



MARGARET MARY **HEALTH**

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2013 AND 2012

MARGARET MARY COMMUNITY HOSPITAL, INC.

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Margaret Mary Community Hospital, Inc.
Batesville, Indiana

Report on the Consolidated Financial Statements

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

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Hospital'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 Hospital'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.

To the Board of Directors
Margaret Mary Community Hospital, Inc.
Batesville, Indiana

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2013 and 2012, and its results of operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information identified 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 entities, 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 supplementary information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

Indianapolis, Indiana
March 31, 2014

MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2013 AND 2012

ASSETS		
	2013	2012
Current assets		
Cash and cash equivalents	\$ 2,340,818	\$ 5,296,991
Investments	433,011	20,068
Patient accounts receivable, net of allowance for uncollectible accounts of \$3,688,000 in 2013 and \$4,940,000 in 2012	9,087,834	7,551,507
Inventories and other current assets	3,032,508	2,918,830
Current portion of assets whose use is limited	1,593,019	1,198,232
Total current assets	16,487,190	16,985,628
Assets whose use is limited		
Board designated for capital improvements	66,848,330	53,598,706
Board designated for retirement plan	803,007	622,185
Donor restricted	63,269	59,531
Held by trustee for debt service	110,150	62,098
	67,824,756	54,342,520
Less current portion	1,593,019	1,198,232
Assets whose use is limited - noncurrent	66,231,737	53,144,288
Property and equipment, net	54,966,720	56,001,342
Bond issue costs, net	320,182	376,959
Total assets	\$ 138,005,829	\$ 126,508,217
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable	\$ 1,996,361	\$ 3,438,909
Accrued wages and related liabilities	4,876,880	4,516,508
Estimated third-party settlements	2,702,750	2,484,100
Current portion of long-term debt	1,593,019	1,198,232
Total current liabilities	11,169,010	11,637,749
Derivative liability	1,883,053	3,311,447
Long-term debt, less current portion	29,820,453	31,434,572
Total liabilities	42,872,516	46,383,768
Net assets		
Unrestricted	95,070,044	80,064,918
Temporarily restricted	63,269	59,531
Total net assets	95,133,313	80,124,449
Total liabilities and net assets	\$ 138,005,829	\$ 126,508,217

See accompanying notes to consolidated financial statements.

MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Unrestricted revenue, gains and other support		
Net patient service revenue	\$ 84,267,267	\$ 80,785,223
Less provision for bad debts	6,678,259	6,533,475
Net patient service revenue net of provision for bad debts	77,589,008	74,251,748
Other revenue	1,330,465	490,277
Net assets released from restrictions	72,619	112,443
Total revenue, gains and other support	78,992,092	74,854,468
Expenses		
Salaries and wages	30,517,893	27,954,720
Employee benefits	10,965,669	8,988,045
Physician fees	2,538,260	2,853,034
Medical and surgical supplies	9,692,626	8,660,859
Other supplies	364,675	348,938
Purchased services	6,102,197	5,643,753
Equipment rentals	201,614	284,590
Food	455,034	394,015
Utilities	1,094,452	1,019,618
Insurance	686,101	669,623
Depreciation and amortization	6,151,099	5,470,329
Interest	1,580,450	1,380,698
Other	3,861,309	4,348,621
Total expenses	74,211,379	68,016,843
Operating income	4,780,713	6,837,625
Nonoperating gain (loss)		
Contributions	394,424	60,398
Loss on disposal of property and equipment	(37,957)	(19,242)
Investment income	2,596,729	3,346,698
Unrealized gain on derivative	1,428,394	53,154
Total nonoperating gain (loss)	4,381,590	3,441,008
Excess revenue over expenses	9,162,303	10,278,633
Other changes in unrestricted net assets		
Unrealized gain on investments	5,842,823	2,738,693
Change in unrestricted net assets	\$ 15,005,126	\$ 13,017,326

See accompanying notes to consolidated financial statements.

MARGARET MARY COMMUNITY HOSPITAL, INC.

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

	<u>2013</u>	<u>2012</u>
Unrestricted net assets		
Change in unrestricted net assets	\$ 15,005,126	\$ 13,017,326
Temporarily restricted net assets		
Contributions	76,357	77,247
Net assets released from restrictions	<u>(72,619)</u>	<u>(112,443)</u>
Change in temporarily restricted net assets	<u>3,738</u>	<u>(35,196)</u>
Change in net assets	15,008,864	12,982,130
Net assets		
Beginning of year	<u>80,124,449</u>	<u>67,142,319</u>
End of year	<u><u>\$ 95,133,313</u></u>	<u><u>\$ 80,124,449</u></u>

See accompanying notes to consolidated financial statements.

MARGARET MARY COMMUNITY HOSPITAL, INC.

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

	2013	2012
Operating activities		
Change in net assets	\$ 15,008,864	\$ 12,982,130
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation and amortization	6,151,099	5,470,329
Provision for bad debts	6,678,259	6,533,475
Realized and unrealized gain on investments, net	(6,249,314)	(4,358,932)
Loss on disposal of property and equipment	37,957	19,242
Unrealized gain on derivative	(1,428,394)	(53,154)
Change in operating assets and liabilities		
Patient accounts receivable	(8,214,586)	(6,998,029)
Inventories and other current assets	(113,678)	46,021
Accounts payable	(1,442,548)	298,600
Accrued wages and related liabilities	360,372	895,934
Estimated third-party settlements	218,650	1,099,930
Net cash flows from operating activities	11,006,681	15,935,546
Investing activities		
Proceeds from sale of investments	4,873,915	20,038,105
Purchases of investments	(12,519,780)	(27,218,251)
Proceeds from disposal of property and equipment	-0-	20,310
Additions to property and equipment	(5,097,657)	(9,580,361)
Net cash flows from investing activities	(12,743,522)	(16,740,197)
Financing activities		
Principal payments on long-term debt	(1,219,332)	(1,149,269)
Net change in cash and cash equivalents	(2,956,173)	(1,953,920)
Cash and cash equivalents		
Beginning of year	5,296,991	7,250,911
End of year	\$ 2,340,818	\$ 5,296,991
Noncash investing, capital and related financing activities		
Property and equipment included in liabilities	\$ -0-	\$ 544,182
Supplemental disclosure of cash flows information		
Cash paid for interest net of amounts capitalized of \$-0- in 2013 and \$370,000 in 2012	\$ 1,580,450	\$ 1,380,698

