

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Beacon Health System, Inc. and Affiliated Corporations
Years Ended December 31, 2015 and 2014
With Reports of Independent Auditors

Ernst & Young LLP



Building a better
working world

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Financial Statements
and Supplementary Information

Years Ended December 31, 2015 and 2014

Contents

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets	3
Consolidated Statements of Operations and Changes in Net Assets	5
Consolidated Statements of Cash Flows.....	7
Notes to Consolidated Financial Statements.....	8
Supplementary Information	
Report of Independent Auditors on Supplementary Information	51
Details of Consolidated Balance Sheet, December 31, 2015.....	52
Details of Consolidated Balance Sheet, December 31, 2014.....	54
Details of Consolidated Statement of Operations and Changes in Net Assets, Year Ended December 31, 2015.....	56
Details of Consolidated Statement of Operations and Changes in Net Assets, Year Ended December 31, 2014.....	58



Ernst & Young LLP
155 North Wacker Drive
Chicago, IL 60606-1787

Tel: +1 312 879 2000
Fax: +1 312 879 4000
ey.com

Report of Independent Auditors

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

We have audited the accompanying consolidated financial statements of Beacon Health System, Inc. and Affiliated Corporations (the Corporation), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

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

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



Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Beacon Health System, Inc. and Affiliated Corporations at December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 3, 2016

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Balance Sheets
(In Thousands)

	December 31	
	2015	2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 63,838	\$ 96,532
Short-term investments	61,512	85,919
Patient accounts receivable, less allowances for doubtful accounts (2015 – \$33,633; 2014 – \$26,375)	163,256	140,259
Due from third-party payors	12,487	18,253
Other receivables	9,949	11,884
Inventories	24,111	22,868
Prepaid expenses	9,416	12,088
Total current assets	<u>344,569</u>	<u>387,803</u>
Assets limited as to use:		
Internally designated investments	547,515	570,198
Restricted cash	3,012	6,144
Externally designated investments – insurance trust	2,656	2,619
Board-designated endowment	19,477	20,801
Endowment and temporarily restricted investments	6,217	6,610
	<u>578,877</u>	<u>606,372</u>
Property and equipment:		
Land	45,749	43,597
Buildings and improvements	633,254	614,625
Furniture and equipment	447,712	408,363
Construction-in-progress	105,257	63,954
	<u>1,231,972</u>	<u>1,130,539</u>
Less allowances for depreciation and amortization	<u>605,738</u>	<u>554,795</u>
	<u>626,234</u>	<u>575,744</u>
Unamortized bond issuance costs, net	2,077	2,188
Deferred charges and other assets	31,564	30,695
Interest rate swap	598	–
Total assets	<u><u>\$ 1,583,919</u></u>	<u><u>\$ 1,602,802</u></u>

	December 31	
	2015	2014
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 49,184	\$ 60,246
Accrued salaries and benefits	35,096	48,204
Accrued expenses	4,522	4,961
Due to third-party payors	11,265	9,737
Current maturities of long-term debt	8,231	8,693
Total current liabilities	<u>108,298</u>	131,841
Non-current liabilities:		
Long-term debt, less current maturities	241,885	249,797
Pension and other liabilities	100,437	97,245
Interest rate and basis swaps	20,523	27,752
	<u>362,845</u>	374,794
Total liabilities	<u>471,143</u>	506,635
Net assets:		
Unrestricted:		
Undesignated	1,080,002	1,059,437
Board-designated endowment	19,477	20,801
Total unrestricted	<u>1,099,479</u>	1,080,238
Temporarily restricted	12,706	15,338
Permanently restricted	591	591
Total net assets	<u>1,112,776</u>	1,096,167
Total liabilities and net assets	<u><u>\$ 1,583,919</u></u>	<u><u>\$ 1,602,802</u></u>

