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May 15, 2013

Board of Directors
Major Health Partners
150 W. Washington Street
Shelbyville, IN 46176

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2012 to December 31, 2012. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Major Health Partners, as of December 31, 2012 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS



**CONSOLIDATED FINANCIAL STATEMENTS
AND
SUPPLEMENTARY INFORMATION
DECEMBER 31, 2012 AND 2011**

CPAs / ADVISORS



MAJOR HEALTH PARTNERS

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Major Health Partners
Shelbyville, Indiana

We have audited the accompanying consolidated financial statements of Major Health Partners (MHP), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of revenues, expenses and changes in net position, 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 and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Board of Trustees
Major Health Partners
Shelbyville, Indiana

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MHP as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Reports on Required Supplementary Information and Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information as listed in the accompanying table of contents is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC
Indianapolis, Indiana
April 25, 2013

REQUIRED SUPPLEMENTARY INFORMATION

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

This section of Major Health Partners' (MHP) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of MHP's financial performance. This MD&A does include a discussion and analysis of the activities and results of MHP which is the consolidated entity that consists of Major Hospital (the Hospital) and its blended component units, Major Affiliates, Inc., Major Hospital Foundation and MDSolutions, LLC. Please read it in conjunction with MHP's financial statements that follow this MD&A.

FINANCIAL HIGHLIGHTS

- MHP reported a positive change in net position for 2012 of approximately \$9.4 million compared to a positive change in net position of approximately \$3.9 million in 2011, representing an increase of approximately \$5.5 million in comparison to the 2011 results.
- MHP spent \$6.3 million on equipment and capital projects in 2012 net of disposals. Major capital equipment expenditures include the addition of digital imaging technology in radiology, a remote radiographic and fluoroscopic system, a nurse call system, ICU patient monitors, sleep lab diagnostic equipment, eye surgery equipment, ventilators, laparoscopic instruments, lab analyzers, electro surgical units for surgery, and a phone system upgrade. Capital expenditures related to information technology include backup servers, archiving software and hardware, security audit software, virus protection software, and various other software upgrades to comply with meaningful use requirements. The Hospital also spent money for ongoing building maintenance and improvements, including renovations to the basement and first floor at the main campus and purchase of a long-term care facility building.

USING THIS ANNUAL REPORT

MHP's consolidated financial statements consist of three consolidated statements – a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These financial statements and related notes provide information about the activities and the financial position of MHP.

The consolidated balance sheet includes all of MHP's assets, deferred outflows, and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to MHP creditors (liabilities).

All of the current year's revenue earned and expenses incurred are accounted for in the consolidated statement of revenues, expenses and changes in net position.

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

Finally, the consolidated statement of cash flows' purpose is to provide information about MHP's cash flows from operating activities, financing activities including capital additions, and investing activities. This statement provides information on the sources and uses of cash and the change in the cash balance during the year.

THE BALANCE SHEET AND STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

The balance sheet and the statement of revenues, expenses and changes in net position report information about MHP's resources and its activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These statements report MHP's net position and changes in them. Think of MHP's net position—the difference between assets and liabilities—as one way to measure MHP's financial health, or financial position. Over time, increases or decreases in MHP's net position are one indicator of whether its financial health is improving or deteriorating. Consider other nonfinancial factors, however, such as changes in MHP's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of MHP.

MAJOR HEALTH PARTNERS' NET POSITION

Table 1: Balance Sheets

	2012	2011	2010
Assets			
Current assets	\$ 29,997,523	\$ 27,654,676	\$ 19,243,479
Assets whose use is limited	60,607,198	52,384,336	56,157,234
Capital assets, net	44,971,189	42,730,261	44,421,983
Other assets	9,987,935	7,085,238	6,335,212
Total assets	145,563,845	129,854,511	126,157,908
Deferred outflows - interest rate swaps	387,726	551,660	485,000
Total assets and deferred outflows	<u>\$ 145,951,571</u>	<u>\$ 130,406,171</u>	<u>\$ 126,642,908</u>
Liabilities			
Current liabilities	\$ 18,494,720	\$ 12,064,517	\$ 11,163,196
Other liabilities	1,719,533	981,136	1,067,683
Long-term debt	28,396,494	29,424,123	30,418,945
Total liabilities	48,610,747	42,469,776	42,649,824
Net Position			
Net investment in capital assets	15,578,641	12,336,598	13,032,658
Restricted	1,044,204	950,005	983,799
Unrestricted	80,717,979	74,649,792	69,976,627
Total net position	<u>97,340,824</u>	<u>87,936,395</u>	<u>83,993,084</u>
Total liabilities and net position	<u>\$ 145,951,571</u>	<u>\$ 130,406,171</u>	<u>\$ 126,642,908</u>

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

The significant changes in Major Health Partners' assets resulted from an increase in assets whose use is limited of approximately \$8.2 million. The increase in assets whose use is limited is primarily due to market improvements. Total liabilities increased in 2012 by approximately \$6.1 million in comparison to 2011. The increase is attributable to an increase in operating payables and third-party settlements.

OPERATING RESULTS AND CHANGES IN NET POSITION AND CASH FLOWS

Table 2: Statements of Revenues, Expenses and Changes in Net Position

	2012	2011	2010
Revenues			
Net patient service revenue	\$ 121,996,164	\$ 93,259,735	\$ 88,996,560
Other operating revenue	2,594,030	3,378,258	1,272,450
Total revenues	124,590,194	96,637,993	90,269,010
Expenses			
Salaries and benefits	57,720,755	51,899,749	47,641,589
Supplies	15,515,642	15,515,128	14,657,881
Depreciation and amortization	5,245,716	5,171,449	5,075,381
Other operating expenses	39,731,569	20,890,892	19,732,081
Total expenses	118,213,682	93,477,218	87,106,932
Operating income	6,376,512	3,160,775	3,162,078
Non-operating revenue (expense), net	3,027,917	782,536	3,286,724
Change in net position	9,404,429	3,943,311	6,448,802
Net position			
Beginning of year	87,936,395	83,993,084	77,544,282
End of year	\$ 97,340,824	\$ 87,936,395	\$ 83,993,084

SOURCES OF REVENUE

During 2012, Major Health Partners derived substantially all of its revenue from patient service and other related activities. A significant portion of the patient service revenue is from patients that are insured by government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenues from the Medicare and Medicaid programs represented 56% of MHP's gross revenues in 2012 but 50% of MHP's net patient service revenues.

Major Health Partners' service mix remained relatively consistent between 2012 and 2011. Inpatient revenue accounted for 28% and 25% of gross revenue in 2012 and 2011, respectively. Outpatient revenue was 72% and 75% of total gross revenue in 2012 and 2011, respectively.

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

Following is a table of major sources of gross patient revenues for the past three years:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Medicare	41%	42%	41%
Medicaid	15%	15%	15%
Anthem	15%	16%	15%
Commercial	21%	19%	21%
Self Pay	8%	8%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

OPERATING AND FINANCIAL PERFORMANCE

Major Health Partners had a gain from operations of \$6.4 million in 2012, which resulted in a return on equity of 6.6% compared to a gain from operations of \$3.2 million in 2011 and return on equity of 3.6%.

This following section highlights the major financial factors for 2012 for MHP:

- The Hospital's discharges increased from 2,670 in 2011 to 2,903 in 2012. The Hospital's adjusted patient days increased to 35,826 in 2012 compared to 33,468 in 2011. The Hospital remained profitable from operations as a result of these increases and pricing changes.
- Overall net patient service revenue increased \$28.7 million in 2012. The Hospital received \$2.2 million from the State for the Indiana Medicaid Municipal Hospital Payment Adjustment, consistent with 2011 at \$2.3 million. The increase in net patient service revenue was due to growth in inpatient and outpatient volumes, a 6% rate increase, and the addition of long-term care operations.
- Major Affiliates' total operating revenue increased \$0.8 million or 5.1% from year 2011 to year 2012 for both its' patient services and office rental. This is a result of new physician practices and a general increase in volumes of the physician practices.
- Other operating revenue for MHP decreased by \$0.8 million in 2012 mainly due to revenue recognized for EHR meaningful use initiatives being greater in 2011 compared to 2012.
- Operating expenses increased by \$24.7 million in 2012. This increase is result of an increase in salaries, wages and benefits, purchased services (including expenses associated with long-term care operations) and the hospital assessment fee.

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

- Salaries and wages and benefits expense increased by \$5.8 million or 11.2%. The majority of the increase in salaries relates to new positions to accommodate growth in the outpatient areas at the Hospital and growth in the physician practices. Benefit expense increased as a result of the increase in salaries and wages.
- Medical Professional fees for the Hospital remained consistent between 2012 and 2011.
- Supplies remained consistent between 2012 and 2011.
- Purchased services increased \$12.6 million or 171.4% in 2012. The majority of this increase relates to the Hospital and is the result of additional legal and consulting expense for strategic and revenue cycle initiatives. MHP also experienced higher purchased service fees in outpatient areas proportionate to growth in those areas.

Table 3: Statements of Cash Flows

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?" The following is a summary of cash flows:

	2012	2011	2010
Cash flows from			
Operating activities	\$ 14,245,507	\$ 7,599,232	\$ 8,020,097
Capital and related financing	(9,200,153)	(5,576,863)	(6,166,396)
Investing	(7,151,292)	3,777,517	1,843,706
Change in cash and cash equivalents	<u>\$ (2,105,938)</u>	<u>\$ 5,799,886</u>	<u>\$ 3,697,407</u>

Cash and cash equivalents decreased by \$2.1 million in 2012 compared to an increase of \$5.8 million in 2011. The majority of the 2012 decrease relates to the classification of assets whose use is limited and purchases of capital assets.

