Network, Inc. and Affiliates (the "Network"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

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

Management is responsible for the preparation and fair presentation of the consolidated 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 consolidated 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 the consolidated 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 our 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, we consider internal control relevant to the Network'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 Network'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 financial position of Community Health Network, Inc. and Affiliates at December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

Indianapolis, IN  
April 16, 2014

**Community Health Network, Inc. and Affiliates**  
**Consolidated Balance Sheets (in 000's)**  
**Years Ended December 31, 2013 and 2012**

	2013	2012
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 253,514	\$ 190,039
Patient accounts receivable, less allowance for doubtful accounts of \$295,102 and \$461,849 in 2013 and 2012	204,734	228,127
Estimated third-party payor settlements receivable	55,622	15,024
Current portion of assets limited as to use—held by trustee	38,172	89,697
Inventories	27,313	25,647
Other accounts receivable	32,567	27,324
Other current assets	12,099	16,474
Total current assets	<u>624,021</u>	<u>592,332</u>
Assets limited as to use		
Funds held by trustee, net of current portion	65,500	36,900
Board-designated funds	540,184	475,013
Reinsurance trust assets	11,951	13,753
Property, plant and equipment, net	792,055	789,162
Investments in unconsolidated affiliates	32,027	20,470
Capitalized software, net of accumulated amortization	59,659	56,421
Deferred financing costs, net of accumulated amortization	6,791	7,115
Other assets	12,229	13,101
Total assets	<u>\$ 2,144,417</u>	<u>\$ 2,004,267</u>
<b>Liabilities and net assets</b>		
Current liabilities		
Short-term borrowings	\$ 50,000	\$ 50,000
Current portion of long-term debt	27,248	16,240
Accounts payable	72,032	81,449
Accrued salaries and wages	78,171	66,610
Estimated third-party payor settlements payable	50,352	10,738
Incurred but not reported liabilities	34,370	32,210
Other current liabilities	28,970	23,654
Total current liabilities	<u>341,143</u>	<u>280,901</u>
Accrued postretirement benefit cost	-	5,010
Accrued pension	11,120	25,742
Long-term debt, net of current portion	632,756	609,520
Pension underfunded liability	104,796	191,717
Interest rate swap liabilities	4,667	8,757
Other liabilities	8,552	20,330
Total liabilities	<u>1,103,034</u>	<u>1,141,977</u>
<b>Net assets</b>		
Unrestricted net assets		
Network unrestricted net assets	1,011,580	835,284
Noncontrolling interest	18,220	16,801
Total unrestricted net assets	<u>1,029,800</u>	<u>852,085</u>
Temporarily restricted net assets	7,148	5,834
Permanently restricted net assets	4,435	4,371
Total net assets	<u>1,041,383</u>	<u>862,290</u>
Total liabilities and net assets	<u>\$ 2,144,417</u>	<u>\$ 2,004,267</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets (in 000's)**  
**Years Ended December 31, 2013 and 2012**

	2013	2012
Revenues and gains		
Net patient service revenue	\$ 1,760,110	\$ 1,654,721
Provisions for bad debts	<u>86,538</u>	<u>76,269</u>
Net patient service revenue less provision for bad debts	1,673,572	1,578,452
Service fee revenue	25,551	23,552
Other revenue	32,875	43,168
Other revenue - electronic health record incentive payments	13,321	10,455
Gain on contribution to joint venture	8,118	-
Earnings from unconsolidated affiliates	<u>9,932</u>	<u>11,204</u>
Total unrestricted revenues and gains	<u>1,763,369</u>	<u>1,666,831</u>
Operating expenses		
Salaries, benefits and pension	999,551	931,255
Supplies and other expenses	608,562	580,066
Depreciation and amortization	81,045	75,390
Interest and financing costs- loss on early extinguishment of debt	-	17,871
Interest and financing costs	<u>20,062</u>	<u>14,562</u>
Total operating expenses	<u>1,709,220</u>	<u>1,619,144</u>
Income from operations	54,149	47,687
Realized and unrealized gains on investments, net	57,342	64,756
Unrealized gain on interest rate swaps	4,090	710
Excess of net assets acquired in Howard acquisition	-	87,291
Other, net	<u>(1,101)</u>	<u>1,248</u>
Excess of revenues over expenses and noncontrolling interests before income taxes	114,480	201,692
Provision for income taxes	<u>7,464</u>	<u>5,215</u>
Excess of revenues over expenses	<u>107,016</u>	<u>196,477</u>
Excess of revenues attributable to noncontrolling interest	<u>(17,879)</u>	<u>(15,555)</u>
Excess of revenues over expenses attributable to the Network	<u>\$ 89,137</u>	<u>\$ 180,922</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets (in 000's)**  
**Years Ended December 31, 2013 and 2012**

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	2013	2012
<b>Change in unrestricted net assets</b>		
Excess of revenues over expenses attributable to the Network	\$ 89,137	\$ 180,922
Over (under) funding of pension assets, net	86,921	(60,374)
Change in noncontrolling interest	1,419	5,063
Other changes, net	<u>238</u>	<u>(959)</u>
Increase in total unrestricted net assets	<u>177,715</u>	<u>124,652</u>
<b>Change in temporarily restricted net assets</b>		
Increase in temporarily restricted net assets	<u>1,314</u>	<u>1,161</u>
<b>Change in permanently restricted net assets</b>		
Increase in permanently restricted net assets	<u>64</u>	<u>54</u>
Increase in total net assets	179,093	125,867
Total net assets, beginning of year	<u>862,290</u>	<u>736,423</u>
Total net assets, end of year	<u>\$ 1,041,383</u>	<u>\$ 862,290</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows (in 000's)**  
**December 31, 2013 and 2012**

	2013	2012
<b>Cash flows from operating activities</b>		
Increase in net assets	\$ 179,093	\$ 125,867
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	81,045	75,390
Provision for bad debts	86,653	76,583
Deferred tax benefit	3,158	3,264
Write off of deferred financing costs	-	5,871
Excess of net assets acquired in the Howard acquisition, before non-controlling interest	-	(89,954)
Gain on contribution to joint venture	(8,118)	-
Earnings from unconsolidated affiliates	(9,932)	(11,204)
Unrealized gains on investments	(26,099)	(41,260)
Other non cash charges, net	-	3,592
Change in underfunded pension/postretirement liabilities/assets	(91,931)	60,374
Distributions received from unconsolidated affiliates	10,976	11,673
Change in prepaid pension cost	(14,622)	(26,729)
Investment income received	(20,744)	8,805
Other adjustments	180	988
Changes in operating assets and liabilities		
Patient accounts receivable	(63,260)	(108,406)
Other assets	(4,612)	(5,805)
Accounts payable	(15,079)	(15,672)
Estimated third-party payor settlements	(984)	2,078
Other liabilities	7,259	22,314
Net cash provided by operating activities	<u>112,983</u>	<u>97,769</u>
<b>Cash flows from investing activities</b>		
Purchases of property, plant and equipment	(72,612)	(75,386)
Purchases of capitalized software	(8,960)	(26,137)
Proceeds from sale of property, plant and equipment	(6)	196
Sales (Purchases) of investments, net	507	(129,895)
Investments in unconsolidated affiliates	(4,483)	(315)
Cash acquired in the acquisition of Howard and its affiliates	-	25,015
Due to unconsolidated affiliates and related parties, net	-	(335)
Net cash used in investing activities	<u>(85,554)</u>	<u>(206,857)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of debt	50,000	485,451
Repayments of debt	(15,756)	(347,964)
Deferred financing costs	-	(4,564)
Changes in restricted contributions and investment income	1,802	1,899
Cash flows provided by financing activities	<u>36,046</u>	<u>134,822</u>
Net increase in cash and cash equivalents	63,475	25,734
Cash and cash equivalents, beginning of year	190,039	164,305
Cash and cash equivalents, end of year	<u>\$ 253,514</u>	<u>\$ 190,039</u>
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during the year for		
Interest	\$ 20,109	\$ 29,495
Income taxes	\$ 3,694	\$ 2,390
<b>Non cash disclosures of cash flow information</b>		
Acquisition of property, plant and equipment included in accounts payable at December 31	\$ 5,662	\$ 4,962

The accompanying notes are an integral part of these financial statements.

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2013 and 2012

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#### 1. Organization and Summary of Significant Accounting Policies

##### Organization

Community Health Network, Inc. ("CHNw"), an Indiana non-profit corporation, and its non-profit and for-profit affiliates (collectively the "Network") comprise a full-service integrated health delivery system in central Indiana. The Network consists of eight acute care and/or specialty hospitals, seven immediate care centers, over 500 primary care and specialty employed physicians, forty ambulatory care centers, ten freestanding surgery centers, seven outpatient imaging centers, two ambulatory centers, and four long term care facilities.

Effective June 2013, the Network contributed its Hook Rehabilitation business to a rehabilitation hospital joint venture with CRH of Indianapolis, LLC in return for a 51% ownership interest. The Network accounts for its investment in the joint venture under the equity method of accounting.

In April 2013, the Network made a capital contribution in return for a 33.3% ownership interest in Accountable Care Consortium, LLC ("ACC"). The Network accounts for its investment in ACC under the equity method of accounting.

Effective December 2012, Community LTC, Inc. ("Community LTC") transferred ownership in the licenses and operations of four of its long term care facilities to Johnson Memorial Hospital ("Johnson"). Community LTC continues to manage the facilities and own the assets associated with the facilities.

Effective July 2012, the Network affiliated with Howard Regional Health System, Inc. and its affiliates (collectively "Howard"). The intent of the affiliation is to provide for the continuous operation of a general acute care hospital and related facilities in Howard County, Indiana. The affiliation was accounted for as an acquisition and thus the net assets and operations of Howard are included in the Network's consolidated financial statements beginning July 1, 2012. See Note 14.

##### Basis of Presentation and Consolidation

The accompanying consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP" or "GAAP") and include the assets, liabilities, revenues and expenses of all wholly owned subsidiaries, and when applicable, entities that are not wholly owned for which the Network has a controlling interest.