See accompanying notes to consolidated financial statements.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

1. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by Margaret Mary Community Hospital, Inc. (Hospital) in the preparation of its consolidated financial statements are summarized below:

Organization

The Hospital, located in Batesville, Indiana, is a not-for-profit acute care hospital providing inpatient, outpatient, and other ancillary services to the residents of Ripley and surrounding counties. Admitting physicians are primarily practitioners in the local area. During 2012, Margaret Mary Health Foundation, Inc. (Foundation) was organized with the Hospital being the sole corporate member. The Foundation supports the efforts and activities of the Hospital in the furtherance of the Hospital's charitable purposes and benefits the community served by the Hospital.

Principles of Consolidation

The accompanying consolidated financial statements include accounts of the Hospital and the Foundation. Because the Hospital is the sole corporate member of the Foundation, the financial position, results of operations and cash flows of the Foundation are included with the Hospital for financial reporting purposes. All material intercompany balances and transactions have been eliminated in consolidation.

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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Hospital considers highly liquid investments available for operating purposes with an original maturity of 90 days or less to be cash and cash equivalents for the purposes of the consolidated statements of cash flows.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Patient Accounts Receivable

Patient service revenue and the related accounts receivable are recorded at the time services to patients are performed. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowance for Uncollectible Accounts

Patient accounts receivable are reduced by an allowance for uncollectible accounts based on the Hospital's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to its service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary. For receivables associated with self-pay payments, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

During 2013, the Hospital's allowance for uncollectible accounts decreased approximately \$1,252,000 from \$4,940,000 to \$3,688,000. The uncollectible allowance related to self-pay balances decreased approximately \$983,000 as overall self-pay balances decreased combined with improvement in self-pay aging categories. The uncollectible estimate decreased to 86% of self-pay balances from 95% at December 31, 2012. The uncollectible allowance for third-party payor accounts decreased approximately \$269,000 as the uncollectible estimate decreased to 3% of third-party payor balances from 5% at December 31, 2012. In addition, the Hospital's self-pay related write-offs increased by approximately \$1,784,000 to \$7,930,000 in 2013 from \$6,146,000 in 2012. The increase was the result of negative trends experienced in the collection of amounts from self-pay patients in 2013. The Hospital did not change its charity care or uninsured discount policies during 2013 or 2012.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

As of December 31, 2013, the allowance for uncollectible accounts of approximately \$3,688,000 was comprised of \$3,490,000 reserved for self-pay balances and \$198,000 reserved for third-party payor balances.

During 2012, the Hospital's allowance for uncollectible accounts increased approximately \$388,000 from \$4,552,000 to \$4,940,000. The uncollectible allowance related to self-pay balances increased approximately \$76,000 as uncollectible estimate increased to 95% of self-pay balances from 93% at December 31, 2011. The uncollectible allowance for third-party payor accounts increased approximately \$312,000 as the uncollectible estimate increased to 5% of third-party payor balances from 3% at December 31, 2011. In addition, the Hospital's self-pay related write-offs increased by approximately \$505,000 to \$6,146,000 in 2012 from \$5,642,000 in 2011. The increase was the result of negative trends experienced in the collection of amounts from self-pay patients in 2012.

As of December 31, 2012, the allowance for uncollectible accounts of approximately \$4,940,000 was comprised of \$4,473,000 reserved for self-pay balances and \$467,000 reserved for third-party payor balances.

Patient Service Revenue

Patient service revenue and the related accounts receivable are recorded at the time services to patients are performed. A summary of the payment arrangements with major third-party payors follows:

Medicare

The Hospital is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). In 2006, the Hospital was granted Critical Access Status by Medicare and is paid for Medicare services based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at an interim rate, with final settlement determined after submission of annual cost reports. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

Medicaid and Hospital Assessment Fee Program

The Hospital 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.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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

During 2013 and 2012, the Hospital recognized HAF Program expense of approximately \$2,135,000 and \$2,804,000, respectively, which resulted in Medicaid rate increases. The HAF Program expense is included in other expenses in the consolidated statements of operations. The Medicaid rate increases under the HAF Program are included in patient service revenue in the consolidated statements of operations. The HAF Program was approved for extension in March 2014 by CMS for the period July 1, 2013 through June 30, 2017.

Other Payment Arrangements

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

The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The year-end cost reports filed with the Medicare and Medicaid programs through December 31, 2010 have been audited by these programs and any resulting differences are reflected in the consolidated financial statements. During 2013 and 2012, the Hospital recognized a decrease in change in net assets due to the differences between original estimates and subsequent revisions for the final settlement of cost reports of approximately \$57,000 and \$-0-, respectively.