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations

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

	Year Ended December 31	
	2015	2014
Unrestricted revenue, gains, and other support		
Net patient service revenue	\$ 934,934	\$ 938,468
Provision for bad debts	(73,035)	(68,927)
Net patient service revenue, less provision for bad debts	861,899	869,541
Other revenue	40,567	43,902
Net assets released from restrictions used for operations	332	322
	902,798	913,765
Expenses		
Salaries and wages	379,739	361,661
Employee benefits	93,500	93,030
Supplies and other	223,052	232,821
Professional fees and purchased services	115,892	113,630
Depreciation and amortization	52,517	50,547
Interest	4,985	5,925
	869,685	857,614
Income from operations	33,113	56,151
Non-operating		
Investment (losses) income, net	(20,496)	29,672
Unrealized gains on swap transactions, net	7,827	9,008
Revenue and gains in excess of expenses	20,444	94,831

Beacon Health System, Inc. and Affiliated Corporations

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

(In Thousands)

	Year Ended December 31	
	2015	2014
Unrestricted net assets		
Revenue and gains in excess of expenses	\$ 20,444	\$ 94,831
Net assets released from restrictions used for capital purposes	5,456	392
Net assets released from board-designated endowment	(815)	(771)
Other	(142)	–
Postretirement benefit adjustments other than periodic costs	(5,702)	(35,714)
Increase in unrestricted net assets	<u>19,241</u>	<u>58,738</u>
Temporarily restricted net assets		
Contributions	3,594	3,334
Investment (losses) income	(438)	356
Net assets released from restrictions used for operating and capital purposes	(5,788)	(714)
(Decrease) increase in temporarily restricted net assets	<u>(2,632)</u>	<u>2,976</u>
Increase in net assets	16,609	61,714
Net assets at beginning of year	1,096,167	1,034,453
Net assets at end of year	<u>\$ 1,112,776</u>	<u>\$ 1,096,167</u>

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended December 31	
	2015	2014
Operating activities		
Increase in net assets	\$ 16,609	\$ 61,714
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	52,517	50,547
Provision for bad debts	73,035	68,927
Unrealized gains on swap transactions, net	(7,827)	(9,008)
Postretirement benefit adjustments other than periodic costs	5,702	35,713
Realized gains on investments	(3,168)	(21,061)
Restricted contributions and investment income	(3,156)	(3,690)
Changes in operating assets and liabilities:		
Patient accounts receivable	(96,032)	(70,236)
Other receivables, inventories, and prepaid expenses	3,364	(3,754)
Other assets	(2,566)	(3,998)
Restricted cash	3,132	(950)
Investments – trading	51,938	(4,456)
Accounts payable, accrued salaries and benefits, and accrued expenses	(24,609)	10,966
Due to/from third-party payors, net	7,294	(12,039)
Other long-term liabilities	(2,276)	(3,952)
Net cash provided by operating activities	73,957	94,723
Investing activities		
Net additions to property and equipment	(101,433)	(83,098)
Net cash used in investing activities	(101,433)	(83,098)
Financing activities		
Principal payments on long-term debt and other debt obligations	(8,374)	(7,452)
Net proceeds from issuance of long-term debt and other debt obligations	–	3,876
Payment of bond issue costs	–	(1,070)
Restricted contributions and investment income	3,156	3,690
Net cash used by financing activities	(5,218)	(956)
(Decrease) increase in cash and cash equivalents	(32,694)	10,669
Cash and cash equivalents at beginning of year	96,532	85,863
Cash and cash equivalents at end of year	\$ 63,838	\$ 96,532
Supplemental disclosure of cash flow information		
Interest paid	\$ 5,022	\$ 5,974

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements

(In Thousands)

December 31, 2015

1. Organization and Basis of Consolidation

The accompanying consolidated financial statements represent the accounts of Beacon Health System, Inc. (the Corporation) and its various affiliated corporations under the control of the Corporation (collectively, BHS). The Corporation is an Indiana not-for-profit corporation exempt from federal income tax under Internal Revenue Code (the Code) Section 501(a) as an organization described in Section 501(c)(3) and a public charity as described in Section 509(a)(3). The Corporation is the sole corporate member of the following entities:

- Elkhart General Hospital, Inc. (EGH)
- Memorial Hospital of South Bend, Inc. (MHSB)
- Memorial Health Foundation, Inc. (MHF)
- Beacon Medical Group, Inc. (BMG), formerly Memorial Health System, Inc.
- Beacon Health Ventures, Inc. (BHV)
- Community Occupational Medicine, LLC (COM)
- CHA ACO, LLC (CHA ACO)

EGH, MHSB, BMG, and MHF are also exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) and as public charities described in Sections 509(a)(1) and 509(a)(2). BHV is an Indiana for-profit corporation. COM and CHA ACO are for-profit Indiana limited liability companies. EGH is a 365-licensed-bed (270 available) acute care community hospital located in Elkhart, Indiana. MHSB is a 657-licensed-bed (409 available) acute care trauma center located in South Bend, Indiana. EGH and MHSB (collectively, the Hospitals) provide inpatient, outpatient, and 24-hour emergency care services for residents of Elkhart and South Bend, Indiana, and the surrounding communities. MHF is organized primarily to promote and encourage philanthropic activities for the support of the Corporation and its affiliates. BHV manages the taxable operations of the Corporation, including home care and other post-acute health care services. COM primarily provides occupational medicine services to local employers. BMG operates the physician enterprise of the Corporation. CHA ACO coordinates high-quality care for Medicare beneficiaries participating in the Medicare Shared Savings Programs. All significant intercompany accounts and transactions have been eliminated in consolidation.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

1. Organization and Basis of Consolidation (continued)

The Corporation owns a less than majority ownership or controlling interest in the following:

- 50% interest in Community Health Alliance LLC, an Indiana physician hospital organization
- 50% interest in Memorial Spine and Neuroscience Center, LLC, an outpatient surgery center specializing in neurologic, spine, and pain control procedures
- 42% interest in LaPorte Medical Group Surgery Center, LLP, an outpatient surgery center
- 50% interest in Valparaiso Medical Development, LLC, a professional medical building venture
- 25% interest in Magnetic Resonance Imaging, LLC, an imaging and radiology center
- 33% interest in Michiana Information Health Network, Inc., a health information exchange
- 40% interest in Northern Indiana Ambulatory Surgery Center, LLC, an ambulatory surgery center
- 42% interest in Wakarusa Medical Clinic, LLC, a medical clinic
- 50% interest in Wa Nee Walk-in Clinic, LLC, a medical clinic

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

1. Organization and Basis of Consolidation (continued)

Aggregate financial information relating to these investments is as follows:

	<u>2015</u>	<u>2014</u>
Assets	\$ 37,999	\$ 32,536
Liabilities	17,003	17,033
Net income	5,950	5,843

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ from those estimates.

Cash Equivalents

All investments that are not limited as to use with a maturity of three months or less at the time of acquisition are reflected as cash equivalents. Cash equivalents include checking accounts, money market accounts, corporate credit card accounts, and petty cash. The carrying value of cash equivalents approximates fair value.

Short-Term Investments

Short-term investments include cash reinvested on a daily basis, accrued interest on investments, and money expected to be used in less than a year as part of BHS' community benefit. Also included in short-term investments are restricted and unrestricted investment donations that are in the process of being liquidated.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable

The Corporation evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for doubtful accounts when they are deemed uncollectible.

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Directors (the Board) for future capital improvements and community health enhancement initiatives that the Board, at its discretion, may subsequently use for other purposes. In addition, assets limited as to use also include assets held by trustees under self-funded insurance agreements, and investments externally designated under indenture or donor restriction.

Investments

The Corporation classifies substantially all of its investments as trading. Under a trading classification, all unrestricted realized and unrealized gains and losses are included in revenue and gains in excess of expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Dividend and interest income, realized gains and losses, and changes to fair values of investments are reported as non-operating investment income in the consolidated statements of operations and changes in net assets.