The consolidated financial statements include the following wholly owned entities:

- Community Hospital South, Inc. ("CHS"), a non-profit corporation which operates an acute care hospital facility on the south side of Indianapolis; CHNw and CHS are collectively referred to as ("CHI").
- Indiana Heart Hospital, LLC ("CHVH") d/b/a Community Heart and Vascular Hospital, a non-profit corporation which operates a specialty hospital specializing in cardiac care as well as provides cardiac services to CHNw;
- Community Hospitals of Anderson and Madison County, Inc. ("CHA"), a non-profit corporation which provides acute health care services to residents of Anderson, Indiana and surrounding communities;
- Indianapolis Osteopathic Hospital, Inc. d/b/a Westview Hospital ("Westview"), a non-profit corporation which provides acute health care services to residents on the west side of Indianapolis. Health Institute of Indiana, Inc. ("Healthplex") is a non-profit wholly owned fitness

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

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center of Westview. Westview Hospital Foundation, Inc. ("Westview Foundation") is a non-profit corporation organized to support the activities of Westview;

- Community Howard Regional Health, Inc., ("Howard") a non-profit corporation which provides acute health care services to residents in Howard County, Indiana and surrounding areas. Midwest Racquetball, Inc. d/b/a Kokomo Sports Center is a for profit sports facility of Howard; Community Howard Regional Health Foundation ("Howard Foundation") is a non-profit corporation organized to support the activities of Howard;
- Community Physicians of Indiana, Inc. ("CPI") d/b/a Community Physicians Network, a non-profit corporation which employs the Network's primary care and specialty physicians;
- Community Health Network Foundation, Inc. ("Foundation"), a non-profit corporation established to raise and expend funds for the benefit of CHNw and other related organizations;
- Visionary Enterprises, Inc. ("VEI"), a taxable, for-profit subsidiary corporation which consists primarily of ambulatory surgery center development in Indiana and Michigan, and management and other consulting services;
- Community Home Health Services, Inc. ("CHHS"), a non-profit corporation whose operations consist primarily of providing home health care and hospice services to patients in central Indiana counties; CHHS consolidates its wholly owned subsidiary, Community at Home, LLC, a non-profit Indiana corporation which provides sales of home health care products;
- Indiana ProHealth Network, LLC ("ProHealth"), a provider association consisting of physicians and hospital members in central Indiana and the primary vehicle by which the Network contracts for risk with payors; ProHealth is a pass-through taxable entity that is consolidated into VEI for income tax purposes;
- CHN Assurance Company, Ltd. ("Captive") is a company incorporated under the law of the Cayman Islands and a wholly owned subsidiary of CHNw. The Captive reinsures policies for the Network including: primary hospital professional liability, doctor's professional liability and general liability. The Captive's professional liability policy is on a claims-made basis and includes prior acts coverage for various entities owned by the Network, while the general liability policy is on an occurrence basis. On an annual basis, the Captive's ceding insurer requires the Captive to maintain an outstanding letter of credit to address any potential exposure between premiums paid and expected losses. Due to favorable claims experience and adequate funding, the fronting company does not require a letter of credit for the policy years beginning March 1, 2013 and 2014, respectively.
- The Network also consolidates its interest in the following wholly owned entities:
  - South Campus Surgery Center, LLC ("SCSC")
  - North Campus Surgery Center, LLC ("NCSC")
  - East Campus Surgery Center, LLC ("ECSC")
  - Hamilton Surgery Center, LLC ("Noblesville")
  - Howard Community Surgery Center, LLC ("Howard Surgery")
  - Northwest Surgery Center, LLC ("Northwest")
  - Community LTC, Inc. ("LTC")
  - Howard Regional Specialty Care, LLC ("Howard Rehab")

Significant intercompany accounts and transactions have been eliminated.

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2013 and 2012

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#### **Use of Estimates in the Preparation of Financial Statements**

The preparation of the consolidated financial statements in conformity with U.S. GAAP 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 and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to: (a) allowance for contractual revenue adjustments, (b) allowance for doubtful accounts; (c) depreciation lives of long-lived assets and (d) reserves for professional, workers' compensation and comprehensive general insurance liabilities risk. Future events and their effects cannot be predicated with certainty; accordingly the accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of the consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. The Network evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluation, as considered necessary. Actual results could differ from those estimates.

#### **Reclassifications**

Certain immaterial reclassifications have been made to the 2012 financial statements to conform to the 2013 presentation.

#### **Revision of Previously Reported Data**

In connection with the preparation of our consolidated financial statements, we made an adjustment to our December 31, 2012 balance sheet to reflect the proper classification of our pension underfunded liability. Previously, we had reported \$20,660 as a current liability. This amount has been adjusted to be appropriately classified as a long-term liability. The adjustment was immaterial to our consolidated balance sheet and there was no impact to our consolidated statement of operations and changes in net assets or our consolidated statement of cash flows.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, amounts due from banks and funds invested temporarily in money market accounts that are purchased with original maturities of three months or less.

The Network has entered into overnight sweep transaction agreements to purchase and resell direct obligations of, or obligations that are insured as to principal and interest by, U.S. Government agencies. At December 31, 2013 and 2012, cash and cash equivalents include \$86,249 and \$68,035, respectively, of overnight sweep transaction agreements.

#### **Allowance for Doubtful Accounts and Contractual Adjustments**

The Network's accounts receivable are reduced by an allowance for doubtful accounts and contractual adjustments. In evaluating the collectability of accounts receivable, the Network analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for contractual adjustments and provision for bad debts. For receivables associated with services provided to patients who have third party coverage, the Network analyzes contractually due amounts and provides an allowance for contractual adjustments. For receivables associated with self-pay patients, including patient deductibles and co-insurance, the Network records a provision for bad debts in the period of service on the basis of its past experience, which indicates 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 adjusted through the allowance for doubtful accounts. For CHNw,

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2013 and 2012

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CHS, VEI and CHVH, accounts that are sent to collection companies remain as accounts receivable on the balance sheet. These accounts are not written off unless returned from the collection company, however are fully reserved within the allowance for doubtful accounts. As such the allowance for doubtful accounts is significant for accounts receivable that have been fully reserved.

#### **Inventories**

Inventories consist primarily of medical and surgical supplies and pharmaceuticals. All inventories are valued at the lower-of-cost or market. Cost is determined by the Network using a weighted average cost method, which approximates cost under the first-in, first-out method.

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

Assets limited as to use consist of cash and cash equivalents, U.S. Government obligations, corporate bonds, mutual funds, marketable equity securities and hedge fund of funds and are stated at fair value. The investments are classified as trading securities. The trading securities classification is based on the Network's investment strategy and investment philosophies which permit investment managers to execute purchases and sales of investments without prior approval of Network management. All unrestricted unrealized gains and losses are recorded in investment income in the period in which they occur.

Reinsurance trust assets are maintained by the Captive. All realized and unrealized gains or losses are recorded in income. For reinsurance trust assets, fair value is determined as described in Note 3. Realized gains and losses on sales of investments are determined using the specific identification cost method and are included in excess of revenues over expenses.

#### **Property, Plant and Equipment**

Property, plant and equipment are recorded at cost or, if donated, at the fair value at date of donation. Assets under capital lease obligations are recorded at the present value of the aggregate future minimum lease payments at the beginning of the lease term. For financial statement purposes, the Network uses the straight-line method of computing depreciation over the shorter of the estimated useful lives of the respective assets or the life of the lease term, excluding any lease renewals, unless the lease renewals are reasonably assured.

Costs of maintenance and repairs are charged to expense when incurred; costs of renewals and betterments are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets.

Long-lived assets are evaluated for possible impairment whenever circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from future estimated cash flows. Fair value estimates are derived from independent appraisals, established market values of comparable assets or internal calculations of future estimated cash flows.

#### **Change in Estimates for Long-lived Assets**

The Network periodically performs assessments of the estimated useful lives of its long-lived assets. In evaluating the useful lives, the Network considers how long the long-lived assets will remain functionally efficient and effective, given changes in the physical and economic environments, the levels of technology and competitive factors. If the assessment indicates that the long-lived assets will continue to be used for a longer period than previously anticipated, the Network will revise the estimated useful lives resulting in a change in estimate. Changes in

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2013 and 2012

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estimates are accounted for on a prospective basis by depreciating the assets current carrying values over their revised remaining useful lives.

#### **Investments in Unconsolidated Affiliates**

Investments in affiliates not controlled by the Network are reported under the equity method of accounting. Under the equity method, the investments are initially recorded at cost, increased or decreased by the investor's share of the profits or losses of the investee and reduced by cash distributions received. Distributions received from investees that represent a return on investment are classified as operating cash flows on the consolidated statement of cash flows. Those distributions that represent a return of investment are classified as investing cash flows.

#### **Deferred Financing Costs**

Costs associated with the issuance of long-term debt are carried at cost, net of accumulated amortization. These amounts are amortized to interest expense using the effective interest method over the life of the bonds.

Discounts and premiums associated with long-term debt are reported as a direct deduction from, or addition to, the face amount of the long-term debt. The discounts/premiums are accreted/amortized using the effective interest method over the life of the related debt. The related income or expense is included in interest expense in the consolidated statement of operations.

#### **Capitalized Software**

The costs of obtaining or developing internal-use software, including external direct costs for materials and services and directly related payroll costs are capitalized. Amortization begins when the internal-use software is ready for its intended use. The software costs are amortized over the estimated useful lives of the software. The estimated useful lives range from 5-10 years. Costs incurred during the preliminary project stage and post-implementation stage as well as maintenance and training costs are expensed as incurred.

#### **Self-Insured Risk**

A substantial portion of the Network's professional and general liability risks, excluding Westview, are insured through a self-insured retention program written by the Network's consolidated wholly-owned offshore captive insurance subsidiary, the Captive, as previously described.

