



UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

AUGUST 31, 2013 AND 2012



UNION HOSPITAL INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Union Hospital
Terre Haute, Indiana

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Union Hospital, Inc. and Subsidiaries (the Corporation), which comprise the consolidated balance sheets as of August 31, 2013 and 2012, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these 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 these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General in the United States and Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

Board of Directors
Union Hospital
Terre Haute, Indiana

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation'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 Corporation'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 the Corporation as of August 31, 2013 and 2012, and its changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

EMPHASIS OF A MATTER

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

Board of Directors
Union Hospital
Terre Haute, Indiana

REPORT ON SUPPLEMENTARY INFORMATION

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

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated December 24, 2013 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control over financial reporting and compliance.

Blue & Co., LLC

Indianapolis, Indiana
December 24, 2013

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AUGUST 31, 2013 AND 2012

ASSETS		
	2013	2012
Current assets		
Cash and cash equivalents	\$ 20,783,737	\$ 33,232,355
Funds held by trustee, current portion	9,624,684	9,357,980
Board designated funds, current portion	15,946,469	11,931,261
Patient accounts receivable, net	55,446,826	51,218,192
Inventories	4,393,058	4,361,427
Prepaid expenses and other current assets	2,217,850	4,276,243
Total current assets	108,412,624	114,377,458
Investments limited as to use, less current portion		
Funds held by trustee	24,409,313	24,270,756
Board designated funds	32,348,588	31,115,861
Permanently restricted	1,403,823	1,309,397
Total investments limited as to use	58,161,724	56,696,014
Property and equipment		
Land and improvements	37,180,324	37,291,582
Buildings and fixed equipment	334,765,916	314,488,563
Movable equipment	125,636,776	119,468,982
	497,583,016	471,249,127
Less allowances for depreciation	213,829,011	191,837,773
	283,754,005	279,411,354
Construction in progress	2,377,340	16,123,962
Total property and equipment, net	286,131,345	295,535,316
Other assets		
Due from Union Hospital Foundation, Inc.	3,022,998	4,495,347
Deferred financing costs, net	2,895,002	3,090,878
Intangible assets, net	4,338,399	5,982,856
Investment in joint ventures	4,351,130	1,876,586
	14,607,529	15,445,667
Total assets	\$ 467,313,222	\$ 482,054,455

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AUGUST 31, 2013 AND 2012

LIABILITIES AND NET ASSETS

	<u>2013</u>	<u>2012</u>
Current liabilities		
Accounts payable and other current liabilities	\$ 22,655,027	\$ 22,725,206
Salaries, wages and related liabilities	21,823,388	19,782,599
Accrued interest	7,809,684	7,842,998
Estimated third party settlements	2,454,979	3,073,530
Current portion of long-term debt	3,516,190	3,476,124
Total current liabilities	<u>58,259,268</u>	<u>56,900,457</u>
Long-term liabilities		
Long-term debt, less current portion	268,480,278	271,498,185
Deferred revenue	210,418	301,122
Pension liability and related obligations	10,707,839	4,886,980
Other long-term liabilities	2,984,073	3,846,484
Total long-term liabilities	<u>282,382,608</u>	<u>280,532,771</u>
Total liabilities	340,641,876	337,433,228
Net assets		
Unrestricted	122,155,376	138,736,584
Temporarily restricted	3,112,147	4,575,246
Permanently restricted	1,403,823	1,309,397
Total net assets	<u>126,671,346</u>	<u>144,621,227</u>
Total liabilities and net assets	<u>\$ 467,313,222</u>	<u>\$ 482,054,455</u>

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED AUGUST 31, 2013 AND 2012

	2013	2012
Operating revenue		
Net patient service revenue (net of contractual allowances and discounts including charity care provisions of \$37,723,498 and \$38,737,421 in 2013 and 2012 respectively)	\$ 434,458,182	\$ 462,535,259
Less provision for bad debts	31,155,783	41,305,687
Net patient service revenue net of provision for bad debts	403,302,399	421,229,572
Other revenue	8,716,212	8,984,417
Total operating revenue	412,018,611	430,213,989
Operating expenses		
Salaries and wages	138,966,294	126,244,707
Employee benefits	27,097,411	27,386,336
Medical supplies and drugs	60,509,432	67,547,992
Physician services	5,844,820	10,742,853
Contract services	66,038,402	65,890,224
Rent and leases	11,811,675	12,068,132
Utilities, supplies, and other	37,756,883	36,646,744
Hospital assessment fee	17,166,074	17,902,630
Depreciation and amortization	25,672,334	24,499,566
Interest	16,224,111	14,902,184
Total operating expenses	407,087,436	403,831,368
Income from operations	4,931,175	26,382,621
Non-operating gains (losses)		
Investment income	709,533	583,708
Investment in joint ventures	(869,620)	1,526,361
Other	(60,699)	(73,927)
Total non-operating gains	(220,786)	2,036,142
Excess of revenue over (under) expenses	4,710,389	28,418,763
Other changes in unrestricted net assets		
Pension related changes other than net pension cost	(14,788,484)	(307,884)
Net unrealized gain on investments	987,600	788,981
Net assets released for property and equipment	1,593,781	1,159,747
Transfers to Union Health System	(9,084,494)	(12,071,545)
Change in unrestricted net assets	(16,581,208)	17,988,062
Temporarily restricted net assets		
Other changes in receivable from Union Hospital Foundation, Inc.	130,682	391,906
Net assets released for property and equipment	(1,593,781)	(1,159,747)
Change in temporarily restricted net assets	(1,463,099)	(767,841)
Permanently restricted net assets		
Net investment income	94,426	74,753
Change in net assets	(17,949,881)	17,294,974
Net assets		
Beginning of year	144,621,227	127,326,253
End of year	\$ 126,671,346	\$ 144,621,227