Investments in alternative investments, primarily hedge fund of funds, that invest in marketable securities and derivative products are reported using the equity method. The estimated fair values are provided by the respective fund managers and are based on historical costs, appraisals, and other estimates that require varying degrees of judgment. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and may differ from the value

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

that would have been used had a ready market for such investments existed. Resulting differences could be material. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in non-operating investment income. The Corporation's holding reflects net contributions to the hedge fund and an allocated share of realized and unrealized investment income and expense.

Inventories

Inventories are stated at the lower of cost (average cost method) or market.

Unamortized Bond Issuance Costs

Costs incurred in connection with the issuance of long-term debt are deferred and amortized over the term of the related financing, which approximates the effective interest method.

Fair Value of Financial Instruments

The Corporation's carrying amount for its financial instruments, which include cash and cash equivalents, investments and assets limited as to use, and accounts receivable, at December 31, 2015 and 2014, approximates fair value. The estimated fair value amounts have been determined by the Corporation using available market information and appropriate valuation methodologies.

Property and Equipment

Property and equipment are carried at cost, except for donated assets, which are recorded at fair value at the date of donation. Allowances for depreciation and amortization are computed primarily utilizing the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years.

Asset Impairment

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine whether the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating expenses at the time the impairment is identified. There was no impairment of long-lived assets in 2015 or 2014.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

The carrying value of goodwill amounted to approximately \$10,409 and \$10,281 at December 31, 2015 and 2014, respectively, and is included in deferred charges and other assets in the consolidated balance sheets. Goodwill is assessed for impairment on an annual basis at the reporting unit level. If the fair value of the reporting unit is less than the carrying value, an impairment loss equal to the difference between the implied fair value of the reporting unit goodwill and the carrying value of the reporting unit goodwill is recognized. There was no impairment of goodwill in 2015 or 2014.

Deferred Charges and Other Assets

Included in deferred charges and other assets are intangible assets, goodwill, and investments in unconsolidated affiliates.

The acquisition of a business entity can result in the recording of intangible assets. Acquired definite-lived intangible assets (excluding goodwill) are amortized over the useful life of the assets. Goodwill is carried at acquisition value, less any impairment reductions.

The Corporation accounts for its investments in less than majority owned and controlled affiliates using either the cost basis or the equity method of accounting. Income from these investments is reflected in other revenue in the consolidated statements of operations and changes in net assets.

Contributions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received to the extent estimated to be collectible by the Corporation. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Temporarily Restricted Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Corporation. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Assets released from restrictions that are used for the purchase of property and equipment or capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Resources restricted by donors for specific operating purposes are reported in unrestricted revenue, gains, and other support to the extent expended within the period.

Permanently Restricted Net Assets

Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. In accordance with the restriction, a majority of the investment income and investment gains or losses from permanently restricted net assets are restricted by the donor for a specific purpose and are therefore temporarily restricted. A specified portion of income earned by the temporarily restricted net assets is released from restriction and used for operations each year and, therefore, is included in the consolidated statements of operations and changes in net assets as other revenue.

Net Patient Service Revenue

Net patient service revenue is recorded in the period in which services are rendered, based upon estimated amounts due from patients and third-party payors. Third parties include Medicare, Medicaid, managed health care plans, and other commercial plans. BHS has agreements with various third-party payors that provide for payments to BHS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts received or due from patients, third-party

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

payors, and others for services rendered. These amounts include estimated adjustments under certain reimbursement agreements with third-party payors, which are subject to audit by the applicable administering agency. These adjustments are accrued on an estimated basis and are adjusted in future periods as final settlements are determined (see Note 3). The Hospitals provide care to all patients regardless of their ability to pay. Charity care provided is excluded from net patient service revenue (see Note 4).