Reserves for professional and general liability risks, including incurred but not reported claims, were \$12,337 and \$13,841 at December 31, 2013 and 2012, respectively. These amounts are recorded and included in the incurred but not reported liabilities on the consolidated balance sheets.

Provisions for the self-insured risks are based upon actuarially determined estimates. Loss and loss expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through the respective consolidated balance sheet dates. The reserves for unpaid losses and loss expenses are estimated using individual case-basis valuations and actuarial analyses. Those estimates are subject to the effects of trends in loss severity and frequency. The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The changes to the estimated reserve amounts are included in current operating results.

Westview's professional and general liability risks are insured through a self-insurance retention program written by Suburban Health Organization Segregated Portfolio Company, LLC ("SHO Captive"), a captive insurance company. Westview is a member of the SHO Captive through a

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2013 and 2012

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20% ownership interest. Westview accounts for its interest in the SHO Captive through the equity method of accounting. The premiums paid to the SHO Captive are reflected in operating expenses on the consolidated statements of operations and changes in net assets.

The Network is self-insured for employee medical benefit risks through ProHealth except for Westview which is self-insured. Reserves for medical claims liabilities and estimated incurred but not reported claims were \$22,840 and \$17,966 at December 31, 2013 and 2012, respectively. These amounts are recorded and included in incurred but not reported liabilities on the consolidated balance sheets for the Network. Incurred but not reported claims reserves are determined using individual case-basis data and are continually reviewed and adjusted as new experienced information becomes known. The changes in estimated reserve amounts are included in current operating results.

Although considerable variability is inherent in reserve estimates, management believes the reserves for losses and loss expenses are adequate; however, there can be no assurance that the ultimate liability will not exceed management's estimates.

#### **Derivative Instruments**

The Network records derivative instruments on the consolidated balance sheet as either an asset or a liability as measured at its fair value. Changes in a derivatives' fair value are recorded each period either in revenues in excess of expenses or unrestricted net assets, depending on what type of hedge the derivative is designated as and whether or not the hedged transaction is effective or not. Changes in the fair value of derivative instruments recorded to unrestricted net assets are reclassified into earnings in the period affected by the underlying hedged item. Any portion of the fair value of a derivative instrument deemed ineffective is recognized in current earnings.

The Network had two interest rate swaps outstanding at December 31, 2013 and 2012. See Note 7 for further discussion of the two swap transactions.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Network has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Network in perpetuity.

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

The Network recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Network recognizes revenue on the basis of its standard rates for services provided or on the basis of discounted rates if in accordance with policy. On the basis of historical experience, a portion of the Network's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Network records a provision for bad debts related to uninsured patients in the period the services are provided.

Patient service revenue, net of contractual allowances and discounts recognized in the period from these major payor sources, is as follows for the years ended December 31, 2013 and 2012, respectively:

**Community Health Network, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements (in 000's)**  
**December 31, 2013 and 2012**

<b>2013</b>	<u>Third Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances and discounts)	\$ 1,666,086	\$ 94,024	\$ 1,760,110
<b>2012</b>	<u>Third Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances and discounts)	\$ 1,580,962	\$ 73,759	\$ 1,654,721

**Charity Care**

The Network maintains records to identify and monitor the level of charity care it provides. The Network provides 100% charity care to patients whose income level is below 200% of the Federal Poverty Level. Patients with income levels ranging from 200% - 300% of the current year's Federal Poverty Level will qualify for partial assistance determined by a sliding scale. The Network uses cost as the measurement basis for charity care disclosure purposes with the cost being identified as the direct and indirect costs of providing the charity care.

Charity care at cost was \$83,731 and \$58,163 for the years ended December 31, 2013 and 2012, respectively. Charity care cost was estimated on the application of the associated cost-to-charge ratios.

**Donor-restricted Gifts**

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. 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 statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements.

The following is a summary of pledge receivables as of December 31, 2013 and 2012.

	<b>2013</b>	<b>2012</b>
Pledge receivables in less than one year	\$ 668	\$ 388
Pledge receivables in one to five years	305	277
Pledge receivables in more than five years	<u>19</u>	<u>27</u>
	992	692
Less: allowable for doubtful accounts	<u>(117)</u>	<u>(109)</u>
	<u>\$ 875</u>	<u>\$ 583</u>

**Electronic Health Record Incentive Payments**

The America Recovery and Reinvestment Act of 2009 ("ARRA") established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. Under the programs incentive payments will be paid out over a four year period to hospitals and physicians meeting designated EHR meaningful use criteria. The Centers for Medicare and Medicaid Services

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("CMS") has chosen to take a phased approach to defining meaningful use (through three stages), using criteria that becomes more stringent over time.

The definitions of the stages are as follows:

Stage 1- The hospital must electronically capture health information in a coded format. Additionally, the hospital must use EHR technology during the meaningful use period to meet 14 required objectives. The hospital must also elect five additional objectives to meet.

Stage 2- The hospital expands on Stage 1 to focus on continuous quality improvement at point of care. Additionally, the hospital must demonstrate greater use of computerized physician order entry and more exchange of information.

Stage 3- The hospital expands on the previous stages to focus on promoting improvements in quality, safety and efficiency with an emphasis on decision support, patient access to self-management tools, access to comprehensive patient data and improving population health.

In order to receive incentive payments, a hospital which is able to meet the meaningful use criteria must attest that during the EHR reporting period, the hospital:

- Used certified EHR technology and specify the technology used;
- Satisfied the required meaningful use objectives and associated measures for the applicable stage;
- Must specify the EHR reporting period and provide the result of each applicable measure for all patients admitted to the inpatient and emergency department of the hospital during the EHR reporting period for which a selected measure is applicable.

The results of the measurements are required to be submitted to CMS. For Medicare and Medicaid, the meaningful use periods follow the Federal fiscal year of October 1 to September 30. Meaningful use is measured on a year by year basis. The EHR reporting period for the first payment year is any continuous 90 day period. Subsequent payments years are 365 days per year.

The incentive payments are computed as the product of a base amount times the number of discharges times a Medicare factor computed based on inpatient days and charity care charges times a transition factor as determined by CMS.

The Network recognizes the EHR incentives payments using a government grant recognition model. The Network determined the EHR incentive payments are similar to grants that are related to income and recognizes the incentive payments ratably over each meaningful use period. The Network recognizes the incentive payments when it is reasonably assured that it will comply with the conditions attached to them and that the grants will be received.

The recognition of the income related to the EHR incentive payments is based on Network management's best estimates and the amounts are subject to change, with such changes impacting the operations in the period in which they occur. The Network recognized \$13,321 and \$10,455 for the years ended December 31, 2013 and 2012, respectively.

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#### **Acquisition Costs**

The Network records acquisitions costs as incurred as operating expenses.

#### **Tax Status**

CHNw, CHS, CHA, CHHS, CPI, CHVH, Westview and Howard are exempt from federal income taxes under Section 501(c) (3) of the Internal Revenue Code (the "Code"), and the Foundation, Westview Foundation and the Howard Foundation are exempt from federal income taxes under Section 501a(c) (3) of the Code. VEI is a for-profit taxable entity and is subject to federal and state income taxes. ProHealth, NCSC, SCSC, ECSC, Noblesville, Howard Surgery, Northwest and MSI, which are wholly owned subsidiaries of VEI, are generally not subject to federal or state income taxes as income earned flows through to its members.

#### **Fair Value of Financial Instruments/Measurements**

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and other current liabilities approximate fair value because of the relatively short maturities of these financial instruments. The fair value of long-term debt is determined using discounted future cash flows, with a discount rate equal to interest rates for similar types of borrowing arrangements.

The fair value of the Network's long-term debt instruments (level 2) and related interest approximates \$620,755 and \$633,515 as compared to carrying values of \$660,004 and \$625,760 as of December 31, 2013 and 2012, respectively. See Note 6 for additional information regarding the bond financing completed in November 2012.

The Network measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Network uses also a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The Network uses a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1- Observable inputs such as quoted prices in active markets;
- Level 2- Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3- Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

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Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- Market approach- Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- Cost approach- Amount that would be required to replace the service capacity of an asset (i.e. replacement cost); and
- Income approach- Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models and lattice models.)

#### **Subsequent Events**

The Network evaluated subsequent events through April 16, 2014, the date the Network consolidated financial statements were issued. All material matters are disclosed in the footnotes to the consolidated financial statements.

## **2. Net Patient Service Revenue and Concentrations of Credit Risk**

The Network has agreements with third-party payors that provide for payments to the Network at amounts different from its established rates. Payment arrangements with major third-party payors include:

- Medicare—Inpatient acute care services, outpatient services and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The Network is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Network and audits thereof by the Medicare fiscal intermediary. The Network's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Network. The Network's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2011 except for Westview's cost report which has been audited through August 31, 2010 (Westview's prior fiscal year-end) and Howard's stub cost report which has been audited through December 31, 2011 (Howard's stub period-end before the affiliation with the Network). Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates could change by a material amount in the near term. Adjustments to revenue related to prior period cost reports increased net patient service revenue by approximately \$886 and \$12,637 for the years ended December 31, 2013 and 2012, respectively. Medicare patients account for approximately 41.6% and 40.1% of gross patient charges for years ended December 31, 2013 and 2012, respectively.

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- Medicaid—Inpatient services rendered to Medicaid program beneficiaries are reimbursed based on prospectively determined rates per discharge and outpatient services are reimbursed based on a fee for service basis, based on predetermined fee schedules. Medicaid patients account for approximately 13.5% and 12.8% of gross patient charges for years ended December 31, 2013 and 2012, respectively. The Network has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Network under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the established charges for services and estimated total payments to be received from third-party payors. Estimated settlements are accrued in the period the related services are rendered and adjusted in future periods as settlements are determined.