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED AUGUST 31, 2013 AND 2012

	2013	2012
Operating activities		
Change in net assets	\$ (17,949,881)	\$ 17,294,974
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	22,721,006	21,958,692
Amortization	2,951,328	2,540,874
Provision for bad debts	31,155,783	41,305,687
Transfers to Union Health System	9,084,494	12,071,545
Loss on property disposals	60,699	73,927
Net unrealized gain on investments	(987,600)	(788,981)
Pension related changes other than net periodic pension cost	14,788,484	307,884
Changes in operating assets and liabilities		
Patient accounts receivable	(35,384,417)	(43,152,884)
Other current and noncurrent assets	1,113,572	(3,269,900)
Accounts payable and other current liabilities	(229,479)	805,374
Salaries, wages and related liabilities	2,040,789	2,563,041
Other long-term liabilities	(9,830,036)	(3,965,631)
Estimated third-party payor settlements	(618,551)	3,683,588
Accrued interest	(33,314)	(27,136)
Deferred revenue	(90,704)	(100,325)
Net cash flows from operating activities	18,792,173	51,300,729
Investing activities		
Purchases of property and equipment	(13,283,120)	(26,296,982)
Proceeds from sale of property and equipment	64,686	52,284
Payments of intangible asset	(1,200,000)	(900,000)
Change in trustee held investments	(405,261)	11,507,331
Change in board designated funds and other	(4,354,761)	(17,605,715)
Net cash flows from investing activities	(19,178,456)	(33,243,082)
Financing activities		
Repayments on long-term debt	(3,570,698)	(3,867,216)
Proceeds from long-term debt	592,857	261,735
Transfers to Union Health System	(9,084,494)	(12,071,545)
Net cash flows from financing activities	(12,062,335)	(15,677,026)
Change in cash and cash equivalents	(12,448,618)	2,380,621
Cash and cash equivalents		
Beginning of year	33,232,355	30,851,734
End of year	\$ 20,783,737	\$ 33,232,355
Noncash investing activities		
Issuance of capital leases	\$ 567,203	\$ 601,591
Capital acquisitions included in accounts payable	\$ 159,300	\$ 956,000

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

1. ORGANIZATION

Nature of Operations

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

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

During 2010, the Corporation became part of an affiliated group. Union Health System, Inc. (UHS), an Indiana not-for-profit corporation, is the sole member of the Corporation. UHS was the sole member of Union Associated Physicians Clinic, LLC (UAPC) through August 31, 2012. Effective September 1, 2012, UHS transferred 50% of its membership of UAPC to the Corporation. Certain physicians who were members or employees of Associated Physicians and Surgeons (AP&S), an outside and unrelated party (physician practice), became employees of UAPC. AP&S provides certain personnel, equipment, supplies and other administrative support to UAPC. The Corporation has entered into transactions with the affiliated group as is disclosed in Note 3. The Corporation is consolidated into the affiliated group financial statements. These financial statements reflect only the financial position, results of operations, changes in net assets and cash flows of the Corporation.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

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

Charity Care and Community Benefit

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

Of the Corporation's total expenses reported (approximately \$407,100,000 and \$403,800,000 during 2013 and 2012, respectively), an estimated \$13,100,000 and \$13,300,000 arose from providing services to charity patients during 2013 and 2012, respectively. The estimated costs of providing patient assistance services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses divided by gross patient service revenue.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Use of Estimates

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

Net Patient Service Revenue and Other

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

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

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

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

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

Management believes that adequate provisions have been made for any adjustments which may result from such final settlements. Differences between prior estimates and subsequent actual settlements are immaterial to these financial statements for 2013 and 2012.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

	<u>2013</u>	<u>2012</u>
Inpatient revenue	\$ 502,038,002	\$ 517,090,741
Outpatient revenue	615,219,061	606,605,537
Physician revenue	<u>54,359,978</u>	<u>53,626,628</u>
Gross patient revenue	1,171,617,041	1,177,322,906
Charity care revenue foregone	37,723,498	38,737,421
Contractual adjustments	<u>699,435,361</u>	<u>676,050,226</u>
Total adjustments	<u>737,158,859</u>	<u>714,787,647</u>
Net patient service revenue	434,458,182	462,535,259
Less provision for bad debts	<u>31,155,783</u>	<u>41,305,687</u>
	<u>\$ 403,302,399</u>	<u>\$ 421,229,572</u>

A summary of gross patient service revenue at established rates by payor source for 2013 and 2012, respectively, is as follows:

	<u>2013</u>	<u>2012</u>
Medicare	47%	46%
Medicaid	16%	16%
Commercial insurance	3%	3%
Other managed care	26%	27%
Self-pay and other	8%	8%
	<u>100%</u>	<u>100%</u>

There is a single insurance provider that constituted 17% of patient service revenue at established rates for the years ended August 31, 2013 and 2012.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

During 2012, Hospital Assessment Fee (HAF) Program for the period July 1, 2011 through June 30, 2013 was approved by Centers for Medicare & Medicaid Services (CMS) retroactive to July 1, 2011. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share payments for Indiana inpatient providers. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates. During 2013 and 2012, the Corporation recognized HAF Program expense of approximately \$17,200,000 and \$17,900,000, respectively, which resulted in increased Medicaid reimbursement.

The State legislature has extended the HAF Program through June 30, 2017 and is pending CMS final approval of the program. CMS has already reviewed the program and submitted questions, none of which raised issues or concerns on the part of the State. The Corporation has accrued approximately \$2,500,000 for the HAF program expenses for the remaining two months of fiscal year 2013.

Cash and Cash Equivalents

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

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

During 2013, the Corporation's allowance for uncollectible accounts for patient and physician services decreased approximately \$3,700,000 from approximately \$19,100,000 to approximately \$15,400,000. This decrease is due to a substantial improvement in the average age of accounts receivable as well as a favorable payor mix change of accounts receivable from 2012 to 2013. As of August 31, 2013, the allowance for uncollectible accounts of \$15,400,000 was comprised of approximately \$10,000,000 reserved for self-pay balances and approximately \$5,400,000 reserved for third-party payor balances. As of August 31, 2012, the allowance for uncollectible accounts of \$19,100,000 was comprised of approximately \$11,900,000 reserved for self-pay balances and approximately \$7,200,000 reserved for third-party payor balances.

The Corporation grants credit to patients, substantially all of whom are local residents of the communities served. The Corporation does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The Corporation has not changed its charity care or uninsured discount policies during 2013 or 2012.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

At August 31, 2013 and 2012, net accounts receivable from patients and third party were comprised of the following:

	<u>2013</u>	<u>2012</u>
Medicare	31%	32%
Medicaid	9%	13%
Commercial insurance	9%	7%
Other managed care	29%	28%
Self-pay and other	22%	20%
	<u>100%</u>	<u>100%</u>

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

Inventories

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

Investments Limited as to Use

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

Investments are generally commingled for investment purposes and consist of short-term investments (principally money market mutual funds), U.S. government and governmental agency obligations, mutual and common trust funds, corporate obligations and marketable equity securities. Fair values for investments are based on quoted market prices.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

Property and Equipment

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

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs are capitalized as a component of the cost of constructing the assets. In addition, interest earnings on unexpended borrowed project funds related to tax-exempt financings are netted against capitalized interest. Net interest costs capitalized approximated \$-0- in 2013 and \$1,528,000 in 2012. Repair and maintenance costs are expensed when incurred.