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.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

A summary of patient service revenue for 2013 and 2012 follows:

	<u>2013</u>	<u>2012</u>
Gross patient service revenue		
Inpatient routine	\$ 7,725,899	\$ 7,886,203
Inpatient ancillary	17,123,916	19,025,298
Outpatient services	<u>120,213,752</u>	<u>107,699,617</u>
Total gross patient service revenue	145,063,567	134,611,118
Less provisions for		
Contractual adjustments under third-party reimbursement programs	58,826,996	52,011,666
Charity care	<u>1,969,304</u>	<u>1,814,229</u>
	<u>60,796,300</u>	<u>53,825,895</u>
Net patient service revenue	84,267,267	80,785,223
Less provision for bad debts	<u>6,678,259</u>	<u>6,533,475</u>
Net patient service revenue net of provision for bad debts	<u>\$ 77,589,008</u>	<u>\$ 74,251,748</u>

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

Of the Hospital's total expenses reported (approximately \$74,211,000 and \$68,017,000 during 2013 and 2012, respectively), an estimated \$1,007,000 and \$917,000 arose from providing services to charity patients during 2013 and 2012, 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.

Investments

Investments consist of cash equivalents and mutual funds which are recorded at fair market value.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Inventories and Other Current Assets

Inventories, consisting of mainly medical supplies and pharmaceuticals, are valued at the lower of cost or market with cost being determined on an average cost method. Inventories and other current assets are comprised of the following as of December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Other receivables	\$1,169,867	\$1,104,617
Inventories	958,868	987,074
Prepaid expenses	903,773	827,139
	<u>\$ 3,032,508</u>	<u>\$ 2,918,830</u>

Property and Equipment and Provision for Depreciation

Property and equipment are recorded at historical cost except for donations, which are recorded at fair market value at the date of the donation. Property and equipment include expenditures for additions and repairs that substantially increase the useful lives of existing property and equipment. Maintenance, repairs and minor renewals are expensed as incurred.

The property and equipment of the Hospital are being depreciated over their estimated useful lives using the straight-line method. The ranges of useful lives used in computing depreciation are as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	12-24 years
Buildings and improvements	10-40 years
Equipment	3-20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor restrictions about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. During 2013 and 2012, there were no gifts of long-lived assets with restrictions.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Assets Whose Use is Limited

Assets whose use is limited by internal board designation includes cash and cash equivalents, accrued interest receivable, and marketable securities. Marketable securities include mutual funds, private equity investments and common stock. Such securities are stated at fair market value. Donated securities are recorded at fair market value at the date of the donation.

Private equity funds consist of investments in limited liability companies which invest in the common stock of small and medium capitalization companies. Investments in those limited liability companies are reported at fair value as determined by the individual managers. Although the managers use their best judgment in estimating the fair value of the investments in the investment funds, there are inherent limitations in any estimation technique. Therefore, the values reported are not necessarily indicative of the amount that the investments funds could realize in a current transaction.

These estimated values may differ significantly from the values that would have been used had a ready market for the investments in the investment funds existed and the difference could be material. Private equity investments totaled approximately \$9,220,000 (13.6% of investment portfolio) and \$7,315,000 (13.5% of investment portfolio) as of December 31, 2013 and 2012, respectively.

Assets held by trustee include cash, certificates of deposit and investments for debt service payments and/or capital improvements in compliance with the Indiana Health Facility Financing Authority bond issues described in the long-term debt note.

Bond Issue Costs

Unamortized bond issue costs as of December 31, 2013 and 2012 were approximately \$320,000 and \$377,000, respectively. Bond issue costs are amortized over the life of the bonds. Accumulated amortization as of December 31, 2013 and 2012 was approximately \$309,000 and \$252,000, respectively. Amortization expense for the years ending December 31, 2014 through 2018 is approximately \$57,000 annually.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by external sources for a specific time period or purpose. When a restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Contributions that are received and whose restrictions that are satisfied within the same reporting period are reported as unrestricted contributions. As of December 31, 2013 and 2012, temporarily restricted net assets were approximately \$63,300 and \$59,500, respectively.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

A summary of temporarily restricted net assets as of December 31, 2013 and 2012 follows:

	<u>2013</u>	<u>2012</u>
Speaking of Women's Health	\$ 5,189	\$ 10,104
Education Center	22,004	-0-
Grants	18,432	-0-
Oncology	-0-	32,269
Think Pink	15,182	9,135
Other	2,462	8,023
	<u>\$ 63,269</u>	<u>\$ 59,531</u>

Performance Indicator

The consolidated statements of operations include a performance indicator, excess revenue over expenses. Changes in unrestricted net assets that are excluded from performance indicator include unrealized gain and loss on investments other than trading securities and contributions of long-lived assets.

Federal and State Income Taxes

The Hospital and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code. As such, the Hospital and Foundation are generally exempt from income taxes. However, both are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

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

The Hospital filed its federal and state income tax returns for periods through December 31, 2012. 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). The Foundation was organized during 2012 and its initial federal and state income tax returns are due May 15, 2014.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Costs of Borrowing

Except for capital assets acquired through gifts, contributions or capital grants, interest cost on borrowed funds, as well as interest earned on those funds, during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Capitalized interest cost was approximately \$-0- and \$370,000 in 2013 and 2012, respectively.

Advertising Costs

The Hospital's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were approximately \$396,000 and \$348,000 in 2013 and 2012, respectively.