The Network has qualified as a Medicaid Disproportionate Share (“DSH”) provider under Indiana Law (IC 12-15-16(1-3)) and, as such, is eligible to receive DSH payments for the most recently determined state fiscal year 2013. The amount of these additional DSH funds is dependent on regulatory approval by agencies of the federal and state governments, and is determined by the level, extent and cost of uncompensated care as well as other factors. For the years ended December 31, 2013 and 2012, DSH payments have been made by the State of Indiana and amounts received were recorded as revenue based on data acceptable to the State of Indiana less any amounts management believes may be subject to adjustment. DSH payments are recorded by the Network after eligibility is determined by the State of Indiana and the payments are determined to be earned. If payments are received prior to eligibility being determined, the payments are recorded as current deferred revenue and recorded in current other liabilities until eligibility is determined. There is no deferred revenue related to DSH at December 31, 2013 or 2012.

Beginning June 2012, the State of Indiana offered voluntary participation in the State of Indiana’s Hospital Assessment Fee (“HAF”) program, retroactive to July 1, 2011. The State of Indiana implemented this program to utilize supplemental reimbursement programs for the purpose of providing reimbursement to providers to offset a portion of the cost of providing care to Medicaid and indigent patients. This program is designed with input from Centers for Medicare and Medicaid Services and is funded with a combination of state and federal resources, including fees or taxes levied on the providers.

As a result of participating in the HAF program, for the year ended December 31, 2012, the Network recognized reimbursements of \$78,197 and fees of \$43,453 related to the period July 1, 2011 through June 30, 2012.

The Network recognizes revenues and related fees associated with the HAF program in the period in which amounts are estimable and collection or payment is reasonably assured. Reimbursement under the program is reflected within net patient service revenue and the fees paid for participation in the HAF program are recorded in supplies and other expenses within the consolidated statement of operations and changes in net assets. The fees and reimbursements are settled monthly.

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The HAF program runs on an annual cycle from July 1 to June 30 and was originally effective until June 30, 2013. The program was subsequently renewed on March 21, 2014 effective through June 30, 2017 with a retroactive effective date of July 1, 2013. As a result of the retroactive date of July 1, 2013, the Network has accrued both the estimated reimbursement and expense for the period July 1, 2013 through December 31, 2013 in estimated third-party payor settlements on the December 31, 2013 balance sheet. The consolidated balance sheet at December 31, 2013 includes \$46,036 and \$35,240 in estimated third-party payor settlements receivable and payable, respectively, related to the HAF program.

Net patient service revenue, as reflected in the accompanying consolidated statements of operations and changes in net assets, consist of the following for the years ended December 31, 2013 and 2012:

	<b>2013</b>	<b>2012</b>
Gross patient service revenue	\$ 4,633,501	\$ 3,924,938
Deductions from gross patient service revenue		
Medicare/Medicaid contractual adjustments	1,889,198	1,340,367
Other contractual adjustments	802,166	813,877
Charity discounts for patient care	182,027	115,973
Net patient service revenue	<u>1,760,110</u>	<u>1,654,721</u>
Provision for bad debts	<u>86,538</u>	<u>76,269</u>
Net patient service revenue less provision for bad debts	<u>\$ 1,673,572</u>	<u>\$ 1,578,452</u>

The Network grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. A significant portion of the Network's revenue is concentrated by payor mix. The concentration of gross receivables by payor class for both patients and third-party payors at December 31, 2013 and 2012 is as follows:

	<b>2013</b>	<b>2012</b>
Medicare	26%	23%
Medicaid	9%	13%
Managed care and commercial insurance	45%	44%
Patients	20%	20%
	<u>100%</u>	<u>100%</u>

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Adjustments to the allowance for doubtful accounts are made after the Network has analyzed historical cash collections and considered the impact of any known material events. Uncollectible accounts are written-off against the allowance for doubtful accounts after exhausting collection efforts. Any subsequent recoveries are recorded against the provision for bad debts.

**3. Assets Limited as to Use**

**Funds Held by Trustee**

The following is a summary of assets limited as to use, which are held by trustees, at December 31, 2013 and 2012:

	2013	2012
Cash and cash equivalents	\$ 4,621	\$ 22,623
Fixed Income and U.S. Treasury obligations	89,193	103,974
Mutual Funds	9,858	-
	<u>103,672</u>	<u>126,597</u>
Less amount classified as current assets to meet current obligations	<u>38,172</u>	<u>89,697</u>
Noncurrent asset	<u>\$ 65,500</u>	<u>\$ 36,900</u>

2013 Description	Fair Value Measurements at Reporting Date			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 4,621	\$ 4,621	\$ -	\$ -
Fixed Income and U.S. Treasury obligations	89,193	-	89,193	-
Mutual Funds	9,858	9,858	-	-
Total	<u>\$ 103,672</u>	<u>\$ 14,479</u>	<u>\$ 89,193</u>	<u>\$ -</u>

2012 Description	Fair Value Measurements at Reporting Date			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 22,623	\$ 22,623	\$ -	\$ -
Fixed Income and U.S. Treasury obligations	103,974	-	103,974	-
Total	<u>\$ 126,597</u>	<u>\$ 22,623</u>	<u>\$ 103,974</u>	<u>\$ -</u>

The Hospital Revenue Bond Agreements (see Note 6) require that the initial bond proceeds be held by a bank trustee until such funds are expended for eligible assets. Certain other funds are also held by the bank trustee as additional security for the bondholders and the periodic deposits of principal and interest requirements. These amounts, including interest earned from temporary investments, are segregated in accounts maintained by a bank trustee. Use of the funds is restricted to debt service requirements. The funds reflected in current assets relate to construction costs anticipated to be incurred during 2014.

Investment income for 2013 and 2012 related to funds held by trustee consists of the following:

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	<b>2013</b>	<b>2012</b>
Interest and dividend income	\$ 404	\$ 68
Unrealized gain	2,190	(3)
Net realized gain on sales of investment securities	<u>1,176</u>	<u>620</u>
Total investment income	<u>\$ 3,770</u>	<u>\$ 685</u>

**Board-designated Funds**

The Network classifies its Board designated funds and reinsurance trust assets as trading securities. Those investments are marked to market each month. The following is a summary of the investments limited as to use, which are board-designated funds at December 31, 2013 and 2012:

	<b>2013 Cost</b>	<b>2013 Market</b>
Cash and cash equivalents	\$ 118	\$ 118
Equity securities	488	648
Corporate bonds	206	199
Mutual funds	449,452	484,386
Hedge fund of funds/REITS/Other	<u>48,073</u>	<u>54,833</u>
	<u>\$ 498,337</u>	<u>\$ 540,184</u>

	<b>2012 Cost</b>	<b>2012 Market</b>
Cash and cash equivalents	\$ 13,576	\$ 13,576
Equity securities	24,543	30,603
Corporate bonds	59	56
Mutual funds	393,271	410,384
Hedge fund of funds/REITS/Other	<u>21,951</u>	<u>20,394</u>
	<u>\$ 453,400</u>	<u>\$ 475,013</u>

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2013 Description	Fair Value Measurement at Reporting Date			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 118	\$ 118	\$ -	\$ -
Equity securities	648	648	-	-
Corporate bonds	199	-	199	-
Mutual funds	484,386	484,386	-	-
Hedge fund of funds/REITS/Other	54,833	-	327	54,506
Total	<u>\$ 540,184</u>	<u>\$ 485,152</u>	<u>\$ 526</u>	<u>\$ 54,506</u>

2012 Description	Fair Value Measurement at Reporting Date			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 13,576	\$ 13,576	\$ -	\$ -
Equity securities	30,603	30,603	-	-
Corporate bonds	56	-	56	-
Mutual funds	410,384	410,384	-	-
Hedge fund of funds/REITS/Other	20,394	-	-	20,394
Total	<u>\$ 475,013</u>	<u>\$ 454,563</u>	<u>\$ 56</u>	<u>\$ 20,394</u>

	<b>Rollforward of Level 3 Investments</b>
<b>Balance as of January 1, 2012</b>	\$ 18,824
Purchases	3,056
Investment loss-realized/unrealized	(1,486)
<b>Balance as of December 31, 2012</b>	<u>\$ 20,394</u>
<b>Balance as of January 1, 2013</b>	\$ 20,394
Purchases	28,850
Investment loss-realized/unrealized	5,262
<b>Balance as of December 31, 2013</b>	<u>\$ 54,506</u>

As a practical expedient, the Network is permitted under US GAAP to estimate the fair value of investments in investment companies that have a calculated value of their capital account or net asset value ("NAV") at the measurement date using the reported NAV without further adjustment unless the entity expects to sell the investment at a value other than NAV or if the NAV is not calculated in accordance with US GAAP. The Network's investments in mutual funds and hedge fund of funds are fair valued based on the most current NAV.

The fair values of the board designated funds are provided to the Network's investment manager and are determined as follows:

- a) The funds designated as level 1 inputs represent equity securities and investable mutual fund shares that are traded on major stock exchanges. Thus, the fair value is determined based on quoted prices in an active market.

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- b) The funds designated as level 2 inputs represent fixed income securities generally determined on the basis of valuations provided by a pricing service which will typically utilize industry accepted valuation models and observable market inputs to determine valuation; some valuations or model inputs provided/used by the pricing service may be, or be based upon, broker quotes.
- c) The funds designated as level 3 inputs represent hedge funds. The fair values of the hedge funds are obtained from individual hedge fund managers and custodians. The hedge fund of fund manager employs best practices controls and due diligence to ensure the valuations are reflective of fair value. Additionally, the individual hedge funds are audited annually and an audit report issued.

The following table presents liquidity information for the financial instruments carried at net asset value at December 31, 2013 and 2012:

<b>Investment Type</b>	<b>Redemption Frequency</b>	<b>Notice Period</b>
Mutual Funds	Daily	N/A
Hedge Fund of funds	Quarterly	70 days

Investment income for 2013 and 2012 related to Board-designated funds consists of the following:

	<b>2013</b>	<b>2012</b>
Interest and dividend income	\$ 14,476	\$ 14,235
Unrealized gain	19,819	41,260
Net realized gain on sales of investment securities	19,842	8,234
Total investment income	<u>\$ 54,137</u>	<u>\$ 63,729</u>

The Network's investment expenses for the years ended December 31, 2013 and 2012 were \$394 and \$532, respectively.