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

CAPITAL ASSETS

During 2012, Major Health Partners invested \$7.3 million in capital assets along with retirements and transfers of \$1.1 million. The change in capital assets is outlined in the following table:

	2012	2011	2010
Land and land improvements	\$ 11,328,726	\$ 8,290,857	\$ 7,447,161
Leasehold improvements	2,322,553	2,086,265	2,072,785
Buildings and improvements	49,735,425	48,490,047	48,311,303
Equipment	36,739,841	34,956,167	32,587,263
Construction in progress	255,963	292,231	777,983
Total property and equipment	100,382,508	94,115,567	91,196,495
Less accumulated depreciation	55,411,319	51,385,306	46,774,512
Capital assets, net	<u>\$ 44,971,189</u>	<u>\$ 42,730,261</u>	<u>\$ 44,421,983</u>

Capital assets have increased due to purchases in the 2012. Assets purchased during 2012 exceeded depreciation expense for the year. As previously mentioned MHP strives to meet the needs of the community and provide high quality care by adding new equipment and facilities or by replacing or upgrading equipment as it becomes obsolete.

DEBT

MHP has debt outstanding in the Indiana Finance Authority Hospital Revenue Bonds, capital lease obligations and notes payable. More detailed information about MHP's long-term debt is presented in the notes to the consolidated financial statements.

ECONOMIC OUTLOOK

Management believes that the health care industry's and MHP's operating margins will continue to be under pressure because of changes in payor mix and growth in operating expenses that are in excess of the increases in contractually arranged and legally established payments received for services rendered. Another factor that poses a challenge to management is the increasing competitive market for the delivery of health care services. The ongoing challenge facing MHP is to continue to provide quality patient care in this competitive environment, and to attain reasonable rates for the services that are provided while managing costs. The most significant cost factor affecting MHP is the increases in labor costs due to the increasing competition for quality health care workers.

MAJOR HEALTH PARTNERS

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

CONTACTING MAJOR HEALTH PARTNERS' FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of MHP's finances and to show MHP's accountability for the money it receives. If you have questions about this report or need additional financial information, contact MHP's Administration Department, at 150 W. Washington St., Shelbyville, IN 46176.

MAJOR HEALTH PARTNERS

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2012 AND 2011

ASSETS AND DEFERRED OUTFLOWS

	2012	2011
Current assets		
Cash and cash equivalents	\$ 10,316,378	\$ 11,635,244
Patient accounts receivable, net of allowance for uncollectible accounts of \$3,490,121 in 2012 and \$3,428,852 in 2011	11,595,944	10,973,621
Inventory and other current assets	7,263,201	4,257,811
Current portion of assets whose use is limited	822,000	788,000
Total current assets	29,997,523	27,654,676
Assets whose use is limited		
Internally designated	60,384,994	52,222,331
Donor restricted funds	1,044,204	950,005
Total assets whose use is limited	61,429,198	53,172,336
Less current portion	822,000	788,000
Noncurrent assets whose use is limited	60,607,198	52,384,336
Capital assets, net	44,971,189	42,730,261
Property held for sale	4,576,627	4,576,627
Other assets, net	5,411,308	2,508,611
Total assets	145,563,845	129,854,511
Deferred outflows - interest rate swaps	387,726	551,660
Total assets and deferred outflows	<u>\$ 145,951,571</u>	<u>\$ 130,406,171</u>

See accompanying notes to consolidated financial statements.

MAJOR HEALTH PARTNERS

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2012 AND 2011

LIABILITIES AND NET POSITION

	2012	2011
Current liabilities		
Accounts payable and accrued expenses	\$ 4,351,738	\$ 2,309,194
Accrued wages and related liabilities	9,046,928	7,460,783
Estimated third-party settlements	4,100,000	1,325,000
Current portion of long term debt		
Loans payable and capital leases	174,054	181,540
Revenue bonds payable	822,000	788,000
Total current liabilities	18,494,720	12,064,517
Derivative liability	387,726	551,660
Other liabilities	1,331,807	429,476
Long term debt, net of current portion		
Loans payable and capital leases	1,817,494	2,023,123
Revenue bonds payable	26,579,000	27,401,000
Total long term debt	28,396,494	29,424,123
Total liabilities	48,610,747	42,469,776
Net position		
Net investment in capital assets	15,578,641	12,336,598
Restricted		
Expendable - other specific purpose	189,357	95,158
Non-expendable	854,847	854,847
Total restricted net position	16,622,845	13,286,603
Unrestricted	80,717,979	74,649,792
Total net position	97,340,824	87,936,395
Total liabilities and net position	<u>\$ 145,951,571</u>	<u>\$ 130,406,171</u>

See accompanying notes to consolidated financial statements.

MAJOR HEALTH PARTNERS

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Revenues		
Net patient service revenue	\$ 121,996,164	\$ 93,259,735
Other revenue	<u>2,594,030</u>	<u>3,378,258</u>
Total revenues	124,590,194	96,637,993
Expenses		
Salaries and wages	44,720,426	40,119,421
Employee benefits	13,000,329	11,780,328
Medical professional fees	5,007,124	5,598,323
Supplies	15,515,642	15,515,128
Purchased services	20,001,554	7,370,336
Equipment rental and maintenance	5,920,336	3,025,725
Utilities	1,527,144	1,395,320
Insurance	653,735	687,712
Depreciation and amortization	5,245,716	5,171,449
Hospital assessment fee	3,740,876	-0-
Other expenses	<u>2,880,800</u>	<u>2,813,476</u>
Total expenses	<u>118,213,682</u>	<u>93,477,218</u>
Operating income	6,376,512	3,160,775
Nonoperating revenues (expenses)		
Investment income	3,621,176	1,428,424
Interest expense	(868,323)	(892,261)
Other nonoperating revenue	<u>275,064</u>	<u>246,373</u>
Nonoperating revenues (expenses), net	<u>3,027,917</u>	<u>782,536</u>
Change in net position	9,404,429	3,943,311
Net position		
Beginning of year	<u>87,936,395</u>	<u>83,993,084</u>
End of year	<u><u>\$ 97,340,824</u></u>	<u><u>\$ 87,936,395</u></u>

See accompanying notes to consolidated financial statements.

MAJOR HEALTH PARTNERS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Operating activities		
Cash received from patient services	\$ 124,148,841	\$ 91,808,232
Cash paid for salaries, wages and benefits	(56,134,610)	(51,062,513)
Cash paid to vendors and suppliers	(56,215,902)	(37,149,014)
Other receipts, net	2,447,178	4,002,527
Net cash flows from operating activities	14,245,507	7,599,232
Capital and related financing activities		
Principal payments on long term debt	(1,001,115)	(995,662)
Interest on long term debt	(868,323)	(892,261)
Purchases of capital assets	(7,324,870)	(3,657,645)
Other	(5,845)	(31,295)
Net cash flows from capital and related financing activities	(9,200,153)	(5,576,863)
Investing activities		
Purchase of other assets, net	(2,750,000)	(1,343,000)
Investment income	3,621,176	1,428,424
Other nonoperating expenses	275,064	246,373
Purchase of investments	(21,369,754)	(12,988,224)
Proceeds from sale of investments	13,072,222	16,433,944
Net cash flows from investing activities	(7,151,292)	3,777,517
Net change in cash and cash equivalents	(2,105,938)	5,799,886
Cash and cash equivalents:		
Beginning of year	16,694,013	10,894,127
End of year	<u>\$ 14,588,075</u>	<u>\$ 16,694,013</u>
Reconciliation of cash and cash equivalents to the consolidated balance sheet		
Cash and cash equivalents		
In current assets	\$ 10,316,378	\$ 11,635,244
In assets whose use is limited - internally designated	4,244,171	5,030,076
In assets whose use is limited - donor restricted	27,526	28,693
Total cash and cash equivalents	<u>\$ 14,588,075</u>	<u>\$ 16,694,013</u>

See accompanying notes to consolidated financial statements.

MAJOR HEALTH PARTNERS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 6,376,512	\$ 3,160,775
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization	5,245,716	5,171,449
Bad debts	10,816,480	8,164,078
Changes in operating assets and liabilities		
Patient accounts receivable	(11,438,803)	(9,640,581)
Inventory and other current assets	(3,005,390)	(751,624)
Other assets	(152,697)	592,974
Accounts payable and accrued expenses	2,042,544	48,952
Accrued wages and related liabilities	1,586,145	828,209
Estimated third-party settlements	2,775,000	25,000
Net cash flows from operating activities	<u>\$ 14,245,507</u>	<u>\$ 7,599,232</u>
Non cash investing and financing activities		
Interest rate swap and deferred outflows	\$ (163,934)	\$ 66,660

See accompanying notes to consolidated financial statements.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

The consolidated financial statements of Major Health Partners (MHP) refer to Major Hospital (the Hospital) and its subsidiaries.

Major Hospital is an acute-care hospital located in Shelbyville, Indiana, organized for the purpose of providing healthcare services to the residents of Shelby County and the surrounding communities. The Hospital is a city-owned facility and operates under the Indiana County Hospital Law, Indiana Code (IC) 16-22. The Hospital provides short-term inpatient, outpatient and long-term health care.