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

Intangible Assets

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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Unamortized Debt Issuance Costs

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

Medical Malpractice Insurance

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

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

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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Pension Plans

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

Financial Statement Presentation

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

Net Assets

Temporarily restricted net assets are those assets whose use by the Corporation has been limited by donors primarily for a specified time period or purpose. When a donor restriction expires or is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released for property and equipment. Temporarily restricted net assets include \$3,023,000 and \$4,495,000 of funds held by the Foundation for the benefit of the Corporation at August 31, 2013 and 2012, respectively. Due from Union Hospital Foundation, Inc. represents contributions received on behalf of the Corporation by the Foundation and other amounts the Foundation has granted to the Corporation. Other miscellaneous funds are held as temporarily restricted net assets. Permanently restricted net assets are those that the donor has requested to be held in perpetuity. In accordance with donor stipulations, certain investment income earned on permanently restricted net assets is unrestricted. Accordingly such income is recorded in the unrestricted net asset class as it is earned.

Deferred Income

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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Health Insurance

The Corporation's employee health care insurance is provided through a combination of self-insurance and purchased re-insurance coverage from a commercial carrier. The Corporation maintains an estimated liability for the amount of claims incurred but not reported. Substantially all employees are covered for major medical benefits. The specific annual attachment point for an individual is \$325,000 with a policy period maximum of \$1,675,000. There is no aggregate limit on claims.

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately \$382,248,000 and \$378,269,000 in 2013 and 2012, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to approximately \$24,839,000 and \$25,562,000 in 2013 and 2012, respectively.

Income Taxes

The Corporation is organized as a not-for-profit corporation under Section 501(c) (3) of the United States Internal Revenue Code. As such, the Corporation is generally exempt from income taxes. However, the Corporation is required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Corporation and recognize a tax liability if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Corporation, and has concluded that as of August 31, 2013 and 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying financial statements. The Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Filings are current through 2012. The impact of the subsidiaries tax consequences is immaterial to these financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

Operating Indicator

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

Performance Indicator

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

Advertising Costs

Advertising costs are expensed as incurred. Total expense for 2013 and 2012 was approximately \$445,000 and \$443,000, respectively.

Electronic Health Records (EHR) Incentive Payments

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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The Corporation recognizes EHR incentive payments as grant income, under the ratable recognition method, when there is reasonable assurance that the Corporation will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the consolidated financial statement effects of the grants must be both recognizable and measurable. During 2013 and 2012, the Corporation recognized approximately \$1,900,000 and \$1,200,000, respectively, in EHR incentive payments as grant income.

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

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

Reclassifications

Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to the 2013 presentation. These reclassifications had no impact on net assets and changes in net assets for 2012, as previously reported.

Subsequent Events

The Corporation has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is December 24, 2013.

3. AFFILIATED ENTITY AND RELATED PARTY TRANSACTIONS

As part of the affiliation with UHS and UAPC, the Corporation purchased certain intangible assets, including medical records and other assets, from AP&S in the amount of \$7,345,000. The intangible assets are being amortized over 5 years with accumulated amortization of \$5,631,000 and \$4,162,000 at August 31, 2013 and 2012, respectively. The Corporation transferred \$9,084,000 and \$12,072,000 during 2013 and 2012, respectively, to UHS. The arrangement with UHS and UAPC contemplates that the Corporation will continue to transfer funds on an as needed basis to fulfill the contract obligation for on-going operational support to the affiliated group. The Corporation purchased the CT and MRI service line of UAPC for \$3,600,000 which is to be paid \$100,000 monthly. As of August 31, 2013, the Corporation has paid \$2,000,000 under this agreement with a balance remaining of \$1,600,000. This liability is included under other long-term liabilities on the statement of financial position.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

The Corporation provided management and other services for the Foundation and other related organizations in the approximate amount of \$634,000 in 2013 and \$495,000 in 2012. At August 31, 2013 and 2012, approximately \$39,000 and \$321,000, respectively, remained unpaid.

The Corporation received approximately \$1,593,000 and \$1,160,000 in contributions from the Foundation for the years ended August 31, 2013 and 2012, respectively. The 5 year capital campaign pledges will be completed on December 31, 2013.

The Corporation collaborates with physicians and physician groups including UAPC, to improve the quality of services, eliminate duplication of services, and to improve standards of care by entering into certain contractual agreements. While certain of the agreements are amended and/or terminated from time to time, the Corporation has had agreements for chemotherapy, ambulatory surgery, cardiac catheterization, laboratory, and radiation oncology therapy services. The costs for these services are included in utilities, supplies, and other in the statement of operations totaling approximately \$64,848,000 and \$64,961,500 for August 31, 2013 and 2012, respectively.

4. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at August 31, 2013 and 2012 is as follows:

	2013	2012
UH West renovation	\$ -0-	\$ 10,288,768
Cardiovascular 1 - West	-0-	3,404,732
UHC air handling system	2,358,142	-0-
Other renovations and upgrades	19,198	2,430,462
	<u>\$ 2,377,340</u>	<u>\$ 16,123,962</u>

The Corporation is in the process of renovating Union West facilities with expected completion during 2014. Commitments for all remaining construction project costs total approximately \$3,017,000 at August 31, 2013.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

5. INVESTMENTS

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

	2013	2012
Cash and short-term investments	\$ 61,645,874	\$ 65,121,340
US Government and government agency obligations	9,330,701	2,564,308
Mutual funds	1,677,141	1,558,769
Marketable equity securities	9,554,554	7,619,789
Corporate obligations	1,102,955	722,825
Collective trusts	421,652	398,224
	83,732,877	77,985,255
Less current portion of:		
Debt service	9,624,684	9,357,980
Board designated	15,946,469	11,931,261
	\$ 58,161,724	\$ 56,696,014

Investment income included in the consolidated statements of operations and changes in net assets is primarily comprised of interest, dividends and realized gains and losses on sale of investments.