Electronic Health Records (EHR) Incentive Payments

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, the Hospital must meet "meaningful use" criteria that become more stringent over time. The Hospital periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Hospital's cost reports. For Critical Access Hospitals, the payment calculation is based upon the net book value of the qualifying assets multiplied by the Medicare utilization using Medicare to total inpatient days plus 20%, not to exceed 100%. The total days are multiplied by a factor of total charges excluding charity care to total charges. Critical Access Hospitals can be reimbursed over a four year period for additional qualifying assets not claimed in the first year. The transitional factor ranges from 100% in the first payment year and decreases by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as grant income when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the consolidated financial statement effects of the grants must be both recognizable and measurable. During 2013 and 2012, the Hospital recognized approximately \$700,000 and \$72,000, respectively, in EHR incentive payments as grant income using the ratable recognition method. Under the ratable recognition method, the Hospital recognizes income 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.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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

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

Reclassification

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

Subsequent Events

The Hospital has 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 March 31, 2014.

2. INVESTMENTS

Investments are recorded at fair market value and consist of the following as of December 31, 2013 and 2012:

	2013	2012
Cash and cash equivalents	\$ 2,281	\$ -0-
Mutual funds	430,730	20,068
	<u>\$ 433,011</u>	<u>\$ 20,068</u>

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

3. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited consist of the following as of December 31:

	2013	2012
Cash and cash equivalents	\$ 1,847,322	\$ 1,953,133
Mutual funds	55,827,478	44,340,528
Private equity funds	9,219,836	7,315,197
Common stocks	930,120	733,662
	<u>\$ 67,824,756</u>	<u>\$ 54,342,520</u>

The following is a reconciliation of investment return for 2013 and 2012:

	2013	2012
Interest and dividends	\$ 2,190,238	\$ 1,726,459
Realized gain on investments	406,491	1,620,239
Investment income	<u>\$ 2,596,729</u>	<u>\$ 3,346,698</u>
Unrealized gain on investments	<u>\$ 5,842,823</u>	<u>\$ 2,738,693</u>

The following schedules summarize the fair value of securities included in assets whose use is limited that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of December 31, 2013 and 2012. The schedules further segregate the securities that have been in a gross unrealized position as of December 31, 2013 and 2012, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary. The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to securities which industry experts expect recovery in the short-term future.

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

Description of securities	December 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	<u>\$ 16,245,095</u>	<u>\$ 516,655</u>	<u>\$ 221,690</u>	<u>\$ 6,117</u>	<u>\$ 16,466,785</u>	<u>\$ 522,772</u>

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Description of securities	December 31, 2012					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	\$ 1,255,150	\$ 10,719	\$ 781,546	\$ 94,474	\$ 2,036,696	\$ 105,193
Private equity funds	-0-	-0-	3,616,544	73,733	3,616,544	73,733
Common stocks	21,090	809	-0-	-0-	21,090	809
Total	<u>\$ 1,276,240</u>	<u>\$ 11,528</u>	<u>\$ 4,398,090</u>	<u>\$ 168,207</u>	<u>\$ 5,674,330</u>	<u>\$ 179,735</u>

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

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital 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.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

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

- *Money market funds:* Valued based at the subscription and redemption activity at a \$1 stable net asset value (NAV). However, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of securities.
- *Mutual funds:* Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily NAV and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Private equity funds:* Valued at the NAV of units of the fund. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the net asset value of the fund and, consequently, the fair value of the Hospital's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the Hospital were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.
- *Common stocks:* Valued at the closing price reported on the active market on which the individual securities are traded.
- *Derivative (Interest rate swap agreement):* 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. See the note disclosure "Derivatives Financial Instruments – Interest Rate Swaps" for additional information related to derivatives.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The following table sets forth by level, within the hierarchy, the Hospital's assets and liabilities measured at fair value on a recurring basis as of December 31, 2013:

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Assets				
Investments				
Money market funds	\$ 2,281	\$ -0-	\$ 2,281	\$ -0-
Mutual funds				
Large Blend	65,550	65,550	-0-	-0-
Intermediate Term Bond	42,375	42,375	-0-	-0-
Mid Value	43,390	43,390	-0-	-0-
Foreign	43,626	43,626	-0-	-0-
Other	235,789	235,789	-0-	-0-
Total mutual funds	<u>430,730</u>	<u>430,730</u>	<u>-0-</u>	<u>-0-</u>
Total investments	<u>\$ 433,011</u>	<u>\$ 430,730</u>	<u>\$ 2,281</u>	<u>\$ -0-</u>
Assets whose use is limited				
Money market funds	\$ 1,847,322	\$ -0-	\$ 1,847,322	\$ -0-
Mutual funds				
Large blend	2,863,794	2,863,794	-0-	-0-
Intermediate term bond	6,238,234	6,238,234	-0-	-0-
Large growth	2,293,946	2,293,946	-0-	-0-
Large value	3,508,195	3,508,195	-0-	-0-
Mid value	2,877,262	2,877,262	-0-	-0-
World bond	2,958,813	2,958,813	-0-	-0-
Foreign	8,731,895	8,731,895	-0-	-0-
Commodities	2,098,458	2,098,458	-0-	-0-
Mid cap blend	2,388,993	2,388,993	-0-	-0-
Small value	2,935,861	2,935,861	-0-	-0-
Multi-sector	2,423,892	2,423,892	-0-	-0-
Diversified	4,764,830	4,764,830	-0-	-0-
Other	11,743,305	11,743,305	-0-	-0-
Total mutual funds	<u>55,827,478</u>	<u>55,827,478</u>	<u>-0-</u>	<u>-0-</u>
Private equity funds				
Multi-strategy funds	9,219,836	-0-	9,219,836	-0-
Common stocks				
Healthcare	584,052	584,052	-0-	-0-
Financial	346,068	346,068	-0-	-0-
Total common stocks	<u>930,120</u>	<u>930,120</u>	<u>-0-</u>	<u>-0-</u>
	<u>\$ 67,824,756</u>	<u>\$ 56,757,598</u>	<u>\$ 11,067,158</u>	<u>\$ -0-</u>
Liabilities				
Derivative	<u>\$ 1,883,053</u>	<u>\$ -0-</u>	<u>\$ 1,883,053</u>	<u>\$ -0-</u>