A Hospital Appointing Board, consisting of one County Commissioner, one County Council person and the Mayor of the City of Shelbyville, appoints the Governing Board of the Hospital. The Hospital is considered a component unit of Shelby County.

Pursuant to the provision of long-term care, MHP owns the operations of certain long-term care facilities by way of an arrangement with managers of the facilities. These facilities provide inpatient and therapy services. Generally, gross revenues from the operation of the long-term care facilities are the property of MHP and MHP is responsible for the associated operating expenses and working capital requirements. While the management and related lease agreements are in effect, the performance of all activities of the managers shall be on behalf of MHP and MHP retains the authority and legal responsibility for the operation of the facilities.

Specifically, during 2012, MHP entered into lease agreements with the long-term care facilities to lease the facilities managed by the respective managers. Concurrently, MHP entered into an agreement with the managers to manage the leased facilities. As part of the agreements, MHP will pay the managers a management fee to continue managing the facilities on behalf of MHP in accordance with the terms of the agreements. Rental, management, and other fees paid under these agreements approximated \$3,100,000 for 2012. The agreements expire at various times. All parties involved can terminate the agreement without cause with 90 days written notice.

Accounting principles generally accepted in the United States require that these consolidated financial statements present the Hospital and its significant component units, collectively referred to as the "primary government." The blended component units discussed below are included in the Hospital's reporting entity because of the significance of their operational or financial relationships with the Hospital. Blended component units, although legally separate entities, are in substance part of the primary government's operations and exist solely to provide services for the primary government; data from these units is consolidated with data of the primary government.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Blended Component Units

Major Hospital Foundation (the Foundation) is a blended component unit of the Hospital. The Foundation is a separate not-for-profit entity organized to support the operations of the Hospital.

MDSolutions, LLC is a blended component unit of the Hospital. Major Hospital owns a 95% interest and Major Affiliates, Inc. owns a 5% interest in MDSolutions, LLC, a management services organization for physicians.

Major Affiliates, Inc. is a blended component unit of the Hospital. The Hospital is the sole corporate member of Major Affiliates, Inc. Although it is legally separate from the Hospital, Major Affiliates, Inc. is reported as if it were a part of the Hospital because the two Governing Boards are substantially the same.

Major Affiliates includes Shelby Surgical Associates, LLC, (SSA) which was a physician surgical practice that was a wholly owned subsidiary of Major Affiliates. During 2011, SSA was dissolved. Major Affiliates' primary purpose is to further the mission of Major Hospital through recruiting physicians to the Shelbyville region and leasing office space to physicians.

Major Affiliates, Inc. also owns 100% of MedWorks, Inc., which operates a pharmacy located in Shelbyville, Indiana. MedWorks owns 100% of Major Multi Specialty Associates, LLC, Family Orthopedic and Rehabilitation Center, LLC, Priority Care, LLC, and Dr. Bala and Associates, LLC (Bala). MedWorks also owns 70% of Onsite Solutions, LLC. These practices provide health care services to the community. These entities have been consolidated for financial statement presentation. During 2011, the Hospital purchased a physician practice and subsequently organized a new LLC, Bala, as a subsidiary of MedWorks. Subsequent to December 31, 2012, Dr. Bala and Associates, LLC was renamed to Major Medical Associates, LLC.

The non-controlling interest of Onsite Solutions, LLC is not significant and is included in unrestricted net position for financial statement reporting purposes.

All significant intercompany transactions have been eliminated in the consolidated financial statements.

Use of Estimates

The preparation of 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 and disclosures 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. Actual results could differ from those estimates.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Enterprise Fund Accounting

MHP uses the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

During 2012, MHP adopted Statement of Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of GASB No. 20 for business-type activities to apply post November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on MHP's net position, changes in net position, cash flows or financial reporting disclosures.

Also during 2012, MHP adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This change resulted in renaming net assets to net position within the consolidated balance sheets and consolidated statements of revenues, expenses and changes in net position. This change also resulted in displaying a separate section for deferred outflows within the consolidated balance sheets. GASB No. 63 has been applied retroactively in the accompanying financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include deposits and investments in highly liquid debt instruments with an original maturity date of 90 days or less from the date of purchase. MHP maintains its cash in accounts, which at times, may exceed federally insured limits. MHP has not experienced any losses in such accounts. MHP believes it is not exposed to any significant credit risk on cash and cash equivalents.

Assets Whose Use is Limited

Assets whose use is limited are stated at fair market value in the consolidated financial statements. These assets include investments designated by the Hospital Board for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities, mutual funds, and corporate debt and equity securities. Investment interest, dividends, gains and losses, both realized and unrealized are included in nonoperating revenues (expenses) in the consolidated statements of revenues, expenses and changes in net position.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Nonparticipating certificates of deposit, demand deposits and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at contract value.

Patient Accounts Receivable and Patient Service Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. MHP is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). MHP is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG).

MHP is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At MHP's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

These programs have audited the year-end cost report filed with the Medicare program through December 31, 2007 with differences reflected as deductions from revenue in 2012. Amounts for unresolved cost reports for 2008 through 2012 are reflected in estimated third-party settlements on the consolidated balance sheets. MHP did not recognize any change in net position in 2012 and 2011, due to the differences between original estimates and subsequent revisions for the final settlement of cost reports.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges less an allowance for contractual adjustments and interim payment advances. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting MHP's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Grants and Contributions

MHP received grant funds from Shelby County and the City of Shelbyville, Indiana. Revenues from grants and contributions are recognized when all requirements are met. Grants may be restricted for either specific operation purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues.

Endowments

Endowments are provided to MHP through the Foundation on a voluntary basis by individuals and private organizations. Permanent endowments require that the principal or corpus of the endowment be retained in perpetuity. If a donor has not provided specific instructions, the Foundation's governing board is permitted to expend the net appreciation of the investments of endowment funds.

Charity Care

MHP provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy on a sliding scale on the basis of financial need. Because MHP does not pursue collection of approved charity care balances, the charges are not reflected in net revenue. Rather, charges approved for charity are posted to gross revenue and subsequently written off as a charity adjustment before the resulting net patient service revenue.

Of MHP's total expenses reported (approximately \$118,214,000 and \$93,477,000 during 2012 and 2011, respectively), an estimated \$2,631,000 and \$2,746,000 arose from providing services to charity patients during 2012 and 2011, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses divided by gross patient service revenue.

Inventory

Inventory is valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method. Inventory at year-end consists mainly of pharmaceuticals and medical supplies.

Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

MHP provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Leasehold improvements	15 years
Buildings and improvements	4-50 years
Equipment	5-15 years

Net Position

Net position of MHP is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net position is noncapital net assets that must be used for a particular purpose, as specified by creditors or donors outside MHP, including amounts deposited with trustees as required by revenue bond indentures and net position held by the Foundation. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets net of related debt or restricted net position.

Consolidated Statements of Revenues, Expenses and Changes in Net Position

MHP's consolidated statements of revenues, expenses and changes in net position distinguishes between operating and nonoperating revenues and expenses. For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as revenues and expenses. Peripheral or incidental transactions such as investment activities are reported as nonoperating gains or losses.

Consolidated Statements of Cash Flows

For the purposes of the consolidated statement of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

Costs of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No interest was capitalized during December 31, 2012 and 2011.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Bond Issue Costs

The Hospital provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs were approximately \$244,000 as of December 31, 2012 and 2011. Accumulated amortization as of December 31, 2012 and 2011 was approximately \$171,000 and \$122,000, respectively. Bond issue costs are recorded in other assets on the consolidated balance sheets. Annual amortization expense related to bond issue costs is approximately \$49,000.

Goodwill

During 2011, MHP acquired 100% of Dr. Bala and Associates through an asset purchase. The acquisition price was approximately \$1,500,000. MHP recorded goodwill of approximately \$1,100,000 related to this acquisition. The remainder of the acquisition price was allocated at fair value to patient accounts receivable, inventory, capital assets and identifiable intangibles. Goodwill is included within other assets on the consolidated balance sheets and is amortized over an estimated life of approximately 10 years. Annual amortization expense related to goodwill is approximately \$100,000.

Effective December 31, 2012, MHP acquired 100% of Westpark Rehabilitation Center through an asset purchase agreement. The acquisition price was \$7,000,000. MHP recorded goodwill of approximately \$2,750,000 related to this acquisition. The remainder of the acquisition price was allocated at fair value to capital assets. Goodwill is included within other assets on the consolidated balance sheets and is amortized over an estimated life of approximately 10 years. Annual amortization expense related to goodwill is approximately \$275,000.

Hedge Accounting

MHP follows the requirements of GASB No. 53, Accounting and Financial Reporting for Derivative Instruments. MHP is a party to interest rate swap agreements which are derivative instruments. The guidance requires governmental entities to evaluate each derivative instrument to determine whether the instrument is an effective hedge.

For those instruments deemed to be an effective hedge, governmental entities are required to practice hedge accounting and the instrument continues to be reevaluated at the end of each future reporting period. Under hedge accounting, the fair value of the instrument is recorded on the consolidated balance sheet with the offsetting entry to deferred outflows or deferred inflows, which also reported on the consolidated balance sheet.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

For those instruments deemed to be an ineffective hedge, governmental entities are required to practice investment accounting and the instruments are not evaluated in future reporting periods. Once deemed ineffective, the instrument is considered ineffective for the remainder of its term. Under investment accounting, the fair value of the instrument is recorded on the consolidated balance sheets with the offsetting entry posted to investment income.