Performance Indicator

The consolidated statements of operations and changes in net assets include a performance indicator, revenue and gains in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess of expenses, consistent with industry practice, include contributions of long-lived assets, including assets acquired using contributions, which, by donor restrictions, were to be used for the purpose of acquiring such assets, and pension-related changes other than net periodic costs.

Interest Rate and Basis Swaps

All interest rate and basis swaps are measured at fair value based on techniques consistent with the market approach. None of the swaps are designated as hedging instruments; therefore, the unrealized gains or losses on the fair value of the swaps are included in revenue and gains in excess of expenses in the consolidated statements of operations and changes in net assets.

Asset Retirement Obligations

The Corporation accounts for the fair value of legal obligations associated with long-lived asset retirements by recognizing an expense and accreting a liability over the life of the asset to cover potential legal obligations at the end of the asset's useful life. The asset retirement obligation primarily relates to future asbestos remediation related to buildings on MHSB's campus, as well as ground/soil remediation associated with the removal of underground fuel tanks. The carrying value of the obligation amounted to approximately \$4,302 and \$4,536 at December 31, 2015 and 2014, respectively, and is reflected in pension and other liabilities on the consolidated balance sheets.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncement

In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards update (ASU) 2015-07, *Fair Value Measurement (Topic 820), Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, which requires that investments for which fair value is measured at net asset value per share (or its equivalent) (NAV) using the practical expedient no longer be included in the fair value hierarchy. Investments that calculate NAV but for which the practical expedient is not applied will continue to be included in the fair value hierarchy. With the adoption of ASU 2015-07, these investments are not included in the fair value hierarchy disclosures, but instead disclosed as a reconciling item between fair value investments and total investments in the consolidated balance sheets. ASU 2015-07 amendments are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. Management has elected to adopt ASU 2015-07 early for BHS' investments disclosure, as well as for the investments of the Pension Plan. The adoption had no impact on the consolidated balance sheets or consolidated statements of operations and changes in net assets or on the net assets available for the benefits of the Pension Plans.

In May 2014, the FASB issued guidance related to recognizing revenue from contracts with customers. This new guidance dictates that the standard be applied either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the revenue recognition standard recognized at the date of initial application. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. The Corporation is evaluating the effect this guidance will have on its consolidated financial statements.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. ASU 2015-05 provides explicit guidance on how to account for fees paid in cloud computing arrangements to remove the diversity in practice for accounting for these arrangements. Cloud computing arrangements include software as a service, platform as a service, infrastructure as a service, and other similar hosting arrangements. This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2015, with early adoption permitted. BHS is evaluating the effect this guidance will have on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires that costs incurred to issue debt be presented as a direct deduction from the carrying value of debt. Previous standards required these costs to be shown as deferred charges (i.e., an asset). There is no change as to the presentation or method of amortizing these costs to the consolidated statements of operations and changes in net assets. ASU 2015-03 amendments are effective for fiscal years beginning after December 15, 2015. BHS is evaluating the impact this guidance will have on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern*, that requires management to evaluate whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern. This standard is not effective for the Corporation until December 31, 2016.

Reclassifications

Certain reclassifications were made to the 2014 consolidated financial statements to conform with classifications made in 2015. The reclassifications had no effect on the changes in net assets or on net assets previously reported.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

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

The Medicare and Medicaid programs reimburse the Corporation for inpatient and outpatient services at predetermined rates based on diagnosis and treatment. Changes in the Medicare and Medicaid programs or reduction in funding of the programs could have an adverse effect on future amounts recognized as net patient service revenue.

The laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Managed care reimbursement agreements provide for payment of patient services at a fixed percentage of covered charges. The Corporation has also entered into contractual arrangements with various health maintenance and preferred provider organizations, the terms of which call for the Corporation to be paid for covered services at predetermined rates, including percentage of charges, per diem, and case rate.