	2013	2012
Investment income included with non-operating gains and net investment income on permanently restricted net assets:		
Investment income	\$ 803,959	\$ 658,461
Other changes in net assets:		
Unrealized gain on investments	987,600	788,981
	\$ 1,791,559	\$ 1,447,442

The following schedule summarizes the fair value of securities included in investments by board designated and held by trustee that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of August 31, 2013 and 2012. The schedule further segregates the securities that have been in a gross unrealized position as of August 31, 2013 and 2012, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of August 31, 2013 and 2012:

Description of securities	August 31, 2013					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 518,139	\$ 21,753	\$ 837,181	\$ 79,385	\$ 1,355,320	\$ 101,138
Mutual funds	164,599	3,815	316,021	20,837	480,620	24,652
Government obligations	8,490,060	16,275	-0-	-0-	8,490,060	16,275
Corporate bonds	793,900	18,847	-0-	-0-	793,900	18,847
Total temporarily impaired securities	<u>\$ 9,966,698</u>	<u>\$ 60,690</u>	<u>\$ 1,153,202</u>	<u>\$ 100,222</u>	<u>\$ 11,119,900</u>	<u>\$ 160,912</u>

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

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

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- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of August 31, 2013 and 2012.

- *Common stocks:* Valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds:* Valued at the daily closing price as reported by the fund. Mutual funds held by the Corporation are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by the Corporation are deemed to be actively traded.
- *US government obligations:* Valued using pricing models maximizing the use of observable inputs for similar securities.
- *Corporate obligations:* Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.
- *Collective trusts:* Valued at the NAV of units of a bank collective trust. The NAV, as provided by the trustee, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Were the Corporation to initiate a full redemption of the collective trust, the trustee reserves the right to temporarily delay withdrawal from the trust in order to ensure that securities liquidations will be carried out in an orderly business manner.

UNION HOSPITAL INC. AND SUBSIDIARIES

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The Corporation's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2013 and 2012.

Realized gains and losses and interest income are reported in the consolidated statements of operations and changes in net assets as a component of investment income. Realized gains and losses and interest income approximated \$737,000 and \$602,000 during 2013 and 2012 respectively.

The market value of investments exceeded the cost by approximately \$3,458,000 and \$2,403,000 as of August 31, 2013 and 2012, respectively. The unrealized gain and loss are included in earnings for the period attributable to the change in unrealized gain and loss relating to assets held as of August 31, 2013 and 2012 and are reported in the consolidated statements of operations and changes in net assets as net unrealized gain on investments. During 2013 and 2012, the Corporation recognized an unrealized gain of approximately of \$1,055,000 and \$846,000, respectively, which is included in the consolidated statement of operations and changes in net assets as net unrealized gain on investment within other changes in unrestricted net assets and net investment income within permanently restricted net assets.

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

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

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

Long-term debt: Fair value of the Corporation's long-term debt, based on current quoted market value of similar debt instruments, for the Series 2011, 2007, and 1993 fixed rate tax exempt bonds approximated \$258,636,000 and \$272,354,000 as of August 31, 2013 and 2012, respectively. The fair value of variable rate debt (Series 2004 and 2006B bonds) approximates its carrying value of \$16,312,000 and \$17,456,000 as of August 31, 2013 and 2012.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

7. ENDOWMENT FUNDS

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

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

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

The endowment net assets by type of fund as of August 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Donor-restricted endowment funds		
Permanently restricted	\$ 1,403,823	\$ 1,309,397
Total endowment funds	<u>\$ 1,403,823</u>	<u>\$ 1,309,397</u>

For 2013 and 2012, the Corporation had the following endowment-related activities:

	<u>Permanently restricted</u>	
	<u>2013</u>	<u>2012</u>
Endowment net assets, beginning of year	\$ 1,309,397	\$ 1,234,644
Net investment income and other changes	<u>94,426</u>	<u>74,753</u>
Endowment net assets, end of year	<u>\$ 1,403,823</u>	<u>\$ 1,309,397</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

8. LONG-TERM DEBT

A Master Trust Indenture, as amended, provides for the issuance of long-term debt under an obligated group structure. The Obligated Group consists of the Corporation and subsidiaries. This Obligated Group is required to meet certain covenants under the Master Trust Indenture. The Obligated Group is subject to certain financial performance covenants, among other compliance requirements, that require the maintenance of debt service ratios. As of August 31, 2013, management of the Obligated Group believes that it is in compliance with all financial covenants.

The following is a summary of long-term debt as of August 31, 2013 and 2012:

	2013	2012
Indiana Health and Educational Facility Financing Authority or Hospital Authority of Vigo County (Indiana):		
Series 2011, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2015 through 2041. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 7.5% to 8% and averages 7.77%. Includes bond discount of approximately \$900,000 as of August 31, 2013.	\$ 54,127,348	\$ 54,072,030
Series 2007, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2027 through 2048. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 5.50% to 5.80% and averages 5.74%. Includes bond discount of approximately \$400,000 as of August 31, 2013.	176,137,438	176,123,660
Series 2006B, taxable variable rate demand revenue bonds, payable in annual principal installments through fiscal 2037. Interest rate is set weekly (payable semiannually) and averages .50% in fiscal 2013.	12,330,000	12,545,000
Series 1993, tax-exempt fixed rate serial and term bonds, payable in annual principal installments through fiscal 2024. Interest (payable semiannually) ranges from 5.125% to 5.250% and averages 5.18% in fiscal 2013.	22,800,000	24,100,000
Loan payable in monthly principal installments commencing in fiscal 2010 through fiscal 2026. Fixed term with variable interest rate set monthly (payable monthly) using LIBOR based rates and averages 3.86% in 2013.	5,093,100	5,910,600
Capital leases and other	1,508,582	2,223,019
Total long-term debt	271,996,468	274,974,309
Less current portion	3,516,190	3,476,124
	\$ 268,480,278	\$ 271,498,185

UNION HOSPITAL INC. AND SUBSIDIARIES

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

Year Ending August 31,	
2014	\$ 3,516,190
2015	2,584,822
2016	2,482,241
2017	3,635,442
2018	3,575,351
Thereafter	<u>256,202,422</u>
	<u>\$ 271,996,468</u>

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

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

The Corporation has a letter of credit for a maximum of \$13,000,000 attached to the Series 2006B taxable Bonds to cover noncompliance with principal and interest payments. There were no draws on the letter during fiscal year 2013 and 2012, and there are no outstanding amounts under this arrangement at August 31, 2013 and 2012. The letter of credit expires May 2, 2014. However in the event of a failed remarketing, the Corporation is subject to a 367 day period of interest only payments. After 367 days, the amount of the draws would be required to be repaid in accordance with the amortization payment dates stipulated in the agreement.