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The following table sets forth by level, within the hierarchy, the Hospital'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				
Investments				
Mutual funds - short-term bond	\$ 20,068	\$ 20,068	\$ -0-	\$ -0-
Assets whose use is limited				
Money market funds	\$ 1,953,133	\$ -0-	\$ 1,953,133	\$ -0-
Mutual funds				
Large blend	1,587,139	1,587,139	-0-	-0-
Intermediate term bond	5,386,672	5,386,672	-0-	-0-
Large growth	1,665,788	1,665,788	-0-	-0-
Large value	3,060,214	3,060,214	-0-	-0-
Mid value	1,851,863	1,851,863	-0-	-0-
World bond	2,425,780	2,425,780	-0-	-0-
Foreign	7,073,687	7,073,687	-0-	-0-
Commodities	1,545,905	1,545,905	-0-	-0-
Energy	1,242,335	1,242,335	-0-	-0-
Long-term equity	1,417,629	1,417,629	-0-	-0-
Mid cap blend	3,161,295	3,161,295	-0-	-0-
Small Value	3,249,212	3,249,212	-0-	-0-
Multi- sector	1,989,319	1,989,319	-0-	-0-
Diversified	4,178,735	4,178,735	-0-	-0-
Other	4,504,955	4,504,955	-0-	-0-
Total mutual funds	44,340,528	44,340,528	-0-	-0-
Private equity funds				
Multi-strategy funds	7,315,197	-0-	7,315,197	-0-
Common stocks				
Healthcare	402,648	402,648	-0-	-0-
Financial	331,014	331,014	-0-	-0-
Total common stocks	733,662	733,662	-0-	-0-
	\$ 54,342,520	\$ 45,074,190	\$ 7,315,197	\$ -0-
Liabilities				
Derivative	\$ 3,311,447	\$ -0-	\$ 3,311,447	\$ -0-

Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments measured at fair value based on net asset value per share as of December 31, 2013 and 2012, respectively.

December 31, 2013				
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity funds	\$ 9,219,836	None	January 1 & July 1	95 days

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

December 31, 2012

Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity funds	\$ 7,315,197	None	January 1 & July 1	95 days

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

Realized gain and loss are reported in the consolidated statements of operations as a component of investment income. Net realized gains of approximately \$406,000 and \$1,620,000 were recorded during 2013 and 2012, respectively.

The market value of investments exceeded the cost by approximately \$8,015,000 and \$2,173,000 as of December 31, 2013 and 2012, respectively. The unrealized gain or loss is included in earnings for the period attributable to the change in unrealized gain or loss relating to assets held as of December 31, 2013 and 2012 and is reported in the consolidated statements of operations as net unrealized gain or loss on investments. During 2013 and 2012, the Hospital recognized an unrealized gain of approximately of \$5,842,000 and \$2,739,000, respectively.

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

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

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

Long-term debt: Fair value of the Hospital's revenue bonds approximates its carrying value based on incremental borrowing rates available to similar entities with similar credit ratings.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

5. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31:

	<u>2013</u>	<u>2012</u>
Land	\$ 2,371,158	\$ 2,371,158
Land improvements	374,770	366,434
Buildings and improvements	70,371,427	70,380,883
Fixed equipment	6,341,285	6,410,956
Movable and minor equipment	32,063,983	31,079,302
	<u>111,522,623</u>	<u>110,608,733</u>
Less accumulated depreciation	59,119,092	54,718,992
	<u>52,403,531</u>	<u>55,889,741</u>
Construction in progress	2,563,189	111,601
	<u>\$ 54,966,720</u>	<u>\$ 56,001,342</u>

Depreciation expense for 2013 and 2012 was approximately \$6,094,000 and \$5,414,000 respectively. No significant construction commitments existed as of December 31, 2013.

6. DERIVATIVE FINANCIAL INSTRUMENTS – INTEREST RATE SWAPS

Objectives and Strategies for Using Derivatives

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

As of December 31, 2013, the Hospital had outstanding an interest rate swap agreement with a financial institution, having a notional amount of \$16,145,000. The agreement effectively changes the Hospital's interest rate exposure on its Variable Rate Demand Revenue Bonds Series 2004A-1 due 2029 to a fixed 3.48%. The interest rate swap agreement matures at the time the related long-term debt matures. The Hospital is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the Hospital does not anticipate nonperformance by the counterparties.

The derivative is not designated as a hedging instrument, and is marked-to-market on the consolidated balance sheet at fair value. The related gains and losses are included in excess revenue and gains over expenses and losses, the performance indicator, for the reporting period. Cash flows from interest rate swap contracts are classified as an operating activity on the consolidated statement of cash flows.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The asset derivatives are reported in the consolidated balance sheets as other assets and liability derivatives are reported as derivative liabilities. As of December 31, 2013 and 2012, the fair values of derivatives recorded in the consolidated balance sheets are as follows:

	<u>2013</u>	<u>2012</u>
Derivative liability	\$ 1,883,053	\$ 3,311,447

During 2013 and 2012, the amount of gain or loss recognized in the consolidated statements of operations and reported as a component of nonoperating gain (loss) is as follows:

	<u>2013</u>	<u>2012</u>
Unrealized gain on derivative	\$ 1,428,394	\$ 53,154

Additional information regarding fair value measurements of the interest rate swap agreements is disclosed in Fair Value of Financial Instruments note.