MHP's interest rate swap agreements were determined to be effective hedges as of December 31, 2012 and 2011.

Income Taxes

The Hospital is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The Hospital is exempt from federal income tax under Section 115 of the Internal Revenue Code of 1986. As such, the Hospital is generally exempt from income taxes as a unit of local government. No income tax filings are required of the Hospital as it is a governmental instrumentality.

The blended component units of Major Hospital Foundation, Inc. and Major Affiliates, Inc. are tax-exempt organizations under Internal Revenue Code 501(c)(3). As such, the Foundation and Major Affiliates, Inc. are generally exempt from income taxes. However, the Foundation and Major Affiliates, Inc. are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

The blended component unit of MDSolutions is organized as a limited liability company, whereby net taxable income is taxed directly to the members and not MDSolutions. Thus, the financial statements do not include any provision for Federal or State income taxes. MDSolutions has filed its federal and state income tax returns for periods through December 31, 2011. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

MedWorks, Inc. is a corporation subject to Federal and state income taxes. Income taxes for these entities are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes. However, the effects of recording a deferred tax provision have been deemed immaterial and have not been recorded in the accompanying consolidated financial statements.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The remaining consolidated subsidiaries of Major Affiliates, Inc. and MedWorks, Inc. are organized as limited liability companies, whereby net taxable income is taxed directly to the members of the limited liability companies. Thus, the consolidated financial statements do not include any provision for Federal or State income taxes related to these entities.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by MHP (and their affiliates) and recognize a tax liability if MHP 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 MHP and has concluded that as of December 31, 2012 and 2011, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. MHP is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

These entities have filed their federal and state income tax returns for periods through December 31, 2011. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

Compensated Absences

MHP's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 372 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheet.

Advertising

MHP's policy is to expense advertising costs when the advertising first takes place. Advertising expense was \$270,000 and \$209,000 for 2012 and 2011, respectively.

Electronic Health Records (EHR) Incentive Payments

MHP receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, MHP must meet "meaningful use" criteria that become more stringent over time. MHP 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 30th).

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in MHP'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.

MHP recognizes EHR incentives as revenue when there is reasonable assurance that MHP will comply with the conditions of the meaningful use objectives and any other specific contract requirements. In addition, the financial statement effects of the revenue must be both recognizable and measurable. During 2012 and 2011, MHP recognized approximately \$900,000 and \$1,800,000 respectively, in EHR incentive payments as other revenue using the ratable recognition method. Under the ratable recognition method, MHP recognizes revenue ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

EHR incentive revenue is included in other revenue in the consolidated statement of revenues, expenses and changes in net position. 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 MHP as prescribed by the programs, subject to future audits and may be subject to repayment upon a determination of noncompliance.

Litigation

MHP is involved in litigation arising in the normal course of business. After consultation with MHP's legal counsel, management estimates that these matters will be resolved without material adverse effect on MHP's future financial position, results from operations, and cash flows.

Risk Management

MHP is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified for comparative purposes to conform to the current year presentation. The reclassifications had no effect on the previously reported consolidated net position and consolidated change in net position.

Subsequent Events

MHP evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is April 25, 2013.

2. NET PATIENT SERVICE REVENUE

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

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment Hospital). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment with the exception of a few select items, such as bad debts. MHP's classification of patients under the Prospective Payment Hospital and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with MHP to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid

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

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

MHP is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. MHP recognized reimbursement from these programs within net patient revenue of approximately \$2,200,000 and \$2,300,000 for 2012 and 2011, respectively. These programs are Federal programs administered by the State of Indiana.

During 2012, the Hospital Assessment Fee (HAF) Program for the period July 1, 2011 through June 30, 2013 was approved by Centers for Medicare & Medicaid Services retroactive to July 1, 2011. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana hospitals as reflected in the HAF Program expense reported in the consolidated statements of revenues, expenses and changes in net position. 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 2012, MHP recognized HAF Program expense of approximately \$3,700,000 which resulted in Medicaid rate increases of approximately \$8,300,000.

Other Payors

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

The following is a summary of net patient service revenue for 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Patient service revenue		
Inpatient	\$ 75,980,999	\$ 57,092,417
Outpatient	<u>190,719,886</u>	<u>174,329,084</u>
Gross patient service revenue	266,700,885	231,421,501
Deductions from revenue		
Contractual allowances	127,953,109	123,198,681
Charity care	5,935,132	6,799,007
Bad debts	<u>10,816,480</u>	<u>8,164,078</u>
Total deductions from revenue	<u>144,704,721</u>	<u>138,161,766</u>
Net patient service revenue	<u>\$ 121,996,164</u>	<u>\$ 93,259,735</u>

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

3. ASSETS WHOSE USE IS LIMITED

The classification "Assets whose use is limited" includes:

Internally designated – Amounts transferred by MHP's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to MHP buildings as authorized by IC 16-22-3-13.

Restricted – Amounts designated by outside parties for other specific purposes. Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets.

The composition of assets whose use is limited includes the following as of December 31:

	2012	2011
Internally designated		
Cash and cash equivalents	\$ 4,244,171	\$ 5,030,076
Certificates of deposit	1,000,000	50,000
US Government securities	23,600,342	21,008,355
Mutual funds	29,626,183	24,439,341
Corporate equity securities	1,662,005	1,451,989
Corporate debt securities	252,293	242,570
Total internally designated	60,384,994	52,222,331
Donor restricted		
Cash and cash equivalents	27,526	28,693
US Government securities	51,964	64,540
Mutual funds	368,078	326,188
Corporate equity securities	419,893	368,401
Corporate debt securities	176,743	162,183
Total donor restricted	1,044,204	950,005
Total assets whose use is limited	<u>\$ 61,429,198</u>	<u>\$ 53,172,336</u>

The corporate debt and equity securities are owned by the Foundation.

4. DEPOSITS AND INVESTMENTS

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Investments are carried at fair market value except for certificates of deposit and money market funds which are carried at contract value. Net realized gains and losses on security transactions are determined on the specific identification cost basis.

MHP's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2012 and 2011, MHP had the following investments and maturities, all of which were held in MHP's name by custodial banks that are agents of MHP:

December 31, 2012					
Investment Maturities (in years)					
	Carrying Amount	Less than 1	1-5	6-10	More than 10
US Government securities	\$ 23,652,306	\$ -0-	\$ 15,157,583	\$ 6,048,807	\$ 2,445,916
Certificates of deposit	1,000,000	1,000,000.00	-0-	-0-	-0-
Mutual funds	29,994,261	29,994,261	-0-	-0-	-0-
Corporate equity securities	2,081,898	2,081,898	-0-	-0-	-0-
Corporate debt securities	429,036	18,025.00	174,416	102,614	133,981
	<u>\$ 57,157,501</u>	<u>\$ 33,094,184</u>	<u>\$ 15,331,999</u>	<u>\$ 6,151,421</u>	<u>\$ 2,579,897</u>

December 31, 2011					
Investment Maturities (in years)					
	Carrying Amount	Less than 1	1-5	6-10	More than 10
US Government securities	\$ 21,072,895	\$ 56,605	\$ 12,140,790	\$ 5,385,269	\$ 3,490,231
Certificates of deposit	50,000	50,000	-0-	-0-	-0-
Mutual funds	24,765,529	24,765,529	-0-	-0-	-0-
Corporate equity securities	1,820,390	1,820,390	-0-	-0-	-0-
Corporate debt securities	404,753	61,696	211,111	113,313	18,633
	<u>\$ 48,113,567</u>	<u>\$ 26,754,220</u>	<u>\$ 12,351,901</u>	<u>\$ 5,498,582</u>	<u>\$ 3,508,864</u>

Interest rate risk - MHP does have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk - Statutes authorize MHP to invest in interest bearing deposit accounts, passbook savings accounts, certificates of deposit, money market accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by US Government or US Government Agency obligations.

Concentration of credit risk - MHP maintains its investments, which at times may exceed federally insured limits. MHP has not experienced any losses in such accounts. MHP believes that it is not exposed to any significant credit risk on investments.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Deposits and investments consist of the following as of December 31, 2012 and 2011:

	2012	2011
Carrying amount		
Deposits	\$ 14,588,075	\$ 16,694,013
Investments	57,157,501	48,113,567
	<u>\$ 71,745,576</u>	<u>\$ 64,807,580</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 10,316,378	\$ 11,635,244
Internally designated	60,384,994	52,222,331
Restricted funds	1,044,204	950,005
	<u>\$ 71,745,576</u>	<u>\$ 64,807,580</u>

5. FAIR VALUE MEASUREMENTS

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

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

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2012 and 2011.

- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by MHP 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 and to transact at that price. The mutual funds held by MHP in the deferred compensation plan are deemed to be actively traded.
- *Corporate equity securities*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Corporate debt securities*: 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.
- *U.S. government securities*: Valued using pricing models maximizing the use of observable inputs for similar securities.
- *Interest rate swap agreements*: Valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap.

MHP's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels during 2012 and 2011.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The following table sets forth by level, within the hierarchy, MHP's assets and liabilities measured at fair value on a recurring basis as of December 31, 2012.