Estimated amounts due are calculated from contractually obligated terms of payment for each payor, as well as uninsured discounts applied for patients with no insurance coverage. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the years ended December 31 from these major payor sources is as follows (in thousands):

Payor	2015	2014
Anthem	\$ 195,920	\$ 203,479
Commercial	285,132	265,230
Medicare	267,108	253,610
Medicaid	133,904	151,949
Self-pay	52,870	64,200
Net patient service revenue	934,934	938,468
Provision for bad debts	(73,035)	(68,927)
Net patient service revenue, less provision for bad debts	\$ 861,899	\$ 869,541

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

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

Net patient service revenues related to the Medicare program are 29% and 27% for the years ended December 31, 2015 and 2014, respectively. Net patient service revenues related to the Medicaid program are 14% and 16% for the years ended December 31, 2015 and 2014, respectively. Amounts reported under the Anthem payor contract account for 21% and 22% of net patient service revenue for the years ended December 31, 2015 and 2014, respectively. Credit is granted without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Major components of net patient accounts receivable include 29% from Medicare and 19% from Anthem at December 31, 2015, and 26% from Medicare and 22% from Anthem at December 31, 2014.

The provision for bad debts is based upon management's assessment of historical and expected net collections, taking into consideration the trends in health care coverage, historical economic trends, and other collection indicators. Management assesses the adequacy of the allowances periodically throughout the year based upon historical write-off experience by major payor category. The results of the review are then utilized to make modifications, as necessary, to the provision for bad debts to provide for an appropriate allowance for uncollectible accounts. A significant portion of the Corporation's uninsured patients will be unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided. The allowance for doubtful accounts recognized at December 31 by major payor source is as follows:

Payor	2015	2014
Third-party payors	\$ 18,699	\$ 14,363
Self-pay	14,934	12,012
	<u>\$ 33,633</u>	<u>\$ 26,375</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

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

Adjustments arising from reimbursement arrangements with third-party payors are accrued for on an estimated basis in the period in which the services are rendered, with the exception of Indiana Medicaid Disproportionate Share (DSH) reimbursement. DSH payments by the state of Indiana, if eligible, are paid according to the fiscal year of the state, which ends on June 30 of each year, and are based on the cost of uncompensated care provided by the DSH providers during their respective fiscal year ended during the state fiscal year. DSH payments are recorded after eligibility is determined, and payments are probable and reasonably estimable. In 2014, MHSB qualified for the State DSH program for SFYs 2014 and 2015. MHSB recorded net patient service revenue of \$19,920 for the year ended December 31, 2015, related to SFY 2014 DSH payments. MHSB recorded net patient service revenue of \$10,700 for the year ended December 31, 2014, related to SFY 2014 and 2013 DSH payments.

The Indiana Hospital Assessment Fee program (HAF) was approved by the Centers for Medicare & Medicaid Services (CMS) for the period July 2013 through June 2017. CMS ratified the HAF program retroactively to July 1, 2013 in April 2014. Under HAF, Indiana hospitals receive additional federal Medicaid funds for the state's health care system, administered by the Indiana Family and Social Services Administration. HAF includes both a payment to the Hospitals from the state (included in net patient service revenue) and an assessment (included in supplies and other expenses) against the Hospitals, which is paid to the state the same year. BHS recognized revenues and assessments as follows:

	Year Recognized	
	2015	2014
Year ended December 31, 2015 HAF revenue	\$ 44,796	\$ —
Year ended December 31, 2015 HAF assessments	(23,880)	—
Year ended December 31, 2014 HAF revenue	—	49,490
Year ended December 31, 2014 HAF assessments	(160)	(25,203)
Year ended December 31, 2013 HAF revenue	—	28,863
Year ended December 31, 2013 HAF assessments	—	(13,358)
	\$ 20,756	\$ 39,792

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

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

HAF revenue is included in net patient service revenue and HAF assessments are included in supplies and other expenses in the consolidated statements of operations and changes in net assets.