**Reinsurance Trust Assets**

The assets in the trust are maintained in a domestic trust account. These assets are restricted and may not be withdrawn or used without the consent of the trust administrator.

The following is a summary of the investments limited as to use, which are reinsurance trust assets, at December 31, 2013 and 2012:

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	2013 Cost	2013 Market	2012 Cost	2012 Market
Corporate bonds	\$ 11,819	\$ 11,592	\$ 7,724	\$ 8,011
Federal Government Agency mortgage backed securities	157	156	5,001	5,186
Cash and cash equivalents held in trust	203	203	556	556
	<u>\$ 12,179</u>	<u>\$ 11,951</u>	<u>\$ 13,281</u>	<u>\$ 13,753</u>

<u>2013</u> Description	<u>Fair Value Measurements at Reporting Date</u>			
	2013	Level 1	Level 2	Level 3
Federal Government Agency and mortgage backed securities	\$ 156	\$ -	\$ 156	\$ -
Corporate bonds	11,592	-	11,592	-
Cash and cash equivalents held in trust	203	203	-	-
Total	<u>\$ 11,951</u>	<u>\$ 203</u>	<u>\$ 11,748</u>	<u>\$ -</u>

<u>2012</u> Description	<u>Fair Value Measurements at Reporting Date</u>			
	2012	Level 1	Level 2	Level 3
Federal Government Agency and mortgage backed securities	\$ 5,186	\$ -	\$ 5,186	\$ -
Corporate bonds	8,011	-	8,011	-
Cash and cash equivalents held in trust	556	556	-	-
Total	<u>\$ 13,753</u>	<u>\$ 556</u>	<u>\$ 13,197</u>	<u>\$ -</u>

The fair values of the reinsurance trust assets are provided by the Captive's investment manager and are determined as follows:

- a) The fair value of fixed income securities including corporate debt are generally determined on the basis of valuations provided by a pricing service which will typically utilize industry accepted valuation models and observable market inputs to determine valuation; some valuations or model inputs provided/used by the pricing service may be, or be based upon, broker quotes.
- b) The fair value of investments in money market funds (included in cash and cash equivalents within the tables above) is determined based on the net asset value per share provided by the administrators of the funds.

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Investment income for 2013 and 2012 related to reinsurance trust assets consists of the following:

	<b>2013</b>	<b>2012</b>
Interest income	\$ 409	\$ 388
Net realized/unrealized gains on investment securities	(974)	(46)
Total investment income	<u>\$ (565)</u>	<u>\$ 342</u>

**4. Property, Plant and Equipment**

Property, plant and equipment and accumulated depreciation consist of the following at December 31, 2013 and 2012:

	<b>Estimated Useful Lives</b>	<b>2013</b>	<b>2012</b>
Land and land improvements	0-20 years	\$ 38,700	\$ 38,395
Buildings and improvements	10-90 years	929,175	904,320
Equipment	3-20 years	624,018	615,131
Construction in progress		29,744	19,650
		<u>1,621,637</u>	<u>1,577,496</u>
Less: Accumulated depreciation		829,582	788,334
		<u>\$ 792,055</u>	<u>\$ 789,162</u>

Depreciation expense was \$75,207 and \$74,177 for 2013 and 2012, respectively.

Property, plant and equipment include \$1,338 and \$1,578 of capitalized interest at December 31, 2013 and 2012, respectively.

**5. Investments in Unconsolidated Affiliates**

The Network has equity investments in various surgery centers, Mid America Clinical Laboratory ("MACL") and other entities. The following is a summary of the Network's investments in unconsolidated affiliates for the years ended December 31, 2013 and 2012:

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	<b>Surgery Centers</b>	<b>MACL</b>	<b>Other</b>	<b>Total</b>
<b>Balance, December 31, 2011</b>	\$ 10,762	\$ 4,671	\$ 4,846	\$ 20,279
Capital contributions	-	-	315	315
Distributions	(6,714)	(1,540)	(3,419)	(11,673)
Equity in net income	6,193	2,657	2,354	11,204
Other	-	-	345	345
<b>Balance, December 31, 2012</b>	\$ 10,241	\$ 5,788	\$ 4,441	\$ 20,470
Capital contributions	490	-	3,993	4,483
Distributions	(6,683)	(1,725)	(2,568)	(10,976)
Equity in net income	6,850	2,749	333	9,932
Gain on contribution to JV	-	-	8,118	8,118
<b>Balance, December 31, 2013</b>	\$ 10,898	\$ 6,812	\$ 14,317	\$ 32,027

Summarized and aggregated financial statement information for the surgery centers, MACL and the other unconsolidated affiliates is as follows:

	<b>Surgery Centers</b>	<b>MACL</b>	<b>Other</b>	<b>Total</b>
Total assets	\$ 21,459	\$ 44,535	\$ 66,241	\$ 132,235
Total liabilities	8,954	13,571	30,176	52,701
Net assets	12,505	30,964	36,065	79,534
Revenues	58,112	108,905	77,788	244,805
Operating income	15,731	12,475	9,965	38,171
Net income	15,370	12,493	8,176	36,039
Network's equity in net income of unconsolidated affiliates	6,850	2,749	8,451	18,050

**6. Debt**

**Short-term Borrowings**

Short-term borrowings represent outstanding borrowings under bank lines of credit. At December 31, 2013 and 2012 the following amounts were outstanding:

	<b>Maximum Borrowings</b>	<b>Outstanding Balance</b>	
		<b>2013</b>	<b>2012</b>
CHI	\$ 50,000	\$ 50,000	\$ 50,000
CHA	2,000	-	-
		<u>\$ 50,000</u>	<u>\$ 50,000</u>

The bank lines of credit are due on demand. CHI's short-term debt is collateralized under the same terms as the Master Indentures described below. Interest is at a floating rate. The weighted-

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average effective rates on CHI's short term borrowings were 0.84% and 1.72% for the years ended December 31, 2013 and 2012, respectively.

In January 2014, CHI subsequently paid down its line of credit. At January 31, 2014, there was no balance outstanding on CHI's \$50.0 million line of credit.

**Long-term debt**

Long-term debt at December 31, 2013 and 2012 is summarized as follows:

	<b>Obligated Entity</b>	<b>2013</b>	<b>2012</b>
Indiana Finance Authority, Adjustable Rate Hospital Revenue Bonds, Series 2012A Interest payable monthly (ranging from 2.0% - 5.0%) Due May 1, 2013 to May 1, 2028 4.00% term bonds due May 1, 2025 5.00% term bonds due May 1, 2042 Unamortized premium	CHNw	\$ 106,700 88,930 174,455 27,135 <hr/> \$ 397,220	\$ 112,810 88,930 174,455 28,074 <hr/> \$ 404,269
Indiana Finance Authority, Adjustable Rate Hospital Revenue Bonds Series 2012B, Interest payable monthly (1.05% rate at 12/31/13) Due November 27, 2012 to November 27, 2039	CHNw	\$ 72,665 <hr/> \$ 72,665	\$ 74,250 <hr/> \$ 74,250
Indiana Finance Authority, Adjustable Rate Hospital Revenue Bonds, Series 2009A Interest payable monthly (.05% rate at 12/31/13) Due July 1, 2009 to July 1, 2039 Unamortized discount	CHNw	\$ 37,455 (126) <hr/> \$ 37,329	\$ 38,335 (131) <hr/> \$ 38,204

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	<b>Obligated Entity</b>	<b>2013</b>	<b>2012</b>
Indiana Finance Authority, Adjustable Rate Hospital Revenue Bonds, Series 2005A and 2005B; Interest payable monthly (0.03% - 0.05% effective rate at December 31, 2013) due January 1, 2007 to January 1, 2035	Howard	\$ 44,470	\$ 45,420
Indiana Health Facility Financing Authority, Adjustable Rate Hospital Revenue Bonds, Series 2000A and 2000B Interest payable monthly (0.05% effective rate at December 31, 2013) due July 1, 2002 to July 1, 2028	CHNw	\$ 35,000	\$ 37,800
Fifth Third Bank, Term Loan; interest payable quarterly (1.50% effective rate at December 31, 2013), Due December 31, 2014	WV	\$ 5,680	\$ 6,108
Salin Bank Notes, interest payable monthly (3.16% effective rate at December 31, 2013), Due September 8, 2025	Howard	\$ 8,799	\$ 9,406
BMO Harris Bank; Term Loan; Interest payable monthly (1.33%) or (3.27%) Due November 18, 2020	CHNw	\$ 49,470	\$ -
Other long-term debt		<u>\$ 9,371</u>	<u>\$ 10,303</u>
		\$ 660,004	\$ 625,760
Less: Current portion of long-term debt		27,248	16,240
Long-term debt, net of current portion		<u>\$ 632,756</u>	<u>\$ 609,520</u>

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

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#### **Series 2012A and 2012B**

On November 27, 2012, the Indiana Finance Authority ("IFA") issued Hospital Revenue Bonds, Series 2012A and Adjustable Rate Hospital Revenue Bonds, Series 2012B, in the aggregate amount of \$450,445 for the purpose of making a loan to CHNw. The proceeds of this loan from IFA are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. The Series 2012 A and Series 2012 B bonds are subject to redemption prior to their stated maturity at the option of CHNw on a thirty day notice in whole or in part, at a redemption price equal to 100% of the principal amount plus interest at the date of redemption.

Proceeds from the issuance of the Series 2012A and Series 2012B bonds were used to refinance the following series of bonds: 1988, 1993, 1992, 1995, 1997A and B, 2005A, B and C, and 2009B.