	December 31, 2012			
	Total	Level 1	Level 2	Level 3
Assets				
Assets whose use is limited				
US Government securities				
US treasury notes	\$ 18,401,908	\$ 18,401,908	\$ -0-	\$ -0-
Federal home loan bank	2,223,005	-0-	2,223,005	-0-
Mortgage backed securities	3,027,393	-0-	3,027,393	-0-
Total US Government securities	23,652,306	18,401,908	5,250,398	-0-
Mutual funds				
Fixed income	14,051,654	14,051,654	-0-	-0-
Large cap blended	7,215,402	7,215,402	-0-	-0-
Small cap blended	1,543,876	1,543,876	-0-	-0-
Large cap value	1,493,722	1,493,722	-0-	-0-
Mid cap blended	1,224,674	1,224,674	-0-	-0-
Other	4,464,933	4,464,933	-0-	-0-
Total mutual funds	29,994,261	29,994,261	-0-	-0-
Corporate equity securities				
Large cap growth	637,139	637,139	-0-	-0-
Large cap core	425,796	425,796	-0-	-0-
Large cap value	321,083	321,083	-0-	-0-
Other	697,880	697,880	-0-	-0-
Total corporate equity securities	2,081,898	2,081,898	-0-	-0-
Corporate debt securities				
Financial services	144,155	-0-	144,155	-0-
Other	284,881	-0-	284,881	-0-
Total corporate debt securities	429,036	-0-	429,036	-0-
	56,157,501	\$ 50,478,067	\$ 5,679,434	\$ -0-
Cash and equivalents	4,271,697			
Certificates of deposit	1,000,000			
Total assets whose use is limited	\$ 61,429,198			
Liabilities				
Derivative	\$ 387,726	\$ -0-	\$ 387,726	\$ -0-

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The following table sets forth by level, within the hierarchy, MedWorks' assets and liabilities measured at fair value on a recurring basis as of December 31, 2011.

	December 31, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Assets whose use is limited				
US Government securities				
US treasury notes	\$ 9,264,888	\$ 9,264,888	\$ -0-	\$ -0-
FNMA	5,281,847	-0-	5,281,847	-0-
Federal home loan bank	2,274,185	-0-	2,274,185	-0-
Mortgage pass through pools	4,251,975	-0-	4,251,975	-0-
Total US Government securities	21,072,895	9,264,888	11,808,007	-0-
Mutual funds				
Large cap blended	9,102,874	9,102,874	-0-	-0-
Fixed income	5,859,149	5,859,149	-0-	-0-
Small cap blended	1,443,966	1,443,966	-0-	-0-
Large cap value	1,304,615	1,304,615	-0-	-0-
Large cap growth	1,149,765	1,149,765	-0-	-0-
Mid cap blended	1,107,396	1,107,396	-0-	-0-
Other	4,797,764	4,797,764	-0-	-0-
Total mutual funds	24,765,529	24,765,529	-0-	-0-
Corporate equity securities				
Large cap growth	553,404	553,404	-0-	-0-
Large cap core	360,647	360,647	-0-	-0-
Large cap value	290,639	290,639	-0-	-0-
Small cap value	615,700	615,700	-0-	-0-
Total corporate equity securities	1,820,390	1,820,390	-0-	-0-
Corporate debt securities				
Financial services	150,317	-0-	150,317	-0-
Technology	60,948	-0-	60,948	-0-
Industrial	193,488	-0-	193,488	-0-
Total corporate debt securities	404,753	-0-	404,753	-0-
	48,063,567	\$ 35,850,807	\$ 12,212,760	\$ -0-
Cash and equivalents	5,058,769			
Certificates of deposit	50,000			
Total assets whose use is limited	\$ 53,172,336			
Liabilities				
Derivative	\$ 551,660	\$ -0-	\$ 551,660	\$ -0-

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The following methods and assumptions were used by MHP 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: The carrying value of MHP's variable rate revenue bonds approximates fair value based upon current traded value. The carrying value of loans payable and capital lease obligations approximates fair value based on current fixed rates available to similar entities with similar credit ratings.

6. ENDOWMENT – RESTRICTED NON-EXPENDABLE NET POSITION

MHP, through the Foundation, has restricted non-expendable net position. Unless a contributor provides specific instructions, the Foundation's governing board is permitted to expend the net appreciation (realized and unrealized) of the investments in its endowments. When administering its power to spend net appreciation, the governing board is required to consider the Foundation's and supported organization's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation that is spent is required to be spent for the purposes designated by the contributor. The Foundation's governing board chooses to spend the investment income (including changes in the value of investments) under the established investment policy.

Restricted non-expendable net position as of December 31, 2012 and 2011, represent the principal amounts of permanent endowments, restricted to investment in perpetuity. Investment earnings from the Foundation's permanent endowments are expendable to support the programs as established by the contributors.

The following is a summary of the restricted non-expendable net position as of December 31, 2012 and 2011:

	2012	2011
Compton Endowment	\$ 521,714	\$ 521,714
McFadden Endowment	333,133	333,133
	<u>\$ 854,847</u>	<u>\$ 854,847</u>

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

7. CAPITAL ASSETS

Capital Assets, Net

A summary of property and equipment, including assets under capital leases for 2012 and 2011 follows:

	December 31, 2011	Additions	Disposals	Transfers	December 31, 2012
Land and land improvements	\$ 8,290,857	\$ 3,045,338	\$ (7,469)	\$ -0-	\$ 11,328,726
Leasehold improvements	2,086,265	236,288	-0-	-0-	2,322,553
Buildings and improvements	48,490,047	801,086	(17,501)	461,793	49,735,425
Equipment	34,956,167	2,816,633	(1,032,959)	-0-	36,739,841
Construction in progress	292,231	425,525	-0-	(461,793)	255,963
Total property and equipment	94,115,567	7,324,870	(1,057,929)	-0-	100,382,508
Less accumulated depreciation					
Land improvements	1,451,285	257,924	(7,082)	-0-	1,702,127
Leasehold improvements	676,728	132,724	(390)	-0-	809,062
Buildings and improvements	24,315,287	1,747,899	(17,284)	-0-	26,045,902
Equipment	24,942,006	2,907,049	(994,827)	-0-	26,854,228
Total accumulated depreciation	51,385,306	5,045,596	(1,019,583)	-0-	55,411,319
Capital assets, net	<u>\$ 42,730,261</u>	<u>\$ 2,279,274</u>	<u>\$ (38,346)</u>	<u>\$ -0-</u>	<u>\$ 44,971,189</u>
	December 31, 2010	Additions	Disposals	Transfers	December 31, 2011
Land and land improvements	\$ 7,447,161	\$ 8,719	\$ -0-	\$ 834,977	\$ 8,290,857
Leasehold improvements	2,072,785	1,682	11,798	-0-	2,086,265
Buildings and improvements	48,311,303	159,522	(6,601)	25,823	48,490,047
Equipment	32,587,263	2,668,129	(743,770)	444,545	34,956,167
Construction in progress	777,983	819,593	-0-	(1,305,345)	292,231
Total property and equipment	91,196,495	3,657,645	(738,573)	-0-	94,115,567
Less accumulated depreciation					
Land improvements	1,200,107	250,477	701	-0-	1,451,285
Leasehold improvements	548,120	125,088	3,520	-0-	676,728
Buildings and improvements	22,671,371	1,776,516	(132,600)	-0-	24,315,287
Equipment	22,354,914	2,970,601	(383,509)	-0-	24,942,006
Total accumulated depreciation	46,774,512	5,122,682	(511,888)	-0-	51,385,306
Capital assets, net	<u>\$ 44,421,983</u>	<u>\$ (1,465,037)</u>	<u>\$ (226,685)</u>	<u>\$ -0-</u>	<u>\$ 42,730,261</u>

Assets under Capital Leases

The assets acquired through capital leases still in effect are as follows:

	2012	2011
Equipment	\$ 309,061	\$ 309,061
Less accumulated depreciation	273,656	206,879
	<u>\$ 35,405</u>	<u>\$ 102,182</u>

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Property Held for Sale

MHP currently holds approximately 41 acres of land available for sale. The land is located in the Intelliplex Park where the Hospital's Cancer Center is located. The land is valued at cost plus improvements and will be sold in lots in varying size.

8. LONG TERM DEBT

A summary of long term debt as of December 31, 2012 is as follows:

- Indiana Finance Authority Hospital Revenue Bonds, Series 2009 for \$30,000,000 were issued during 2009. The Series 2009 Bonds are variable interest rate and mature June 1, 2029. On June 23, 2009, the Hospital, the Indiana Finance Authority (Authority) and Regions Bank (Bank) entered into a Bond Purchase Agreement (Agreement) whereby the Bank purchased from the Authority all of the Series 2009 Bonds in a private placement. The Agreement provides that the Bank will hold the Series 2009 Bonds during the Initial Monthly Mode Period which runs through July 2014. During this Initial Monthly Mode Period, the Series 2009 Bonds bear interest at the lesser of 12% per annum or a rate of 59.5% of one month LIBOR plus 1.73% (rate as of December 31, 2012 – 1.86%). At the end of the Initial Monthly Mode Period, the Series 2009 Bonds may be converted to another interest rate mode and remarketed to another bondholder or holders or renewed for another Monthly Mode Period with the Bank. The Series 2009 Bonds could be converted to another interest rate mode to accommodate market conditions at that time. If the Series 2009 Bonds cannot be remarketed at the end of the Initial Monthly Mode Period, the Hospital would be subject to payment of the remaining principal of \$27,401,000 at the end of the Initial Monthly Mode Period. The Series 2009 Bonds are secured ultimately by the gross revenues of the Hospital.
 - The capital lease obligation with interest of 4.5% executed for property and equipment is due in monthly installments of \$1,881 including interest, due August 2014.
 - Loans payable with an original amount of \$2,300,000 with local financial institutions, due in monthly installments of approximately \$13,000 including interest with a balloon payment in 2016 at an interest rate of LIBOR plus 300 basis points as of December 31, 2012 (3.17%), secured by certain assets of a subsidiary with a net book value of approximately \$2,000,000 as of December 31, 2012.
 - Loans payable with an original amount of \$628,000 with a local financial institution is due in monthly installments of \$5,900 through 2022 at an interest rate of 7.7% and is unsecured.
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MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The revenue bonds require the Hospital to maintain certain financial ratios. As of December 31, 2012, the Hospital was in compliance with the financial ratios.