7. LONG-TERM DEBT

The following is the summary of long-term debt as of December 31:

	<u>2013</u>	<u>2012</u>
Indiana Finance Authority Health Facility Variable Rate Demand Revenue Bonds Series 2004A-1; dated March 1, 2004, due 2029	\$ 16,145,000	\$ 16,890,000
Indiana Finance Authority Health Facility Revenue Bonds Series 2010; dated December 1, 2010, due 2035	<u>15,268,472</u>	<u>15,742,804</u>
	31,413,472	32,632,804
Less current portion	<u>1,593,019</u>	<u>1,198,232</u>
	<u>\$ 29,820,453</u>	<u>\$ 31,434,572</u>

In 2004, the Hospital borrowed from the Indiana Finance Authority (the Authority) \$22,000,000 for the addition and improvement of the Hospital facilities. The Authority, created under Indiana Code 5-1-16, provides funds to eligible health facilities for financing capital expenditures.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

In 2009, the Hospital, the Authority and Branch Banking and Trust Company, Inc. (BB&T) entered into a Bond Purchase Agreement (Agreement) whereby BB&T purchased from the Authority all of the Series 2004A Bonds in a private placement. The Agreement provides that BB&T would hold the Series 2004A Bonds during the Initial Long Mode Period which was to run through October 2014. During this Initial Long Mode Period, the Series 2004A Bonds bore interest at a variable rate of 68% of one month LIBOR plus 1.30% with a floor of 2.35% (rate as of December 31, 2012 - 2.35%).

During 2013, the interest rate on the Series 2004A Bonds was converted from the Initial Long Mode to Successive Long Mode which is 68% of one month LIBOR plus .95% with no floor (rate as of December 31, 2013 – 1.12%). The Successive Long Mode period runs through 2029. Additionally, BB&T agreed to hold the Series 2004A Bonds through the maturity date in 2029.

In December 2010, the Hospital borrowed \$16,625,235 from the Authority the Health Facility Revenue Bonds, Series 2010 to provide for future capital projects. The Series 2010 Bonds bear interest at rates as determined by daily, weekly, flexible, semiannual or long modes.

On December 16, 2010, the Hospital, the Authority and Key Government Finance, Inc. (Key) entered into an Agreement whereby Key purchased from the Authority all of the Series 2010 Bonds in a private placement. The Agreement provided that Key would hold the Series 2010 Bonds during the Initial Long Mode Period which ran through November 2020. During the Initial Long Mode Period, the Series 2010 Bonds bore interest at the fixed rate long mode (4.64%) for 120 months with principal and interest payments determined using a 25-year amortization schedule.

During 2013, the interest rate on the Series 2010 Bonds was converted from the Initial Long Mode to a new Long Mode with a fixed interest rate of 3.36%. The new Long Mode period runs through 2028. Additionally, Key agreed to hold the Series 2010 Bonds through 2028 compared to the Series 2010 Bond maturity date in 2035. At the end of the Long Mode period in 2028, the Series 2010 Bonds could be converted to another interest rate mode and remarketed to another bondholder or holders or renewed for another Long Mode Period with Key. If the Series 2010 Bonds could not be remarketed at the end of the Long Mode Period in 2028, the Hospital would be subject to payment of the remaining principal balance at that time.

Both the Series 2004A and 2010 Bonds are covered under a Master Trust Indenture and are secured by an interest in the gross revenues of the Hospital.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

Annual maturities of long-term debt for the years succeeding December 31, 2013 are as follows:

<u>Year Ending December 31,</u>	
2014	\$ 1,593,019
2015	1,653,231
2016	1,702,357
2017	1,762,477
2018	1,828,625
Thereafter	<u>22,873,763</u>
	<u><u>\$ 31,413,472</u></u>

8. RETIREMENT PLANS

The Hospital has a defined contribution pension plan, which covers all eligible employees. Allocations of plan contributions are made based upon the earnings of qualified employees. Contribution percentages are at the discretion of the Hospital.

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

Total pension expense under all retirement plans was approximately \$658,000 and \$676,000 for 2013 and 2012, respectively.

9. CONCENTRATIONS OF CREDIT RISK

The Hospital is located in Batesville, Indiana. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Accounts receivable and revenues from self-pay and third-party payors were as follows:

	<u>Receivables</u>		<u>Revenues</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Medicare	24%	29%	40%	40%
Medicaid	9%	6%	10%	11%
Blue Cross	17%	16%	22%	22%
Other third-party payors	24%	18%	25%	23%
Self pay	26%	31%	3%	4%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The Hospital maintains its cash in accounts, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on cash and cash equivalents.

10. COMMITMENTS AND CONTINGENCIES

Self-Funded Health Plan

The Hospital is committed to pay for employees' health care costs. A third-party administrator has been retained to process and present all benefit claims to the Hospital for payment. Under a stop loss agreement, the Hospital is responsible for the funding of all claims and related administrative costs up to \$150,000 per individual per policy year. There is no aggregate limit for the Plan under the stop loss agreement. Group health insurance expense for 2013 and 2012 totaled approximately \$7,421,000 and \$5,720,000, respectively.

Litigation

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

11. RISK MANAGEMENT

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation). The Hospital has purchased commercial insurance for malpractice, general liability, and employee medical claims. The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding \$250,000 or aggregate claims exceeding \$5,000,000, for claims asserted in the policy year. In addition, the Hospital has an umbrella policy with an additional \$5,000,000 of coverage.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on the occurrences during the claims-made term, but reported subsequently, will be uninsured.