UNION HOSPITAL INC. AND SUBSIDIARIES

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

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

Total interest paid on long-term debt (net of amounts capitalized of approximately \$-0- and \$1,540,000) for the years ended August 31, 2013 and 2012, aggregated approximately \$16,200,000 and \$14,700,000, respectively. Total investment income on borrowed funds held by trustee for the years ended August 31, 2013 and 2012, aggregated approximately \$-0- and \$24,000, respectively. Capitalized interest costs net of associated investment income earnings aggregated approximately \$-0- and \$1,528,000.

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

The Corporation leases medical equipment and software under capital leases with various expiration dates. Cost and accumulated depreciation of the equipment under capital leases was approximately \$4,350,000 and \$6,890,000, respectively, and \$2,150,000 and \$3,240,000, respectively, at August 31, 2013 and August 31, 2012. The following is a schedule by year of future minimum lease payments under capital leases as of August 31, 2013, that have initial or remaining lease terms in excess of one year.

Year Ending August 31,	
2014	\$ 776,353
2015	414,915
2016	185,188
2017	150,808
2017	29,419
	<u>1,556,683</u>
Less imputed interest	95,460
	<u>\$ 1,461,223</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

The Corporation has operating leases for medical equipment and office space. Total rent and lease expense for 2013 and 2012 was \$11,827,000 and \$12,068,000, respectively. Future minimum lease payments under noncancelable operating leases as of August 31, 2013 that have initial or remaining lease terms in excess of one year are as follows:

Year Ending August 31,	
2014	\$ 4,554,304
2015	3,096,001
2016	1,745,782
2017	1,431,314
2018	348,154
	<u>\$ 11,175,555</u>

9. PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

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

The Corporation instituted a special voluntary early-retirement pension and health insurance benefit for eligible employees between the ages of 55 to 60 and above through multiple phases throughout 2011. Employees who applied and qualified under the program received monthly annuities based upon the value of their pension, as well as COBRA health benefits for up to 18th months at the current employee costs. Upon the 19th month and until reaching the age of 65, the Corporation will deposit \$500 a month into a benefits account per qualifying retiree to be used for the health benefits.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

The liability outstanding for the estimated cost for those in the program are approximately \$1,671,000 and \$1,896,000 as of August 31, 2013 and 2012. Of these amounts approximately \$458,000 and \$430,000 were recorded as salaries, wages, and related liabilities and approximately \$1,213,000 and \$1,466,000 were recorded as pension liability and related obligations on the consolidated balance sheets as of August 31, 2013 and 2012, respectively.

The Corporation recognizes the funded status of its defined-benefit pension plan in its consolidated balance sheets and the changes therein within its consolidated statements of operations and changes in net assets. Funded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Prior unrecognized net actuarial losses of \$27,308,000 and \$12,519,000 have been included in the unrestricted net assets at August 31, 2013 and 2012, respectively, and have not yet been recognized in net periodic pension cost. The adjustment to unrestricted net assets consisted primarily of the change in cumulative losses on the retirement plan in 2013 and 2012 and changes in the funded status.

Actuarial losses included in unrestricted net assets at August 31, 2013 and 2012, and expected to be amortized in net periodic benefit cost were approximately \$327,000 and \$285,000.

The following table sets forth the defined-benefit pension plan's benefit obligations, fair value of the Plan's assets, and funded status at August 31, 2013 and 2012:

	2013	2012
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 92,485,670	\$ 90,741,573
Interest cost	5,853,350	5,753,943
Benefits paid	(4,557,134)	(4,403,549)
Actuarial loss	13,297,446	393,703
Benefit obligation, end of year	\$ 107,079,332	\$ 92,485,670
Changes in plan assets		
Fair value of plan assets, beginning of year	89,065,460	80,525,011
Actual return on plan assets	4,066,446	5,143,998
Employer contributions	9,010,000	7,800,000
Benefits paid	(4,557,134)	(4,403,549)
Fair value of plan assets, end of year	\$ 97,584,772	\$ 89,065,460
Funded status		
Funded status of the plan, end of year	\$ (9,494,560)	\$ (3,420,210)

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

The liability recorded to account for the funded status of the plan at year end is recognized within the pension liability and related obligations on the consolidated balance sheet as of August 31, 2013 and 2012.

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

	2013	2012
Components of net benefit cost		
Interest cost	\$ 5,853,350	\$ 5,753,943
Expected return on plan assets	(5,884,537)	(5,343,366)
Actuarial loss	327,053	285,187
Net periodic benefit cost	\$ 295,866	\$ 695,764

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

Year Ending August 31,	
2014	\$ 4,929,918
2015	4,994,503
2016	5,164,456
2017	5,518,922
2018	5,765,730
2019-2023	32,773,840
	\$ 59,147,369

The weighted-average assumptions used to determine the Plan's projected benefit obligation (PBO) and net periodic benefit costs (NPBC) for the years ended August 31, 2013 and 2012 are as follows:

	2013	2012
Discount rate	5.5%	6.5%
Expected return on plan assets	6.5%	6.5%
Rate of compensation increase - NPBC	Not Applicable	Not Applicable

The principal long-term determinant of a portfolio's investment return is its asset allocation. The Plan's allocation includes growth assets (45%) and fixed income (51%) investments and other (4%). In addition, active management strategies have added value relative to passive benchmark returns. The expected long-term rate of return assumption is based on the mix of assets in the Plan, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

The Plan's weighted-average asset allocations at August 31, 2013 and 2012, by asset category, are as follows:

	2013	2012
Mutual funds - equity funds	45%	36%
Mutual funds - bond funds	51%	61%
Other	4%	3%
	100%	100%

The following is an analysis of fair value of the major classes of plan assets as of August 31, 2013 and 2012:

	Fair Value	
	2013	2012
Cash and equivalents	\$ 1,780,843	\$ 1,155,469
Mutual funds - equity funds	43,985,942	31,889,829
Mutual funds - bond funds	50,269,980	54,206,652
Private equity funds	1,548,007	1,813,510
Total	\$ 97,584,772	\$ 89,065,460

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

The following is a reconciliation of the fair value of plan assets as of August 31, 2013 and 2012 determined on the basis of valuation techniques:

	Private Equity Funds	
	2013	2012
Balance, beginning of year	\$ 1,813,510	\$ 1,579,531
Return on plan assets:		
Assets held at the end of the year	(57,555)	189,550
Net purchases	(207,948)	44,429
Balance, end of year	\$ 1,548,007	\$ 1,813,510

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AUGUST 31, 2013 AND 2012

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

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

The Corporation expects to contribute approximately \$9,010,000 to the pension plan in 2013 and will meet the required funding amounts for 2012. The Corporation elected to freeze the Plan in 2010, but will continue to fund the plan as required.