The following represents a progression for long term debt for 2012 and 2011:

	December 31, 2011	Additional Borrowings	Payments	December 31, 2012	Current Portion
Revenue bonds					
2009 Bonds	\$ 28,189,000	\$ -0-	\$ (788,000)	\$ 27,401,000	\$ 822,000
Loans payable					
Capital lease obligations	99,340	-0-	(63,149)	36,191	21,383
Loans payable	2,105,323	-0-	(149,966)	1,955,357	152,671
Total long term debt	<u>\$ 30,393,663</u>	<u>\$ -0-</u>	<u>\$ (1,001,115)</u>	<u>\$ 29,392,548</u>	<u>\$ 996,054</u>
	December 31, 2010	Additional Borrowings	Payments	December 31, 2011	Current Portion
Revenue bonds					
2009 Bonds	\$ 28,947,000	\$ -0-	\$ (758,000)	\$ 28,189,000	\$ 788,000
Loans payable					
Capital lease obligations	189,542	-0-	(90,202)	99,340	63,148
Loans payable	2,252,783	-0-	(147,460)	2,105,323	118,392
Total long term debt	<u>\$ 31,389,325</u>	<u>\$ -0-</u>	<u>\$ (995,662)</u>	<u>\$ 30,393,663</u>	<u>\$ 969,540</u>

Scheduled principal and interest repayments on long term debt and payments on capital lease obligations for the years succeeding December 31, 2012 are as follows:

Years Ending December 31,	Principal	Interest	Interest Rate Swaps, Net	Total Payments
2013	\$ 996,054	\$ 574,083	\$ 302,040	\$ 1,872,177
2014	26,749,401	77,190	302,040	27,128,631
2015	158,747	70,346	-0-	229,093
2016	1,192,845	31,341	-0-	1,224,186
2017	49,779	24,861	-0-	74,640
2018 - 2022	245,722	62,953	-0-	308,675
	<u>\$ 29,392,548</u>	<u>\$ 840,774</u>	<u>\$ 604,080</u>	<u>\$ 30,837,402</u>

The interest rate swap agreements do not affect the obligation of MHP under the indenture to repay principal and interest on the Series 2009 Bonds. However, during the term of the swap agreements, MHP effectively pays a fixed rate on a portion of the debt. A portion of the debt service requirements to maturity for the Series 2009 Bonds are based on that fixed rate. MHP will be exposed to variable rates if the counterparty to the swaps defaults or the swap agreements are terminated. A termination of the swap agreements may also result in MHP making or receiving a termination payment.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

As of December 31, 2012, the variable rate on the Series 2009 Bonds was lower than the swap agreements fixed rates. See the footnote on Derivative Instruments – Interest Rate Swaps for additional information.

9. DERIVATIVE INSTRUMENTS – INTEREST RATE SWAPS

Contracts

MHP has three interest rate swap agreements in effect as of December 31, 2012 for the Indiana Finance Authority Hospital Revenue Bonds, Series 2009.

Objectives and Strategies for Using Derivatives

As a means to manage the risk associated with interest rate risk on its variable rate debt, MHP entered into interest rate swaps agreements in connection with its Indiana Finance Authority Hospital Revenue Bonds, Series 2009. The intention of the swap agreements was to effectively change MHP's variable interest rate on the Series 2009 bonds to fixed rates ranging from 2.98% to 3.54%.

Terms, Fair Values and Credit Risk

The swap agreements relate to the Series 2009 bond with notional amounts totaling \$16,000,000. The counter party is the same for each swap agreements. The terms and fair values of the outstanding swaps as of December 31, 2012 are as follows:

<u>Notional Amount</u>	<u>Effective Date</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fair Value</u>	<u>Termination Date</u>
\$ 10,000,000	8/19/2009	3.540%	1.857%	\$ (265,262)	7/1/2014
\$ 3,000,000	10/2/2009	3.335%	1.857%	(69,746)	7/1/2014
\$ 3,000,000	7/1/2010	2.980%	1.857%	(52,718)	7/1/2014
				<u>\$ (387,726)</u>	

As of December 31, 2012, the negative fair values of the agreements may be countered by reductions in total interest payments under the swap agreements should the variable rate on the 2009 Series bonds increase. The variable rate on the swaps is 59.50% of the USD-LIBOR BBA plus 1.73% and resets monthly.

The counterparty carries a guarantee by an entity ("counterparty guarantor") rated Ba2 by Moody's Investors Service (Moody's), BBB- by Standard and Poor's (S&P), and BBB by Fitch Ratings (Fitch). To mitigate the potential for credit risk, the fair value of the swap must be collateralized based on a schedule of the counterparty guarantor credit ratings classifications and exposure thresholds as provided in the agreements.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Basis Risk

The swap and the bonds interest rates are both pegged to USD-LIBOR-BBA index; therefore, basis risk relating to the swap is minimal.

Termination Risk

MHP or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If at the time of termination the swap has a negative fair value, MHP would be liable to the counterparty for a payment equal to the swaps' fair values.

Swap Payments and Associated Debt

Using rates as of December 31, 2012, debt service requirements of the variable rate debt and net swap payments of the Series 2009 bonds, assuming current interest rates remain the same for the term of the bonds are disclosed in the Long Term Debt note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

MHP has determined the swaps to be effective hedges. Accordingly, the fair value of the swaps has been recorded and subsequent changes in fair value will be recorded only in the consolidated balance sheets while the swaps remain effective hedges. Following is an analysis of the recording of the interest rate swap agreements:

	2012	2011
Deferred outflow	<u>\$ 387,726</u>	<u>\$ 551,660</u>
Liability		
Interest rate swap agreements	<u>\$ 387,726</u>	<u>\$ 551,660</u>

See Fair Value Measurements note for additional information.

10. PENSION PLAN

Plan Description

MHP has a defined contribution pension plan as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. The report is available by contacting MHP's accounting department.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Funding Policy

The contribution requirements of plan members are established by the written agreement between MHP's Board of Trustees and the plan administrator. The current employer contribution rate is 7% of annual covered payroll. Employer contributions to the plan for 2012 and 2011 were approximately \$1,897,000 and \$1,743,000, respectively. Employees are not permitted to contribute to the plan.

11. CONCENTRATIONS OF CREDIT RISK

MHP is located in Shelbyville, Indiana. MHP grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. Concentrations of accounts receivable and gross revenue from patients and third party payors are as follows as of December 31:

	Receivables		Revenues	
	2012	2011	2012	2011
Medicare	30%	29%	41%	42%
Medicaid	8%	8%	15%	15%
Anthem	15%	14%	15%	16%
Other third party payors	28%	30%	21%	19%
Self-pay	19%	19%	8%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

12. ESTIMATED MALPRACTICE COSTS

The Indiana Medical Malpractice Act, IC 27-12 (the Act), provides a recovery for an occurrence of malpractice and for any injury or death of a patient due to an act of malpractice in excess of certain thresholds. The Act provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) with the first \$250,000 covered by MHP's insurance and the remainder by the State of Indiana Patient Compensation Fund. The Act requires MHP to maintain medical malpractice liability insurance on a per occurrence basis and in the annual aggregate for amounts below the thresholds of the Act. Management is not aware of any related material adverse effects to its financial position, results from operations, and cash flows.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

13. RISK MANAGEMENT

Medical Benefits to Employees and Dependents

MHP is self-funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$175,000 per year. Provisions are also made for unexpected and unusual claims. Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Self-funded health insurance and related expenses were approximately \$6,939,000 and \$6,147,000 in 2012 and 2011, respectively. A progression of unpaid claims for 2012 and 2011 follows:

	2012	2011
Unpaid claims, beginning of year	\$ 760,000	\$ 600,000
Incurred claims and changes in estimates	6,939,344	6,147,366
Claim payments	(6,639,344)	(5,987,366)
Unpaid claims, end of year	<u>\$1,060,000</u>	<u>\$ 760,000</u>

14. RENTAL EXPENSE

MHP has leases expiring at various times through 2015. Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operating as incurred. The majority of the leases are cancellable. Total rent expense for 2012 and 2011 was approximately \$1,680,000 and \$1,488,700, respectively.

15. COMMITMENTS AND CONTINGENCIES

The Shelby County Council and City of Shelbyville Common Council each passed an ordinance pledging a portion of their share of economic development income tax (EDIT) for the purpose of land acquisition, construction and installation of public infrastructure improvements at the Shelbyville/Shelby County Advanced Technological Industrial Park. Shelby County, the City of Shelbyville, and Major Hospital (a component unit of the City of Shelbyville) share administrative and financial responsibility for this project.