#### **Series 2009A and 2009B**

On June 30, 2009, the Indiana Finance Authority ("IFA") issued Adjustable Rate Hospital Revenue Bonds, Series 2009A and 2009B, in the aggregate amount of \$100,000 for the purpose of making a loan to CHI. The proceeds of this loan from IFA are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHI. As mentioned above, the Series 2009B was refunded with proceeds of Series 2012B. As a result, the letter of credit is no longer outstanding. As credit support for the 2009A bonds, the Network has an outstanding letter of credit with a bank for a maximum aggregate principal draw amount of \$37,455 plus accrued interest as of December 31, 2013. The letter of credit expires for the Series 2009A on September 9, 2015. The Series 2009A bonds are subject to redemption prior to their stated maturity at the option of CHNw on a thirty day notice in whole or in part, at redemption price equal to 100% of the principal amount plus interest at the date of redemption.

#### **Series 2005A, 2005B and 2005C**

On May 1, 2005, the Indiana Health Financing Authority, (the "Authority") issued Hospital Revenue Bonds, Series 2005A and Adjustable Rate Hospital Revenue Bonds, Series 2005B and 2005C, in the aggregate amount of \$190,320 for the purpose of making a loan to CHNw. The proceeds of this loan from the Authority were available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHI. As credit support for the 2005B and 2005C bonds, the Network had two outstanding letters of credit with banks for a maximum aggregate principal draw amount of \$34,000. The Series 2005B and Series 2005C bonds were refunded with proceeds from the Series 2012A and Series 2012B bonds. The Series 2005A bonds were advanced refunded with proceeds from the Series 2012A bonds and were legally defeased.

#### **Series 2005A and 2005B - Howard**

On July 1, 2012, Howard affiliated with the Network and its results since that date are consolidated with the Network as of December 31, 2013 and 2012. As a result, Howard's outstanding bonds are now reflected on the Network's consolidated balance sheet as of December 31, 2013 and 2012.

On January 1, 2005, the Indiana Finance Authority ("IFA") issued Adjustable Rate Hospital Revenue Bonds, Series 2005A and Series 2005B, in the aggregate amount of \$50,000 for the purpose of making a loan to Howard. The proceeds of this loan from IFA are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by Howard. As of December 31, 2013, the outstanding letters of credit with the bank associated with this debt is the principal amount of \$44,470 plus accrued interest. The letters of credit expires November 13, 2015. The Series 2005A and Series 2005B bonds are subject to redemption prior to their stated maturity at the option of CHNw on a thirty day notice in

# Community Health Network, Inc. and Affiliates

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whole or in part, at redemption price equal to 100% of the principal amount plus interest at the date of redemption.

Howard has interest rate swap agreements related to its Series 2005A and Series 2005B bonds. Through the swaps, Howard pays a fixed rate on a portion of the Series 2005A and Series 2005B bonds. The swaps mature on January 1, 2035 consistent with the maturity date of the bonds. See Note 7 for further disclosure related to the interest rate swaps.

#### ***Series 2000A and 2000B***

On November 1, 2000, the Authority issued Adjustable Rate Hospital Revenue Bonds, Series 2000A and 2000B, in the aggregate amount of \$40,000 for the purpose of making a loan to the Network. The proceeds of this loan from the Authority were available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHNw. As of December 31, 2013, the outstanding letter of credit with the bank associated with this debt is the principal amount of \$35,000 plus accrued interest. The letter of credit expires September 9, 2015. The Series 2000A and 2000B bonds are subject to redemption at the option of CHNw on a thirty day notice at a redemption price equal to 100% of the principal amount plus interest at the date of redemption.

#### ***Term Loan - Westview***

On December 29, 2011, Westview refunded its Hospital Authority of Marion County Adjustable Rate Demand Hospital Revenue Bonds, Series 2004 with a term loan financed through Fifth Third Bank ("Term Loan"). The Term Loan bears interest at the 30 day LIBOR rate plus 125 basis points adjusted monthly. Principal and interest payments are due quarterly with a final balloon payment of approximately \$5,250 due December 30, 2014. The Term Loan is secured by a general security agreement pledging Westview's assets and the unconditional guarantee by CHNw.

#### ***Salin Bank Notes***

On September 8, 2005, Howard entered into promissory notes with Salin Bank. The notes bear interest at a five year fixed interest rate equal to the five year U.S. Treasury rate constant plus 1.75%. The interest rate is adjusted every five years on the anniversary date of the loans. The loans mature September 8, 2025. The notes are secured by a pledge of unrestricted receivables.

#### ***Term Loan - CHNw***

On November 18, 2013, CHNw entered into a Master Note Obligation, Series 2013-TL to evidence and secure payments between CHNw and BMO Harris Bank. The loan was made to secure costs associated with the Network's electronic medical record information system. Principal and interest payments are due monthly. The loan matures November 18, 2020.

#### ***Series 1997A and 1997B***

On August 1, 1997, the Authority issued its Adjustable Rate Hospital Revenue Bonds, Series 1997A and Series 1997B in the aggregate amount of \$30,000 for the purpose of making a loan to the Network. The proceeds of this loan from the Authority were used for the financing of certain health facility property. The Series 1997A and Series 1997B bonds were refunded with proceeds from the Series 2012A bonds.

**Community Health Network, Inc. and Affiliates**  
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**Series 1995**

On November 15, 1995, the Authority issued \$75,050 of Hospital Revenue Refunding and Improvement Bonds (Series 1995 Bonds). Concurrent with the issuance of the bonds, the Network and the Authority entered into a loan agreement (the "Agreement") in which the Network agreed to make loan payments to meet the terms of the hospital revenue bonds. The Series 1995 bonds were refunded with proceeds from the Series 2012A bonds. A bank purchased the tendered bonds for par value. Simultaneously, CHNw and the bank entered into an interest rate swap agreement (the "1995 swap"), the purpose of which was to synthetically convert the tendered bonds from a fixed rate to a variable rate based on the Securities Industry and Financial Markets Association Municipal Swap Index ("SIFMA") plus 0.30 percent. The 1995 swap was terminated on November 27, 2012 consistent with when the Series 1995 bonds were refunded.

**Series 1993, 1992, 1992A, and 1988A**

With respect to the Series 1993, 1992, 1992A, and 1988A Hospital Revenue Bonds, there were loan agreements between CHNw, CHA and the conduit issuing authorities with similar terms as described for the Series 1995 Hospital Revenue Bonds except the bonds were callable as follows: January 1, 2007 for Series 1993; May 1, 2002 for Series 1992; July 1, 2002 for Series 1992A; and January 1, 2001 for Series 1988A.

Series 1998, 1993, 1992A and 1988 bonds were refunded with proceeds from the Series 2012A bonds. The Series 1992 bonds matured on May 1, 2012.

A bank purchased the tendered bonds at par value. Simultaneously, CHI and the bank entered into an interest rate swap agreement (the "1992 swap"), the purpose of which was to synthetically convert the tendered bonds from a fixed rate to a variable rate based on the Bond Market Association Municipal Swap Index plus 0.40 percent. The 1992 interest rate swap was terminated on November 27, 2012 consistent with when the Series 1992 bonds were refunded. The 1992A interest rate swap was terminated on May 1, 2012 when the outstanding principal on the Series 1992A bonds was paid.

In general, the various Network debt agreements restrict the amount of indebtedness that the Network may incur, the sale, lease or other disposition of operating assets, and the acceptable investments of the trust funds. In addition, these agreements require a debt service ratio at the end of any fiscal year of at least 1.10. The Network was in compliance with all debt covenants at December 31, 2013.

Scheduled principal repayments on long-term debt are as follows:

2014	\$ 27,248
2015	21,053
2016	21,457
2017	21,985
2018	21,823
Thereafter	<u>519,429</u>
	632,995
Plus: Unamortized premium, net	<u>27,009</u>
	<u>\$ 660,004</u>

**Community Health Network, Inc. and Affiliates**  
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For 2013 and 2012, interest cost incurred and capitalized in connection with the construction of capital assets aggregated \$520 and \$520, respectively.

**7. Derivative Instruments**

Howard has two interest rate swap agreements outstanding on its Series 2005A and Series 2005B bonds. The terms and fair values (level 2) of the outstanding swaps are as follows:

As of December 31, 2013

<b>Original Notional</b>	<b>Current Notional</b>	<b>Effective Date</b>	<b>Fixed Rate</b>	<b>Rate</b>	<b>Fair Value</b>	<b>Termination Date</b>
\$ 30,000	\$ 26,680	October 3, 2005	3.550%	0.12%	\$ (3,500)	January 1, 2035
10,000	8,895	October 3, 2005	3.550%	0.12%	<u>(1,167)</u>	January 1, 2035
					<u>\$ (4,667)</u>	

As of December 31, 2012

<b>Original Notional</b>	<b>Current Notional</b>	<b>Effective Date</b>	<b>Fixed Rate</b>	<b>Rate</b>	<b>Fair Value</b>	<b>Termination Date</b>
\$ 30,000	\$ 27,250	October 3, 2005	3.550%	0.11%	\$ (6,567)	January 1, 2035
10,000	9,085	October 3, 2005	3.550%	0.11%	<u>(2,190)</u>	January 1, 2035
					<u>\$ (8,757)</u>	

The swaps were entered into as a means to manage interest rate risk on Howard's variable rate bond debt. The intention of the swap agreements were to effectively change Howard's variable interest rate on the Series 2005A and 2005B bonds to a fixed rate of 3.55%. The variable rate on the swaps is 70% of the USD-LIBOR BBA and resets monthly. The swaps have been deemed ineffective and have been dedesignated as hedges. As such, Howard accounts for changes in the fair value of the swaps on a marked to market basis each month with the unrealized gains/loss from the changes in the fair value of the swaps being recorded in the Network's non operating income/loss section of the consolidated statement of operations. The net interest activity from the monthly settlement of the swaps is recorded in interest expense in the statement of operations.