The Corporation also has a 403b discretionary defined contribution plan and a 401(k) plan for which contributions during 2013 and 2012 were approximately \$5,240,000 and \$5,075,000, respectively.

10. COMMITMENTS AND CONTINGENCIES

During 2013, the Indiana Health Financing Authority received an Information Document Request (IDR) from the Internal Revenue Service (IRS), Tax Exempt Bonds and Government Entities Division regarding an IRS examination of the series 1993 bonds. The IDR relates to certain post-issuance transactions specific to the bonds, including a total return swap executed by the Hospital related to the aforementioned bonds. The related results of the examination are unknown at this time.

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

SUPPLEMENTARY INFORMATION

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS AUGUST 31, 2013

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Assets					
Current assets					
Cash and cash equivalents	\$ 18,616,951	\$ 2,162,838	\$ 3,948	\$ -0-	\$ 20,783,737
Funds held by trustee, current portion	9,624,684	-0-	-0-	-0-	9,624,684
Board designated funds, current portion	15,946,469	-0-	-0-	-0-	15,946,469
Patient accounts receivable, net	55,252,329	-0-	194,497	-0-	55,446,826
Inventories	4,393,058	-0-	-0-	-0-	4,393,058
Prepaid expenses and other current assets	2,175,015	75,710	149,731	(182,606)	2,217,850
Total current assets	106,008,506	2,238,548	348,176	(182,606)	108,412,624
Investments limited as to use, less current portion					
Funds held by trustee	24,409,313	-0-	-0-	-0-	24,409,313
Board designated funds	32,348,588	-0-	-0-	-0-	32,348,588
Permanently restricted	1,403,823	-0-	-0-	-0-	1,403,823
Total investments limited as to use	58,161,724	-0-	-0-	-0-	58,161,724
Property and equipment					
Land and improvements	37,180,324	-0-	-0-	-0-	37,180,324
Buildings and fixed equipment	334,758,264	7,652	-0-	-0-	334,765,916
Movable equipment	125,524,216	57,211	55,349	-0-	125,636,776
	497,462,804	64,863	55,349	-0-	497,583,016
Less allowances for depreciation	213,762,972	23,693	42,346	-0-	213,829,011
	283,699,832	41,170	13,003	-0-	283,754,005
Construction in progress	2,377,340	-0-	-0-	-0-	2,377,340
Total property and equipment, net	286,077,172	41,170	13,003	-0-	286,131,345
Other assets					
Due from Union Hospital Foundation, Inc.	3,022,998	-0-	-0-	-0-	3,022,998
Deferred financing costs, net	2,895,002	-0-	-0-	-0-	2,895,002
Intangible assets, net	4,338,399	-0-	-0-	-0-	4,338,399
Investment in joint ventures	6,666,751	-0-	-0-	(2,315,621)	4,351,130
	16,923,150	-0-	-0-	(2,315,621)	14,607,529
Total assets	\$ 467,170,552	\$ 2,279,718	\$ 361,179	\$ (2,498,227)	\$ 467,313,222

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS AUGUST 31, 2013

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Liabilities and net assets					
Current liabilities					
Accounts payable and other current liabilities	\$ 22,538,214	\$ 282,998	\$ 16,421	\$ (182,606)	\$ 22,655,027
Salaries, wages and related liabilities	21,797,175	26,213	-0-	-0-	21,823,388
Estimated third party settlements	2,454,979	-0-	-0-	-0-	2,454,979
Accrued interest	7,809,684	-0-	-0-	-0-	7,809,684
Current portion of long-term debt	3,516,190	-0-	-0-	-0-	3,516,190
Total current liabilities	58,116,242	309,211	16,421	(182,606)	58,259,268
Long-term liabilities					
Long-term debt, less current portion	268,480,278	-0-	-0-	-0-	268,480,278
Deferred revenue	210,418	-0-	-0-	-0-	210,418
Pension liability and related obligations	10,707,839	-0-	-0-	-0-	10,707,839
Other long-term liabilities	2,984,073	-0-	-0-	-0-	2,984,073
Total long-term liabilities	282,382,608	-0-	-0-	-0-	282,382,608
Total liabilities	340,498,850	309,211	16,421	(182,606)	340,641,876
Net assets					
Unrestricted	122,155,732	1,970,507	344,758	(2,315,621)	122,155,376
Temporarily restricted	3,112,147	-0-	-0-	-0-	3,112,147
Permanently restricted	1,403,823	-0-	-0-	-0-	1,403,823
Total net assets	126,671,702	1,970,507	344,758	(2,315,621)	126,671,346
Total liabilities and net assets	\$ 467,170,552	\$ 2,279,718	\$ 361,179	\$ (2,498,227)	\$ 467,313,222