The County and City have each pledged \$125,000 each calendar year through 2028 (or such earlier date as all outstanding bonds issued to finance or refinance the projects are defeased). The Hospital recognizes the amounts as revenue when received.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

A schedule of expected payments is as follows:

Years Ending December 31,	
2013	\$ 250,000
2014	250,000
2015	250,000
2016	250,000
2017	250,000
Thereafter	2,750,000
	<u>\$ 4,000,000</u>

16. BLENDED COMPONENT UNITS

MHP's consolidated financial statements include the accounts of its blended component units. Below is condensed financial information of the material blended component units. All significant related party transactions have been eliminated from the consolidated financial statements.

	Foundation	
	2012	2011
Assets and deferred outflows		
Current assets	\$ 253,823	\$ 110,995
Capital assets	5,049	8,638
Other assets	4,150,110	3,734,379
Total assets and deferred outflows	<u>\$ 4,408,982</u>	<u>\$ 3,854,012</u>
Liabilities		
Long-term debt	\$ -0-	\$ -0-
Other liabilities	20,215	15,658
Total liabilities	<u>20,215</u>	<u>15,658</u>
Net position		
Net investment in capital assets	5,049	8,638
Restricted	1,044,204	950,005
Unrestricted	3,339,514	2,879,711
Total net position	<u>4,388,767</u>	<u>3,838,354</u>
Total liabilities and net position	<u>\$ 4,408,982</u>	<u>\$ 3,854,012</u>
Revenues		
Contributions and other	\$ 585,942	\$ 489,810
Investment income (loss)	443,668	(16,418)
Total revenues	<u>1,029,610</u>	<u>473,392</u>
Expenses		
Depreciation	3,589	6,362
Other expenses	475,608	540,229
Total expenses	<u>479,197</u>	<u>546,591</u>
Change in net position	550,413	(73,199)
Net position, beginning of year	3,838,354	3,911,553
Net position, end of year	<u>\$ 4,388,767</u>	<u>\$ 3,838,354</u>

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Major Affiliates, Inc.		
	2012	2011
Assets and deferred outflows		
Current assets	\$ 3,462,942	\$ 3,710,125
Capital assets	10,111,370	10,789,439
Other assets	1,096,080	481,373
Total assets and deferred outflows	<u>\$ 14,670,392</u>	<u>\$ 14,980,937</u>
Liabilities		
Long-term debt	\$ 2,706,371	\$ 3,218,929
Other liabilities	4,060,982	3,153,857
Total liabilities	<u>6,767,353</u>	<u>6,372,786</u>
Net position		
Net investment in capital assets	6,892,442	7,085,532
Unrestricted	1,010,597	1,522,619
Total net position	<u>7,903,039</u>	<u>8,608,151</u>
Total liabilities and net position	<u>\$ 14,670,392</u>	<u>\$ 14,980,937</u>
Operating revenues (patient and other)	\$ 16,983,496	\$ 16,165,138
Expenses		
Depreciation	875,864	869,442
Other expenses	23,492,252	21,274,370
Total expenses	<u>24,368,116</u>	<u>22,143,812</u>
Operating income	(7,384,620)	(5,978,674)
Nonoperating revenues, net	(196,450)	(292,130)
Transfers to	<u>6,875,958</u>	<u>7,240,022</u>
Change in net position	(705,112)	969,218
Net position, beginning of year	8,608,151	7,638,933
Net position, end of year	<u>\$ 7,903,039</u>	<u>\$ 8,608,151</u>

The individual cash flows of the above entities are not significant to the overall consolidated financial statements.

17. SUBSEQUENT EVENTS

Long-Term Facilities

Subsequent to December 31, 2012, MHP entered into multiple agreements with distinct lessor entities to lease long-term care facilities operated by related management companies. Additionally, MHP entered into agreements with the related management companies to manage the leased long-term care facilities. As part of the agreements, MHP will pay the management companies a fee to continue managing the long-term care facilities on behalf of MHP in accordance with the terms of the agreements. While the leases are in effect, the performance of all activities of the management companies shall be on behalf of MHP. Furthermore, MHP retains ultimate authority and legal responsibility for the operation and control of the long-term care facilities.

MAJOR HEALTH PARTNERS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Under these agreements, all gross patient revenues from the operation of the long-term care facilities will be the property of MHP and MHP shall be responsible for all operating expenses and working capital requirements. The agreements expire at various times and all parties involved can terminate the agreement without cause with written notice.

Joint Venture

MedWorks and Franciscan Alliance, Inc. d/b/a Franciscan St. Francis Health have formalized a joint venture arrangement to start a new physician medical practice known as Major Medical Group effective April 1, 2013. MedWorks is the majority owner with 60% ownership.

SUPPLEMENTARY INFORMATION

MAJOR HEALTH PARTNERS

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2012

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
ASSETS AND DEFERRED OUTFLOWS						
Current assets						
Cash and cash equivalents	\$ 7,930,082	\$ 2,129,115	\$ -0-	\$ 257,181	\$ -0-	\$ 10,316,378
Patient accounts receivable, net	10,495,565	1,100,379	-0-	-0-	-0-	11,595,944
Inventory and other current assets	7,394,753	722,591	253,823	195,094	(1,303,060)	7,263,201
Current portion of assets whose use is limited	822,000	-0-	-0-	-0-	-0-	822,000
Total current assets	26,642,400	3,952,085	253,823	452,275	(1,303,060)	29,997,523
Assets whose use is limited						
Internally designated	57,279,088	-0-	3,105,906	-0-	-0-	60,384,994
Donor restricted funds	-0-	-0-	1,044,204	-0-	-0-	1,044,204
Total assets whose use is limited	57,279,088	-0-	4,150,110	-0-	-0-	61,429,198
Less current portion	822,000	-0-	-0-	-0-	-0-	822,000
Noncurrent assets whose use is limited	56,457,088	-0-	4,150,110	-0-	-0-	60,607,198
Capital assets, net	32,643,939	10,111,370	5,049	2,210,831	-0-	44,971,189
Property held for sale	4,576,627	-0-	-0-	-0-	-0-	4,576,627
Other assets	7,381,954	606,937	-0-	(13,726)	(2,563,857)	5,411,308
Total assets	127,702,008	14,670,392	4,408,982	2,649,380	(3,866,917)	145,563,845
Deferred outflows - interest rate swaps	387,726	-0-	-0-	-0-	-0-	387,726
Total assets and deferred outflows	<u>\$ 128,089,734</u>	<u>\$ 14,670,392</u>	<u>\$ 4,408,982</u>	<u>\$ 2,649,380</u>	<u>\$ (3,866,917)</u>	<u>\$ 145,951,571</u>

See report of independent auditors on pages 1 and 2.

MAJOR HEALTH PARTNERS

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2012

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
LIABILITIES AND NET POSITION						
Current liabilities						
Accounts payable and accrued expenses	\$ 3,632,390	\$ 956,454	\$ 17,314	\$ 572,702	\$ (827,122)	\$ 4,351,738
Accrued wages and related liabilities	6,748,809	1,993,931	2,901	301,287	-0-	9,046,928
Estimated third-party settlements	4,100,000	-0-	-0-	-0-	-0-	4,100,000
Current portion of long-term debt						
Loans payable and capital leases	21,383	36,619	-0-	116,052	-0-	174,054
Revenue bonds payable	822,000	-0-	-0-	-0-	-0-	822,000
Intercompany notes payable	-0-	475,938	-0-	-0-	(475,938)	-0-
Total current liabilities	15,324,582	3,462,942	20,215	990,041	(1,303,060)	18,494,720
Derivative liability	387,726	-0-	-0-	-0-	-0-	387,726
Other liabilities	733,767	598,040	-0-	-0-	-0-	1,331,807
Long term debt, net of current portion						
Loans payable and capital leases	14,808	423,838	-0-	1,378,848	-0-	1,817,494
Revenue bonds payable	26,579,000	-0-	-0-	-0-	-0-	26,579,000
Intercompany notes payable	-0-	2,282,533	-0-	-0-	(2,282,533)	-0-
Total long term debt	26,593,808	2,706,371	-0-	1,378,848	(2,282,533)	28,396,494
Total liabilities	43,039,883	6,767,353	20,215	2,368,889	(3,585,593)	48,610,747
Net position						
Net investment in capital assets	5,206,748	6,892,442	5,049	715,931	2,758,471	15,578,641
Restricted						
Expendable - other specific purpose	-0-	-0-	189,357	-0-	-0-	189,357
Nonexpendable	-0-	-0-	854,847	-0-	-0-	854,847
Unrestricted	79,843,103	1,010,597	3,339,514	(435,440)	(3,039,795)	80,717,979
Total net position	85,049,851	7,903,039	4,388,767	280,491	(281,324)	97,340,824
Total liabilities and net position	\$ 128,089,734	\$ 14,670,392	\$ 4,408,982	\$ 2,649,380	\$ (3,866,917)	\$ 145,951,571

See report of independent auditors on pages 1 and 2.