The following amounts have been recorded in the Network's consolidated statement of operations as of December 31, 2013 and 2012:

	<b>2013</b>	<b>2012</b>
<b>Non Operating Income (Expenses)</b>		
Net unrealized gains (losses) on changes in fair value of interest rate swaps	<u>\$ 4,090</u>	<u>\$ 710</u>
<b>Income from Operations</b>		
Interest expense, net	<u>\$ 1,216</u>	<u>\$ 616</u>

# Community Health Network, Inc. and Affiliates

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### December 31, 2013 and 2012

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#### 8. Employee Benefit Plans

##### **Defined Benefit and Other Postretirement Benefit Plans**

The Network has defined benefit retirement plans covering substantially all employees of CHNw, CHA, CHHS and CHVH. Effective December 27, 2010, all Network employees, excluding CHA employees, are employed by CHNw and leased to the Network's respective subsidiaries and/or affiliates rather than being employed by individual employers. Effective with the adoption of the single Network employer on December 27, 2010, CHNw also became the sponsor for all of the Network's defined benefit and defined contributions plans, excluding the CHA and Westview plans.

The Network's funding policy is to contribute the equivalent of the minimum funding required by the Employee Retirement Income Security Act of 1974, as amended. The benefits for these plans are based primarily on years of service and the 60-consecutive-month period of employment producing the highest total income. The measurement date for the Network's plan is December 31 except for the Replacement Plan which is January 1.

The CHNw Retirement Plan is a defined benefit plan. The provisions of this plan relate to all employees of CHNw, CHA, CHHS, CHVH and CPI. These employees are eligible to participate in the plan after one year of eligible service as defined by the plan document. Participants are 100% vested after five years of service. Effective May 27, 2006, CHA froze the accrual of benefits and participation in the CHNw Retirement Plan and established its own 403(b) plan. Effective March 8, 2010, the CHNw Retirement Plan was amended to limit the maximum benefit that may be accrued by individuals who choose to remain participants in the CHNw Retirement Plan after March 7, 2010. Additionally, participants in the CHNw Retirement Plan were offered a onetime choice between continued participation in the CHNw Retirement Plan, and, if applicable, CHNw's 403(b) plan, or participation in the Network's 401(k) plan as of March 8, 2010. All participants who remained in the CHNw Retirement Plan and CHNw 403(b) plan as of March 8, 2010 ceased participation in those plans effective as of December 25, 2011 and began participation in the Network's 401(k) plan effective as of December 26, 2011. CHNw made contributions to the plan of \$12,830 and \$24,574 during 2013 and 2012, respectively.

The Replacement Plan is a defined benefit plan. The fair value of the plan assets was \$13,072 and \$10,153 at January 1, 2013 and January 1, 2012, respectively. The defined benefit provisions of the plan apply to all employees of the Network hired prior to January 1, 1984. The plan was originally established on that date to provide such employees those benefits otherwise available under the Federal Insurance Contributions Act during the period January 1, 1981 to December 31, 1983 when the Network withdrew coverage of its employees under the Act. Pursuant to the Social Security Amendment Act of 1983, the Network reentered the Social Security system on January 1, 1984. As a result funding of the plan was terminated during 1985. If authorized by the Network's Board of Directors, each Replacement Plan participant may elect to contribute to the plan an amount each pay period, subject to the maximum established by the Board of Directors. Such authorization was not granted during 2013 and 2012. No contributions were made during 2013. During 2012, CHNw made contributions to the plan of \$2,100.

In August 2013, the Network terminated its postretirement benefit plan which offered retiree health insurance benefits. As a result of terminating the plan, the Network recognized a one time gain of \$5,700 in its consolidated statement of operations.

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**Effect on Operations**

The components of net periodic pension expense for defined benefit retirement plans and the postretirement benefit plan for the year ended December 31 were as follows:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Service cost	\$ 3,635	\$ 1,757	\$ -	\$ 359
Interest cost	25,365	25,922	\$ -	164
Expected return on plan assets	(34,360)	(32,171)	-	-
Amortization of net (gain) loss	4,481	2,284	-	(42)
Net pension (income) expense	<u>\$ (879)</u>	<u>\$ (2,208)</u>	<u>\$ -</u>	<u>\$ 481</u>

**Obligations and Funded Status**

The change in benefit obligations, plan assets and funded status for the Network's defined benefit retirement plans are as follows:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of period	\$ 659,806	\$ 572,407	\$ -	\$ 3,578
Service cost	3,635	1,757	-	359
Interest cost	25,365	25,922	-	164
Amendments	-	-	-	2,560
Actuarial gain (loss)	(93,942)	81,073	-	845
Participant contributions	-	-	-	13
Expenses paid - actual	(3,569)	(3,554)	-	-
Benefits paid - actual	(19,469)	(17,799)	-	(21)
Benefit obligation, end of period	<u>\$ 571,826</u>	<u>\$ 659,806</u>	<u>\$ -</u>	<u>\$ 7,498</u>

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Change in plan assets</b>				
Fair value of plan assets, beginning of year	\$ 448,955	\$ 389,601	\$ -	\$ -
Actual return on plan assets	20,370	54,032	-	-
Contributions	12,830	26,675	-	21
Expenses paid - actual	(3,569)	(3,554)	-	-
Benefit paid - actual	(19,469)	(17,799)	-	(21)
Fair value of plan assets, end of year	<u>\$ 459,117</u>	<u>\$ 448,955</u>	<u>\$ -</u>	<u>\$ -</u>

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	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<b>Reconciliation of Funded status</b>				
Accrued pension cost, net	\$ (7,913)	\$ (21,622)	\$ -	\$ (5,010)
Prepaid pension (liability) asset	(104,796)	(189,229)	-	(2,488)
(Under) funded status	(112,709)	(210,851)	-	(7,498)
Unrecognized net actuarial loss (gain)	105,048	189,567	-	(190)
Unrecognized prior service (cost) credit	(252)	(338)	-	2,678
Accrued pension cost, net	\$ (7,913)	\$ (21,622)	\$ -	\$ (5,010)

**Accumulated Benefit Obligation**

Selected information from the plans with accumulated benefit obligation in excess of plan assets at December 31, were as follows:

	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Projected benefit obligation	\$ 571,826	\$ 659,806	\$ -	\$ -
Accumulated benefit obligation	\$ 571,826	\$ 659,806	\$ -	\$ 7,498
Fair value of plan assets	\$ 459,117	\$ 448,955	\$ -	\$ -

**Actuarial Assumptions**

Weighted average assumptions used to determine benefit obligations as of December 31:

	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Discount rate	5.03%	3.91%	-	3.91%

Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Discount rate	3.91%	4.61%	-	4.61%
Expected long-term rate of return on plan assets	7.8%-8.0%	8.2%-8.4%	-	-

The expected long term rate of return assumes targeted allocations are maintained and returns fall within standard deviation derived from simulation of ten year range of returns on each plan's assets. The rate is reevaluated based on actual returns in the current period.

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**Assumed Health Care Costs**

In establishing the net periodic postretirement benefit expense and year end benefit obligation, a 6.9% annual rate of increase in per capital cost of covered health benefits was assumed for 2012. The rate was assumed to decrease gradually to 4.5% and 4.5% over a 15-year period and an 18-year period for 2012. Changing the assumed health care cost trend rates by one percentage point in each year would cause an incremental increase in the accumulated postretirement benefit obligation of less than \$882 in 2012. In addition, changing the assumed health care cost trend rates by one percentage point in each year would cause an incremental increase in the service cost and interest cost components of the net periodic postretirement benefit cost of \$85 in 2012. As previously disclosed, the postretirement benefit plan terminated during 2013.

**Plan Assets**

The weighted-average allocation of the defined benefit plans at December 31, 2013 and 2012, by asset category are as follows:

	Retirement Plan			Replacement Plan		
	2013	2012	2012	2013	2012	2012
	Target	Actual	Actual	Target	Actual	Actual
	Allocation	Allocation	Allocation	Allocation	Allocation	Allocation
Equity securities <sup>(a)</sup>	14%	14%	44%	46%	49%	43%
Fixed income securities <sup>(a)</sup>	55%	54%	33%	19%	18%	33%
Real estate <sup>(a)</sup>	6%	6%	6%	8%	8%	7%
Other	25%	26%	17%	27%	25%	17%
Total	100%	100%	100%	100%	100%	100%

(a) Includes mutual funds

The plans are administered under a single investment policy statement, which outlines objectives and guidelines for supervising investment strategy and evaluating the investment performance for all investment assets of CHNw. The policy seeks to preserve principal, emphasizing long-term growth without undue exposure to risk. Investment performance return targets are based on consumer price, corporate bond and stock indexes as well as volatility standards (beta) and positive risk-adjusted performance (alpha). The plan fiduciaries oversee the investment allocation process, which includes selecting investment managers, setting long-term strategic targets and monitoring asset allocations. Target allocation ranges are guidelines, not limitations, and plan fiduciaries may occasionally approve allocations above or below a target range.

The following tables present the fair values of the plan assets at December 31, 2013 and 2012. Refer to Note 3 for explanations of fair value designation.

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<b>2013</b> <b>Description</b>	<b>Fair Value Measurements at Reporting Date</b>			
	<b>2013</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash and Cash Equivalents	\$ 38,383	\$ 38,383	\$ -	\$ -
Corporate bonds	100,846	-	100,846	-
Mutual Funds	166,347	166,347	-	-
U.S. Treasury Obligations	102,334	-	102,334	-
Hedge Fund of Funds	51,207	-	-	51,207
<b>Total</b>	<b>\$ 459,117</b>	<b>\$ 204,730</b>	<b>\$ 203,180</b>	<b>\$ 51,207</b>

<b>2012</b> <b>Description</b>	<b>Fair Value Measurements at Reporting Date</b>			
	<b>2012</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash and Cash Equivalents	\$ 2,154	\$ 2,154	\$ -	\$ -
Equity securities	29,718	29,718	-	-
Corporate bonds	72,665	-	72,665	-
Mutual Funds	253,030	253,030	-	-
U.S. Treasury Obligations	71,855	-	71,855	-
Hedge Fund of Funds	19,533	-	-	19,533
<b>Total</b>	<b>\$ 448,955</b>	<b>\$ 284,902</b>	<b>\$ 144,520</b>	<b>\$ 19,533</b>

	<b>Rollforward of Level 3 Investments</b>
<b>Balance as of January 1, 2012</b>	\$ 18,031
Purchases	-
Investment gain-realized/unrealized	1,502
<b>Balance as of December 31, 2012</b>	<b>\$ 19,533</b>
<b>Balance as of January 1, 2013</b>	\$ 19,533
Purchases	26,320
Investment gain-realized/unrealized	5,354
<b>Balance as of December 31, 2013</b>	<b>\$ 51,207</b>

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**Cash Flows**

The Network expects to make a contribution of \$12,310 to the CHNw Retirement Plan in fiscal 2014.