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS AUGUST 31, 2012

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Assets					
Current assets					
Cash and cash equivalents	\$ 31,063,107	\$ 2,165,300	\$ 3,948	\$ -0-	\$ 33,232,355
Funds held by trustee, current portion	9,357,980	-0-	-0-	-0-	9,357,980
Board designated funds, current portion	11,931,261	-0-	-0-	-0-	11,931,261
Patient accounts receivable, net	51,029,921	-0-	188,271	-0-	51,218,192
Inventories	4,361,427	-0-	-0-	-0-	4,361,427
Prepaid expenses and other current assets	4,229,851	111,536	56,822	(121,966)	4,276,243
Total current assets	111,973,547	2,276,836	249,041	(121,966)	114,377,458
Investments limited as to use, less current portion					
Funds held by trustee	24,270,756	-0-	-0-	-0-	24,270,756
Board designated	31,115,861	-0-	-0-	-0-	31,115,861
Permanently restricted	1,309,397	-0-	-0-	-0-	1,309,397
Total investments limited as to use	56,696,014	-0-	-0-	-0-	56,696,014
Property and equipment					
Land and improvements	37,291,582	-0-	-0-	-0-	37,291,582
Buildings and fixed equipment	314,480,911	7,652	-0-	-0-	314,488,563
Movable equipment	119,362,238	56,850	49,894	-0-	119,468,982
	471,134,731	64,502	49,894	-0-	471,249,127
Less allowances for depreciation	191,786,439	14,485	36,849	-0-	191,837,773
	279,348,292	50,017	13,045	-0-	279,411,354
Construction in progress	16,123,962	-0-	-0-	-0-	16,123,962
Total property and equipment, net	295,472,254	50,017	13,045	-0-	295,535,316
Other assets					
Due from Union Hospital Foundation, Inc.	4,495,347	-0-	-0-	-0-	4,495,347
Deferred financing costs, net	3,090,878	-0-	-0-	-0-	3,090,878
Intangible assets, net	5,982,856	-0-	-0-	-0-	5,982,856
Investment in joint ventures	3,980,230	-0-	-0-	(2,103,644)	1,876,586
	17,549,311	-0-	-0-	(2,103,644)	15,445,667
Total assets	\$ 481,691,126	\$ 2,326,853	\$ 262,086	\$ (2,225,610)	\$ 482,054,455

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS AUGUST 31, 2012

	Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Union Hospital, Inc. and Subsidiaries
Liabilities and net assets					
Current liabilities					
Accounts payable and other current liabilities	\$ 22,386,923	\$ 445,011	\$ 15,238	\$ (121,966)	\$ 22,725,206
Salaries, wages and related liabilities	19,757,553	25,046	-0-	-0-	19,782,599
Estimated Third party settlements	3,073,530	-0-	-0-	-0-	3,073,530
Accrued interest	7,842,998	-0-	-0-	-0-	7,842,998
Current portion of long-term debt	3,476,124	-0-	-0-	-0-	3,476,124
Total current liabilities	56,537,128	470,057	15,238	(121,966)	56,900,457
Long-term liabilities					
Long-term debt, less current portion	271,498,185	-0-	-0-	-0-	271,498,185
Deferred revenue	301,122	-0-	-0-	-0-	301,122
Pension liability and related obligations	4,886,980	-0-	-0-	-0-	4,886,980
Other long-term liabilities	3,846,484	-0-	-0-	-0-	3,846,484
Total long-term liabilities	280,532,771	-0-	-0-	-0-	280,532,771
Total liabilities	337,069,899	470,057	15,238	(121,966)	337,433,228
Net assets					
Unrestricted	138,736,584	1,856,796	246,848	(2,103,644)	138,736,584
Temporarily restricted	4,575,246	-0-	-0-	-0-	4,575,246
Permanently restricted	1,309,397	-0-	-0-	-0-	1,309,397
Total net assets	144,621,227	1,856,796	246,848	(2,103,644)	144,621,227
Total liabilities and net assets	\$ 481,691,126	\$ 2,326,853	\$ 262,086	\$ (2,225,610)	\$ 482,054,455

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2013

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Total Union Hospital, Inc. and Subsidiaries
Operating revenue							
Net patient service revenue	\$ 404,144,154	\$ 29,209,908	\$ 433,354,062	\$ -0-	\$ 1,104,120	\$ -0-	\$ 434,458,182
Less provision for bad debts	27,712,139	3,443,644	31,155,783	-0-	-0-	-0-	31,155,783
Net patient service revenue net of provision for bad debts	376,432,015	25,766,264	402,198,279	-0-	1,104,120	-0-	403,302,399
Other revenue	8,867,445	293,663	9,161,108	1,314,936	-0-	(1,759,832)	8,716,212
Total operating revenue	385,299,460	26,059,927	411,359,387	1,314,936	1,104,120	(1,759,832)	412,018,611
Operating expenses							
Salaries and wages	128,954,736	9,698,184	138,652,920	313,374	-0-	-0-	138,966,294
Employee benefits	25,045,874	1,917,389	26,963,263	134,148	-0-	-0-	27,097,411
Medical supplies and drugs	57,937,292	2,434,751	60,372,043	-0-	137,389	-0-	60,509,432
Physician services	5,656,842	187,978	5,844,820	-0-	-0-	-0-	5,844,820
Contract services	64,848,052	1,069,525	65,917,577	2,732	118,093	-0-	66,038,402
Rent and leases	11,136,445	670,269	11,806,714	17,222	3,303	(15,564)	11,811,675
Utilities, supplies, and other	34,528,869	3,434,831	37,963,700	796,970	740,481	(1,744,268)	37,756,883
Hospital assessment fee	15,927,521	1,238,553	17,166,074	-0-	-0-	-0-	17,166,074
Depreciation and amortization	24,583,521	1,072,283	25,655,804	9,586	6,944	-0-	25,672,334
Interest	16,222,721	1,390	16,224,111	-0-	-0-	-0-	16,224,111
Total operating expenses	384,841,873	21,725,153	406,567,026	1,274,032	1,006,210	(1,759,832)	407,087,436
Income from operations	457,587	4,334,774	4,792,361	40,904	97,910	-0-	4,931,175
Non-operating gains (losses)							
Investment income	635,147	1,579	636,726	72,807	-0-	-0-	709,533
Investment in joint ventures	(657,643)	-0-	(657,643)	-0-	-0-	(211,977)	(869,620)
Other	(59,145)	(1,554)	(60,699)	-0-	-0-	-0-	(60,699)
Total non-operating revenues	(81,641)	25	(81,616)	72,807	-0-	(211,977)	(220,786)
Excess of revenue over expenses	\$ 375,946	\$ 4,334,799	\$ 4,710,745	\$ 113,711	\$ 97,910	\$ (211,977)	\$ 4,710,389