MAJOR HEALTH PARTNERS

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEAR ENDED DECEMBER 31, 2012

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
Revenue						
Net patient service revenue	\$ 105,713,055	\$ 16,408,827	\$ -0-	\$ -0-	\$ (125,718)	\$ 121,996,164
Other	2,129,112	574,669	585,942	1,246,702	(1,942,395)	2,594,030
Total revenue	107,842,167	16,983,496	585,942	1,246,702	(2,068,113)	124,590,194
Expenses						
Salaries and wages	31,468,799	12,902,595	73,288	275,744	-0-	44,720,426
Employee benefits	9,751,318	3,115,295	5,496	128,220	-0-	13,000,329
Medical professional fees	5,007,124	-0-	-0-	-0-	-0-	5,007,124
Supplies	11,807,932	3,692,030	-0-	15,680	-0-	15,515,642
Purchased services	18,938,534	2,183,542	-0-	264,837	(1,385,359)	20,001,554
Equipment rental and maintenance	5,657,948	531,881	-0-	229,952	(499,445)	5,920,336
Utilities	1,114,842	388,394	-0-	23,908	-0-	1,527,144
Insurance	306,380	346,660	-0-	695	-0-	653,735
Depreciation and amortization	4,288,635	875,864	3,589	69,538	8,090	5,245,716
Hospital assessment fee	3,740,876	-0-	-0-	-0-	-0-	3,740,876
Other expenses	2,126,673	331,855	396,824	216,847	(191,399)	2,880,800
Total expenses	94,209,061	24,368,116	479,197	1,225,421	(2,068,113)	118,213,682
Operating income (loss)	13,633,106	(7,384,620)	106,745	21,281	-0-	6,376,512
Nonoperating revenues (expenses)						
Investment income	3,339,167	-0-	443,668	-0-	(161,659)	3,621,176
Interest expense	(780,531)	(198,544)	-0-	(50,907)	161,659	(868,323)
Other nonoperating revenues (expenses)	201,491	2,094	-0-	(57,493)	128,972	275,064
Nonoperating revenues (expenses), net	2,760,127	(196,450)	443,668	(108,400)	128,972	3,027,917
Excess (deficit) of revenues over expenses	16,393,233	(7,581,070)	550,413	(87,119)	128,972	9,404,429
Transfers (to) from affiliates	(6,875,958)	6,875,958	-0-	101,057	(101,057)	-0-
Change in net position	9,517,275	(705,112)	550,413	13,938	27,915	9,404,429
Net position						
Beginning of year	75,532,576	8,608,151	3,838,354	266,553	(309,239)	87,936,395
End of year	\$ 85,049,851	\$ 7,903,039	\$ 4,388,767	\$ 280,491	\$ (281,324)	\$ 97,340,824

See report of independent auditors on pages 1 and 2.

MAJOR HEALTH PARTNERS

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2011

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
ASSETS						
Current assets						
Cash and cash equivalents	\$ 9,837,788	\$ 1,690,536	\$ -0-	\$ 106,920	\$ -0-	\$ 11,635,244
Patient accounts receivable, net	9,699,485	1,274,136	-0-	-0-	-0-	10,973,621
Inventory and other current assets	4,360,860	745,453	110,995	326,792	(1,286,289)	4,257,811
Current portion of assets whose use is limited	788,000	-0-	-0-	-0-	-0-	788,000
Total current assets	24,686,133	3,710,125	110,995	433,712	(1,286,289)	27,654,676
Assets whose use is limited						
Internally designated	49,437,957	-0-	2,784,374	-0-	-0-	52,222,331
Donor restricted funds	-0-	-0-	950,005	-0-	-0-	950,005
Total assets whose use is limited	49,437,957	-0-	3,734,379	-0-	-0-	53,172,336
Less current portion	788,000	-0-	-0-	-0-	-0-	788,000
Noncurrent assets whose use is limited	48,649,957	-0-	3,734,379	-0-	-0-	52,384,336
Capital assets, net	29,676,061	10,789,439	8,638	2,256,123	-0-	42,730,261
Property held for sale	4,576,627	-0-	-0-	-0-	-0-	4,576,627
Other assets	5,076,263	481,373	-0-	18,686	(3,067,711)	2,508,611
Total assets	112,665,041	14,980,937	3,854,012	2,708,521	(4,354,000)	129,854,511
Deferred outflows - interest rate swaps	551,660	-0-	-0-	-0-	-0-	551,660
Total assets and deferred outflows	<u>\$ 113,216,701</u>	<u>\$ 14,980,937</u>	<u>\$ 3,854,012</u>	<u>\$ 2,708,521</u>	<u>\$ (4,354,000)</u>	<u>\$ 130,406,171</u>

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MAJOR HEALTH PARTNERS

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2011

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
LIABILITIES AND NET POSITION						
Current liabilities						
Accounts payable and accrued expenses	\$ 1,665,632	\$ 943,269	\$ 12,757	\$ 522,761	\$ (835,225)	\$ 2,309,194
Accrued wages and related liabilities	5,853,493	1,296,134	2,901	308,255	-0-	7,460,783
Estimated third-party settlements	1,325,000	-0-	-0-	-0-	-0-	1,325,000
Current portion of long-term debt						
Loans payable and capital leases	63,148	33,914	-0-	84,478	-0-	181,540
Revenue bonds payable	788,000	-0-	-0-	-0-	-0-	788,000
Intercompany notes payable	-0-	451,064	-0-	-0-	(451,064)	-0-
Total current liabilities	9,695,273	2,724,381	15,658	915,494	(1,286,289)	12,064,517
Derivative liability	551,660	-0-	-0-	-0-	-0-	551,660
Other liabilities	-0-	429,476	-0-	-0-	-0-	429,476
Long term debt, net of current portion						
Loans payable and capital leases	36,192	460,457	-0-	1,526,474	-0-	2,023,123
Revenue bonds payable	27,401,000	-0-	-0-	-0-	-0-	27,401,000
Intercompany notes payable	-0-	2,758,472	-0-	-0-	(2,758,472)	-0-
Total long term debt	27,437,192	3,218,929	-0-	1,526,474	(2,758,472)	29,424,123
Total liabilities	37,684,125	6,372,786	15,658	2,441,968	(4,044,761)	42,469,776
Net position						
Net investment in capital assets	1,387,721	7,085,532	8,638	645,171	3,209,536	12,336,598
Restricted						
Expendable - other specific purpose	-0-	-0-	95,158	-0-	-0-	95,158
Nonexpendable	-0-	-0-	854,847	-0-	-0-	854,847
Unrestricted	74,144,855	1,522,619	2,879,711	(378,618)	(3,518,775)	74,649,792
Total net position	75,532,576	8,608,151	3,838,354	266,553	(309,239)	87,936,395
Total liabilities and net position	<u>\$ 113,216,701</u>	<u>\$ 14,980,937</u>	<u>\$ 3,854,012</u>	<u>\$ 2,708,521</u>	<u>\$ (4,354,000)</u>	<u>\$ 130,406,171</u>

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MAJOR HEALTH PARTNERS

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEAR ENDED DECEMBER 31, 2011

	Hospital	Major Affiliates	Foundation	MDSolutions	Eliminations	Total
Revenue						
Net patient service revenue	\$ 77,728,476	\$ 15,579,010	\$ -0-	\$ -0-	\$ (47,751)	\$ 93,259,735
Other	2,977,451	586,128	489,810	1,030,950	(1,706,081)	3,378,258
Total revenue	80,705,927	16,165,138	489,810	1,030,950	(1,753,832)	96,637,993
Expenses						
Salaries and wages	28,928,816	10,823,047	70,289	307,329	(10,060)	40,119,421
Employee benefits	8,927,445	2,690,739	5,242	156,902	-0-	11,780,328
Medical professional fees	5,598,323	-0-	-0-	-0-	-0-	5,598,323
Supplies	11,199,094	4,297,215	-0-	18,819	-0-	15,515,128
Purchased services	6,162,873	2,070,242	-0-	300,910	(1,163,689)	7,370,336
Equipment rental and maintenance	3,005,378	412,161	-0-	103,533	(495,347)	3,025,725
Utilities	1,028,228	345,418	-0-	21,674	-0-	1,395,320
Insurance	316,805	369,659	-0-	1,248	-0-	687,712
Depreciation and amortization	4,218,818	869,442	6,362	68,737	8,090	5,171,449
Other expenses	1,968,499	265,889	464,698	207,216	(92,826)	2,813,476
Total expenses	71,354,279	22,143,812	546,591	1,186,368	(1,753,832)	93,477,218
Operating income (loss)	9,351,648	(5,978,674)	(56,781)	(155,418)	-0-	3,160,775
Nonoperating revenues (expenses)						
Investment income	1,630,075	-0-	(16,418)	-0-	(185,233)	1,428,424
Interest expense	(797,689)	(224,625)	-0-	(55,180)	185,233	(892,261)
Other nonoperating revenues (expenses)	114,971	(67,505)	-0-	(23,287)	222,194	246,373
Nonoperating revenues (expenses), net	947,357	(292,130)	(16,418)	(78,467)	222,194	782,536
Excess (deficit) of revenues over expenses	10,299,005	(6,270,804)	(73,199)	(233,885)	222,194	3,943,311
Transfers (to) from affiliates	(7,240,022)	7,240,022	-0-	338,190	(338,190)	-0-
Change in net position	3,058,983	969,218	(73,199)	104,305	(115,996)	3,943,311
Net position						
Beginning of year	72,473,593	7,638,933	3,911,553	162,248	(193,243)	83,993,084
End of year	\$ 75,532,576	\$ 8,608,151	\$ 3,838,354	\$ 266,553	\$ (309,239)	\$ 87,936,395

See report of independent auditors on pages 1 and 2.