**Estimated Future Benefit Payments**

Plan benefit payments, which reflect expected future service, are expected to be paid as follows:

	<b>Pension Benefits</b>
2014	\$ 22,294
2015	\$ 24,053
2016	\$ 25,825
2017	\$ 27,653
2018	\$ 29,274
2019-2023	\$ 168,813

**Other**

The Network sponsors defined contribution plans covering certain employees. As mentioned above, CHNw became the employer of all employees throughout the Network except for CHA and Westview. Effective with the adoption of the single employer on December 27, 2010, CHNw became the sponsor of the entire Network's defined benefit and defined contributions plans except for the CHA and Westview plans. Employer contributions are made to these plans based on a percentage of employee compensation. The cost of the Network's defined contribution plans approximated \$37,523 and \$32,024 for 2013 and 2012, respectively.

Effective July 1, 2012, Howard's two existing defined contribution plans were merged into the Network's defined contribution plans. The assets transferred into the Network's 401k plan were \$21,588. The assets transferred into the Network's 403b plan were \$11,988. All employees of Howard became CHNw employees effective with the affiliation date of July 1, 2012 and participate in the Network's 401k plan.

One of the defined contribution plans relates to VEI's profit sharing 401(k) plan, in which employees are eligible to participate immediately upon hire and after attaining 21 years of age. Effective January 1, 2011, VEI's plan was amended to remove the requirement that an employee must be 21 years of age to participate in the plan. Participants may contribute from 1% to 50% of compensation, as defined. Each year, VEI's Board of Directors may elect to match a portion of participant contributions through a discretionary profit sharing contribution.

CHVH has a 401(k) plan, in which employees are eligible to participate immediately upon hire and after attaining 21 years of age. Participants may contribute from 1% to 100% of compensation, as defined. CHVH matches 50% of participant contributions up to 5% of the participants' compensation.

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CPI has a defined contribution profit sharing plan in which employees who are designated as CPI physicians and are paid on the compensation model are eligible to participate after the completion of one year of service. This plan is an employer funded plan whereby the funding is charged to the participating physician's practice as an overhead expense. The year ending December 31, 2009 was the final year that employer contributions were made to the plan. CPI terminated the plan effective December 31, 2009. CPI distributed the assets of the plan during 2012.

CHA has a defined contribution 403(b) plan. Employees are eligible to participate immediately upon employment. Participants may contribute up to 100% of compensation, as defined. CHA is permitted to match 100% of participant contributions up to 3% of the participant's compensation. CHA elected to cease matching participant contributions effective May 10, 2009.

The Network has a 401(k) plan. Employees of the Network hired after February 9, 2008 are eligible to participate immediately upon employment. Participants may contribute up to 100% of compensation, as defined. The Network matches 100% of participant contributions up to 6% of the participant's compensation. Each year, the Network may elect to provide a discretionary employer contribution to plan participants.

Westview has a 401(k) plan. Employees are eligible to participate in the plan after completing more than one year of service, working 1,000 hours during the year and after attaining 21 years of age. Participants may contribute up to 100% of compensation, as defined. Westview provides funding rates of 5% of each eligible employee's compensation not in excess of the taxable wage base and 10% over the taxable wage base.

Effective January 1, 2014, VEI, CHVH and Westview merged their respective 401(k) plans into the Network's 401(k) plan.

#### **9. Income Taxes**

For 2013 and 2012, federal taxable income originating in the Network's for-profit entities was approximately \$15,800 and \$10,300, respectively. Income tax expense of \$7,464 and \$5,215 respectively, has been provided thereon. The primary difference between income tax expense and taxes computed at the federal statutory rate of 34 percent is state income taxes.

At December 31, 2013, VEI has unused federal income tax operating loss carry forwards of approximately \$1,177, which expire at various dates through 2017.

#### **10. Operating Leases**

The Network leases certain of its facilities and equipment under noncancelable operating lease agreements. The leases contain various renewal options and clauses for escalation based on increases in interest costs, as defined. Rental expense for these leased facilities and equipment aggregated \$42,561 and \$45,618 for 2013 and 2012, respectively.

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Future minimum rental payments for each of the next five years at December 31, 2013 are as follows:

2014	\$ 38,103
2015	28,287
2016	23,444
2017	20,100
2018	18,498
Thereafter	<u>89,105</u>
	<u>\$ 217,537</u>

**11. Functional Expenses**

The Network provides services to residents within its geographic locations. Expenses related to providing these services are as follows:

	<b>2013</b>	<b>2012</b>
Nursing services	\$ 308,920	\$ 301,090
Other professional services	725,033	640,103
General services	113,421	103,572
Fiscal services	254,419	248,213
Administrative services	133,738	145,099
Employee health and welfare	151,671	141,265
Health service claims expense	(79,089)	(68,021)
Depreciation and amortization	81,045	75,390
Interest	20,062	32,433
	<u>\$ 1,709,220</u>	<u>\$ 1,619,144</u>

**12. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Network has been limited by donors to a specific time period or purpose. Temporarily restricted net assets as of December 31, 2013 and 2012 are available for the following purposes:

	<b>2013</b>	<b>2012</b>
Medical education	\$ 2,175	\$ 2,119
Clinical/patient support	1,494	1,163
Capital improvements	3,479	2,552
	<u>\$ 7,148</u>	<u>\$ 5,834</u>

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Permanently restricted net assets have been restricted by donors to be maintained by the Network in perpetuity. Permanently restricted net assets as of December 31, 2013 and 2012 are as follows, with a description of how the investment income is to be used:

	2013	2012
Medical education	\$ 2,455	\$ 2,405
Clinical/patient support	264	258
Capital improvements	1,716	1,708
	<u>\$ 4,435</u>	<u>\$ 4,371</u>

The Network is an income beneficiary of certain irrevocable trusts. The aggregated income (loss) from these trusts was \$735 and \$897 for the years ended December 31, 2013 and 2012, respectively.

**13. Commitments and Contingencies**

**Community Hospital of Anderson and Madison County**

On August 9, 1996, the Network entered into an affiliation agreement with CHA. The agreement provides that if the Network merges, affiliates, or is acquired by another health care organization, the Network must deposit \$31,900 into a foundation to fund health care programs and initiatives in Madison County, Indiana.

**Pending Litigation**

Claims for employment matters, and breach of contract have been asserted against the Network by various claimants, and provision for such claims is made in the financial statements when management considers the likelihood of loss from the contingency to be probable and reasonably estimable. The claims are in various stages of processing and some will ultimately be brought to trial. There are known incidents occurring through December 31, 2013 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. We do not believe that claims and lawsuits individually or in aggregate will have a material adverse effect on the Network's future consolidated financial position, results from operations, or cash flows.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Management believes that the Network is in compliance with applicable government laws and regulations. Regulatory inquiries are made in the normal course of business and compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Violations of these regulations could result in the imposition of significant fines and penalties, as well as having a significant effect on reported income from operations or cash flows.

The Network is in compliance with the Indiana Medical Malpractice Act which limits the amount of recovery to \$1,250 for individual malpractice claims, \$250 of which would be paid by the Network and the balance being paid by the State of Indiana Patient Compensation Fund. Management believes the ultimate disposition of existing medical malpractice and other claims will not have a material effect on the consolidated financial position or results of operations of the Network.

**Purchase Commitments**

As of December 31, 2013, the Network had purchase commitments for various equipment and services of \$48,311.

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**14. Acquisitions**

On July 1, 2012, the Network affiliated with Howard. No consideration was exchanged related to the affiliation. The affiliation was accounted for as an acquisition and thus purchase accounting rules were applied in accordance with ASC 958-805, *Not for Profit Entities: Mergers and Acquisitions* ("ASC 958"). The Network recognized the fair value of Howard's assets and liabilities in its consolidated financial statements as of July 1, 2012 using various fair value techniques, including independent appraisals for property, plant and equipment. The excess of the fair value of the assets received over the liabilities acquired represents an inherent contribution received and is recorded as the excess of net assets acquired in the accompanying consolidated financial statements. Howard's profit and losses are reflected in the Network's accompanying consolidated statements of operations beginning on July 1, 2012.

The fair value of the assets and liabilities acquired as of July 1, 2012 is as follows:

	<b>Preliminary Allocation</b>	<b>Final Allocation Adjustments</b>	<b>Adjusted Allocation</b>
Cash and cash equivalents	\$ 25,015	\$ -	\$ 25,015
Patient accounts receivable, net	10,882	-	10,882
Other current assets	19,640	-	19,640
Property, plant and equipment	126,173	(1,676)	124,497
Other long term assets	3,788	-	3,788
Total assets	<u>185,498</u>	<u>(1,676)</u>	<u>183,822</u>
Current liabilities	24,551	-	24,551
Long term debt	69,317	-	69,317
Total liabilities	<u>93,868</u>	<u>-</u>	<u>\$ 93,868</u>
Excess in fair value of net assets acquired before noncontrolling interest	\$ 91,630	\$ (1,676)	\$ 89,954
Noncontrolling interest	<u>2,663</u>	<u>-</u>	<u>2,663</u>
Excess in fair value of net assets acquired net of noncontrolling interest	<u>\$ 88,967</u>	<u>\$ (1,676)</u>	<u>\$ 87,291</u>

During 2013, the Network finalized and adjusted the purchase price allocation. The December 31, 2012 balance sheet and statement of operations and changes in net assets have been revised for the above adjustments in accordance with ASC 805, *Business Combinations*.