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED AUGUST 31, 2012

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	Eliminations	Total Union Hospital, Inc. and Subsidiaries
Operating revenue							
Net patient service revenue	\$ 431,391,216	\$ 30,081,940	\$ 461,473,156	\$ -0-	\$ 1,062,103	\$ -0-	\$ 462,535,259
Less provision for bad debts	36,602,544	4,703,143	41,305,687	-0-	-0-	-0-	41,305,687
Net patient service revenue net of provision for bad debts	394,788,672	25,378,797	420,167,469	-0-	1,062,103	-0-	421,229,572
Other revenue	9,034,243	373,091	9,407,334	1,604,900	0	(2,027,817)	8,984,417
Total operating revenue	403,822,915	25,751,888	429,574,803	1,604,900	1,062,103	(2,027,817)	430,213,989
Operating expenses							
Salaries and wages	116,694,652	9,206,004	125,900,656	344,051	-0-	-0-	126,244,707
Employee benefits	25,175,660	2,059,390	27,235,050	151,286	-0-	-0-	27,386,336
Medical supplies and drugs	64,771,572	2,655,238	67,426,810	-0-	121,182	-0-	67,547,992
Physician services	10,287,601	455,252	10,742,853	-0-	-0-	-0-	10,742,853
Contract services	64,961,534	812,521	65,774,055	3,224	112,945	-0-	65,890,224
Rent and leases	11,375,306	688,194	12,063,500	16,625	3,118	(15,111)	12,068,132
Utilities, supplies, and other	33,712,622	3,336,423	37,049,045	893,328	717,061	(2,012,690)	36,646,744
Hospital assessment fee	17,186,775	715,855	17,902,630	-0-	-0-	-0-	17,902,630
Depreciation and amortization	23,492,862	992,869	24,485,731	6,891	6,944	-0-	24,499,566
Interest	14,898,275	3,909	14,902,184	-0-	-0-	-0-	14,902,184
Total operating expenses	382,556,859	20,925,655	403,482,514	1,415,405	961,250	(2,027,801)	403,831,368
Income (loss) from operations	21,266,056	4,826,233	26,092,289	189,495	100,853	(16)	26,382,621
Nonoperating gains (losses)							
Investment income	510,036	490	510,526	73,182	-0-	-0-	583,708
Investment in joint ventures	1,889,784	-0-	1,889,784	-0-	-0-	(363,423)	1,526,361
Other	(72,221)	(1,706)	(73,927)	-0-	-0-	-0-	(73,927)
Total nonoperating revenues	2,327,599	(1,216)	2,326,383	73,182	-0-	(363,423)	2,036,142
Excess of revenue over (under) expenses	\$ 23,593,655	\$ 4,825,017	\$ 28,418,672	\$ 262,677	\$ 100,853	\$ (363,439)	\$ 28,418,763

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UNION HOSPITAL INC. AND SUBSIDIARIES

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED AUGUST 31, 2013

Program	Grant ID #	CFDA Number	Federal Expenditures
Major programs			
Department of Health and Human Services Training in Primary Care Training and Enhancement pass through the Bureau of Health Professions	D58HP23232-02	93.884	\$ 245,971
Telehealth Network Grant - Office of Advancement of Telemedicine	H2ARH20178-03-01	93.211	175,000
Telehealth Resource Center Grant Program	G22RH24745-01-00	93.211	40,000
Subtotal for 93.211			<u>215,000</u>
Total major programs			460,971
Non-major programs			
Department of Health and Human Services Community Health Center Grant	CHC 880-5	93.913	85,725
Indiana Area Health Education Center Network pass through the Indiana State University	6U77HP23068-02-01	93.107	20,000
Substance Abuse Prevention and Treatment Block Grant Block Grant pass through the Indiana Division of Mental Health and Addictions	PSUP 245-2	93.959	49,229
National Bioterrorism Hospital Preparedness Program pass through the Indiana State Department of Health - pass through District 7 Hospital Corporation	BHP 1138-1	93.074	12,713
Total non-major programs			<u>167,667</u>
Total federal expenditures			<u>\$ 628,638</u>

Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Corporation under programs of the federal government for the year ended August 31, 2013. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The basic consolidated financial statement classifications may include other financial activity for reporting purposes. Therefore, some of the amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements.



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

Board of Directors
Union Hospital
Terre Haute, Indiana

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited, in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Guidelines for Examination of Entities Receiving Financial Assistance from Governmental Sources, issued by the Indiana State Board of Accounts, the consolidated financial statements of Union Hospital, Inc. and Subsidiaries (the Corporation), which comprise the consolidated balance sheet as of August 31, 2013, and the related consolidated statements of operations, changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 24, 2013. Our report included an explanatory paragraph stating that the Corporation is part of an affiliated group of entities that has been consolidated into the reporting entity Union Health System, Inc., and that these financial statements include only the financial position changes in net assets and cash flows of Corporation.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the consolidated financial statements, we considered the Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Corporation's internal control.

Board of Directors
Union Hospital
Terre Haute , Indiana

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Corporation's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

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

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Regional's internal control and compliance. Accordingly, this communication is not suitable for any other purpose

Blue & Co., LLC

Indianapolis, Indiana
December 24, 2013



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REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

Board of Directors
Union Hospital
Terre Haute, Indiana

REPORT ON COMPLIANCE FOR EACH FEDERAL PROGRAM

We have audited Union Hospital, Inc. and Subsidiaries' (the Corporation) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Corporation's major federal programs for the year ended August 31, 2013. The Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

MANAGEMENT'S RESPONSIBILITY

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on compliance for each of the Corporation's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

Board of Directors
Union Hospital
Terre Haute , Indiana

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Corporation's compliance.

OPINION ON EACH MAJOR FEDERAL PROGRAM

In our opinion, the Corporation complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended August 31, 2013.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

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

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

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

Board of Directors
Union Hospital
Terre Haute , Indiana

PURPOSE OF THIS REPORT

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Blue & Co., LLC

Indianapolis, Indiana
December 24, 2013

UNION HOSPITAL INC. AND SUBSIDIARIES

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED AUGUST 31, 2013

Summary of Auditor's Results

Consolidated Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified? yes none reported

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

Noncompliance material to financial statements noted? yes none reported

Federal Awards

Internal controls over major programs:

Material weakness(es) identified? yes none reported

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

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

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

Identification of major program:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
93.884	Department of Health and Human Services Training in Primary Care Training and Enhancement pass through the Bureau of Health Professions
93.211	Department of Health and Human Services Telehealth Network Grant - Office of Advancement of Telemedicine
93.211	Telehealth Resource Center Grant Program

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

Auditee qualified as low-risk auditee? yes no

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

No matters reported

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

No matters reported

Section IV – Summary schedule of prior audit findings:

No matters reported