MARGARET MARY COMMUNITY HOSPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2013 AND 2012

The Hospital is not aware of any medical malpractice claims, either asserted or unasserted, that would exceed the policy limits. No claims have been settled during the past three years that have exceeded policy coverage limits. The cost of this insurance policy represents the Hospital's cost for such claims for the year, and it has been charged to operations as a current expense.

The Hospital has a \$250,000 letter of credit available with a local financial institution to cover unfunded workers' compensation claims. The letter of credit expires in April 2014. There was no outstanding balance on the letter of credit as of December 31, 2013 and 2012.

12. FUNCTIONAL EXPENSES

The Hospital, located in Batesville, Indiana, is a not-for-profit acute care hospital providing inpatient, outpatient, and other ancillary services to the residents of Ripley and surrounding counties. Expenses related to providing these services for 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Health care services	\$ 65,027,295	\$ 59,599,368
General and administrative	8,956,085	8,333,228
Fundraising	227,999	84,247
	<u>\$ 74,211,379</u>	<u>\$ 68,016,843</u>

Certain costs have been allocated among the health care services, administrative and general and fundraising categories based on the actual direct expenditures and cost allocations based upon time spent by the Hospital's personnel. Although the methods used were appropriate, alternative methods may provide different results.

SUPPLEMENTARY INFORMATION

MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2013

ASSETS	Hospital	Foundation	Eliminations	Total
Current assets				
Cash and cash equivalents	\$ 2,314,305	\$ 26,513	\$ -0-	\$ 2,340,818
Investments	-0-	433,011	-0-	433,011
Patient accounts receivable, net	9,087,834	-0-	-0-	9,087,834
Inventories and other current assets	3,032,508	-0-	-0-	3,032,508
Current portion of assets whose use is limited	1,593,019	-0-	-0-	1,593,019
Total current assets	16,027,666	459,524	-0-	16,487,190
Assets whose use is limited				
Board designated for capital improvements	66,848,330	-0-	-0-	66,848,330
Board designated for retirement plan	803,007	-0-	-0-	803,007
Donor restricted	63,269	-0-	-0-	63,269
Held by trustee for debt service	110,150	-0-	-0-	110,150
	67,824,756	-0-	-0-	67,824,756
Less current portion	1,593,019	-0-	-0-	1,593,019
Assets whose use is limited - noncurrent	66,231,737	-0-	-0-	66,231,737
Property and equipment, net	54,966,720	-0-	-0-	54,966,720
Bond issue costs, net	320,182	-0-	-0-	320,182
Total assets	<u>\$ 137,546,305</u>	<u>\$ 459,524</u>	<u>\$ -0-</u>	<u>\$ 138,005,829</u>
LIABILITIES AND NET ASSETS				
Current liabilities				
Accounts payable	\$ 1,996,361	\$ -0-	\$ -0-	\$ 1,996,361
Accrued wages and related liabilities	4,876,880	-0-	-0-	4,876,880
Estimated third-party settlements	2,702,750	-0-	-0-	2,702,750
Current portion of long-term debt	1,593,019	-0-	-0-	1,593,019
Total current liabilities	11,169,010	-0-	-0-	11,169,010
Derivative liability	1,883,053	-0-	-0-	1,883,053
Long-term debt, less current portion	29,820,453	-0-	-0-	29,820,453
Total liabilities	42,872,516	-0-	-0-	42,872,516
Net assets				
Unrestricted	94,610,520	459,524	-0-	95,070,044
Temporarily restricted	63,269	-0-	-0-	63,269
Total net assets	94,673,789	459,524	-0-	95,133,313
Total liabilities and net assets	<u>\$ 137,546,305</u>	<u>\$ 459,524</u>	<u>\$ -0-</u>	<u>\$ 138,005,829</u>

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MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2013

	Hospital	Foundation	Eliminations	Total
Unrestricted revenue, gains and other support				
Net patient service revenue	\$ 84,267,267	\$ -0-	\$ -0-	\$ 84,267,267
Less provision for bad debts	6,678,259	-0-	-0-	6,678,259
Net patient service revenue net of provision for bad debts	77,589,008	-0-	-0-	77,589,008
Other revenue	1,330,465	-0-	-0-	1,330,465
Net assets released from restrictions	72,619	-0-	-0-	72,619
Total revenue, gains and other support	78,992,092	-0-	-0-	78,992,092
Expenses				
Salaries and wages	30,517,893	-0-	-0-	30,517,893
Employee benefits	10,965,669	-0-	-0-	10,965,669
Physician fees	2,538,260	-0-	-0-	2,538,260
Medical and surgical supplies	9,692,626	-0-	-0-	9,692,626
Other supplies	364,675	-0-	-0-	364,675
Purchased services	6,102,197	-0-	-0-	6,102,197
Equipment rentals	201,614	-0-	-0-	201,614
Food	455,034	-0-	-0-	455,034
Utilities	1,094,452	-0-	-0-	1,094,452
Insurance	686,101	-0-	-0-	686,101
Depreciation and amortization	6,151,099	-0-	-0-	6,151,099
Interest	1,580,450	-0-	-0-	1,580,450
Other	3,861,309	-0-	-0-	3,861,309
Total expenses	74,211,379	-0-	-0-	74,211,379
Operating income	4,780,713	-0-	-0-	4,780,713
Nonoperating gain (loss)				
Contributions	-0-	394,424	-0-	394,424
In-kind revenue	-0-	227,999	(227,999)	-0-
In-kind expense	-0-	(227,999)	227,999	-0-
Loss on disposal of property and equipment	(37,957)	-0-	-0-	(37,957)
Investment income	2,584,887	11,842	-0-	2,596,729
Unrealized gain on derivative	1,428,394	-0-	-0-	1,428,394
Total nonoperating gain	3,975,324	406,266	-0-	4,381,590
Excess revenue over expenses	8,756,037	406,266	-0-	9,162,303
Other changes in unrestricted net assets				
Unrealized gain on investments	5,849,963	(7,140)	-0-	5,842,823
Change in unrestricted net assets	\$ 14,606,000	\$ 399,126	\$ -0-	\$ 15,005,126

See report of independent auditors on pages 1 and 2.

MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2012

ASSETS	Hospital	Foundation	Eliminations	Total
Current assets				
Cash and cash equivalents	\$ 5,236,593	\$ 60,398	\$ -0-	\$ 5,296,991
Investments	20,068	-0-	-0-	20,068
Patient accounts receivable, net	7,551,507	-0-	-0-	7,551,507
Inventories and other current assets	2,918,830	-0-	-0-	2,918,830
Current portion of assets whose use is limited	1,198,232	-0-	-0-	1,198,232
Total current assets	16,925,230	60,398	-0-	16,985,628
Assets whose use is limited				
Board designated for capital improvements	53,598,706	-0-	-0-	53,598,706
Board designated for retirement plan	622,185	-0-	-0-	622,185
Donor restricted	59,531	-0-	-0-	59,531
Held by trustee for debt service	62,098	-0-	-0-	62,098
	54,342,520	-0-	-0-	54,342,520
Less current portion	1,198,232	-0-	-0-	1,198,232
Assets whose use is limited - noncurrent	53,144,288	-0-	-0-	53,144,288
Property and equipment, net	56,001,342	-0-	-0-	56,001,342
Bond issue costs, net	376,959	-0-	-0-	376,959
Total assets	<u>\$ 126,447,819</u>	<u>\$ 60,398</u>	<u>\$ -0-</u>	<u>\$ 126,508,217</u>
LIABILITIES AND NET ASSETS				
Current liabilities				
Accounts payable	\$ 3,438,909	\$ -0-	\$ -0-	\$ 3,438,909
Accrued wages and related liabilities	4,516,508	-0-	-0-	4,516,508
Estimated third-party settlements	2,484,100	-0-	-0-	2,484,100
Current portion of long-term debt	1,198,232	-0-	-0-	1,198,232
Total current liabilities	11,637,749	-0-	-0-	11,637,749
Derivative liability	3,311,447	-0-	-0-	3,311,447
Long-term debt, less current portion	31,434,572	-0-	-0-	31,434,572
Total liabilities	46,383,768	-0-	-0-	46,383,768
Net assets				
Unrestricted	80,004,520	60,398	-0-	80,064,918
Temporarily restricted	59,531	-0-	-0-	59,531
Total net assets	80,064,051	60,398	-0-	80,124,449
Total liabilities and net assets	<u>\$ 126,447,819</u>	<u>\$ 60,398</u>	<u>\$ -0-</u>	<u>\$ 126,508,217</u>

See report of independent auditors on pages 1 and 2.

MARGARET MARY COMMUNITY HOSPITAL, INC.

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2012

	Hospital	Foundation	Eliminations	Total
Unrestricted revenue, gains and other support				
Net patient service revenue	\$ 80,785,223	\$ -0-	\$ -0-	\$ 80,785,223
Less provision for bad debts	6,533,475	-0-	-0-	6,533,475
Net patient service revenue net of provision for bad debts	74,251,748	-0-	-0-	74,251,748
Other revenue	490,277	-0-	-0-	490,277
Net assets released from restrictions	112,443	-0-	-0-	112,443
Total revenue, gains and other support	74,854,468	-0-	-0-	74,854,468
Expenses				
Salaries and wages	27,954,720	-0-	-0-	27,954,720
Employee benefits	8,988,045	-0-	-0-	8,988,045
Physician fees	2,853,034	-0-	-0-	2,853,034
Medical and surgical supplies	8,660,859	-0-	-0-	8,660,859
Other supplies	348,938	-0-	-0-	348,938
Purchased services	5,643,753	-0-	-0-	5,643,753
Equipment rentals	284,590	-0-	-0-	284,590
Food	394,015	-0-	-0-	394,015
Utilities	1,019,618	-0-	-0-	1,019,618
Insurance	669,623	-0-	-0-	669,623
Depreciation and amortization	5,470,329	-0-	-0-	5,470,329
Interest	1,380,698	-0-	-0-	1,380,698
Other	4,348,621	-0-	-0-	4,348,621
Total expenses	68,016,843	-0-	-0-	68,016,843
Operating income	6,837,625	-0-	-0-	6,837,625
Nonoperating gain (loss)				
Contributions	-0-	60,398	-0-	60,398
In-kind revenue	-0-	84,247	(84,247)	-0-
In-kind expense	-0-	(84,247)	84,247	-0-
Loss on disposal of property and equipment	(19,242)	-0-	-0-	(19,242)
Investment income	3,346,698	-0-	-0-	3,346,698
Unrealized gain on derivative	53,154	-0-	-0-	53,154
Total nonoperating gain	3,380,610	60,398	-0-	3,441,008
Excess revenue over expenses	10,218,235	60,398	-0-	10,278,633
Other changes in unrestricted net assets				
Unrealized gain on investments	2,738,693	-0-	-0-	2,738,693
Change in unrestricted net assets	\$ 12,956,928	\$ 60,398	\$ -0-	\$ 13,017,326

See report of independent auditors on pages 1 and 2.