Estimates for DSH, cost report settlements, and contractual allowances can differ from actual reimbursement based on the results of subsequent reviews, government regulatory changes, and cost report audits. For the years ended December 31, 2015 and 2014, net patient service revenue has been decreased by approximately \$303 and \$3,971, respectively, for changes in estimates of third-party payor settlements related to prior years.

4. Charity Care

Charity care represents unreimbursed costs for services rendered at a reduced fee, or no fee, due to the inability of the patient to pay for services. The amount of the charity care provided was approximately \$7,602 and \$12,328 for the years ended December 31, 2015 and 2014, respectively, at estimated cost. The Corporation utilized a cost to charge ratio methodology for the cost analysis. The only reimbursement for financial assistance care received by the Corporation is determined through a settlement process in the Hospitals' annual Medicare cost report filing. Financial assistance care reimbursement was approximately \$981 and \$968 for the years ended December 31, 2015 and 2014, respectively.

5. Retirement Plans

The Corporation maintains a defined contribution employee retirement and savings plan for all employees who have attained 21 years of age and have completed 12 months of continuous service. The Corporation's contributions are based on 100% of the employee's contributions, up to 4% of the employee's salary. Both employee and corporation contributions are subject to certain limitations. Included in employee benefits on the consolidated statements of operations and changes in net assets are contributions of approximately \$10,585 and \$9,508 for the years ended December 31, 2015 and 2014, respectively.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

The Corporation also has a noncontributory, defined benefit pension plan (the MEM Plan), which includes MHSB, BMG, MHF, and BHV with a final average pay plan and a cash balance plan. The cash balance plan was frozen for new participants and accrual of benefits as of December 31, 2007, and the much smaller grandfathered final average pay plan, with fewer participants, remains frozen and has not been altered. The assets in the cash balance plan will continue to earn interest, but service credits are frozen.

The Corporation also has a noncontributory, defined benefit pension plan (the EGH Plan) for EGH. As of December 31, 2007, the EGH Plan was frozen for all participants who had not attained the age of 50 and accumulated 15 years of vesting service as of December 31, 2007. No new participants are allowed into the plan as of December 31, 2007. Participants who were at least 50 years old and had accumulated 15 years of service at December 31, 2007, continued to accrue benefits under the terms of the EGH Plan until it was frozen effective January 1, 2013. Additionally, a lump-sum payout option was effective for all participants on July 1, 2012.

The Corporation's defined benefit plan expense was as follows for the years ended:

	EGH	MEM	Total
December 31, 2015	\$ 3,015	\$ 2,662	\$ 5,677
December 31, 2014	878	1,445	2,323

The Corporation's expected plan expense for the year ending December 31, 2016, is as follows:

	EGH	MEM	Total
Plan expense	\$ 4,136	\$ 3,811	\$ 7,947

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

5. Retirement Plans (continued)

The measurement date of December 31 is utilized for both plans. The summary of the changes in the benefit obligation and plan assets and the resulting funded status of the plans are as follows:

	December 31, 2015		
	EGH	MEM	Total
Accumulated benefit obligation	\$ 150,727	\$ 139,494	\$ 290,221
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	\$ 158,120	\$ 144,094	\$ 302,214
Service cost	620	1,406	2,026
Interest cost	5,510	5,034	10,544
Actuarial gain	(5,653)	(2,066)	(7,719)
Benefits and administrative expenses paid	(6,183)	(4,725)	(10,908)
Lump-sum benefits paid	(1,687)	(4,249)	(5,936)
Projected benefit obligation at end of year	\$ 150,727	\$ 139,494	\$ 290,221
Change in plan assets:			
Fair value of plan assets at beginning of year	\$ 112,907	\$ 103,828	\$ 216,735
Actual return on plan assets	(3,666)	(2,862)	(6,528)
Employer contributions	4,000	4,000	8,000
Benefits and administrative fees paid	(6,183)	(4,725)	(10,908)
Lump-sum benefits paid	(1,687)	(4,249)	(5,936)
Fair value of plan assets at end of year	\$ 105,371	\$ 95,992	\$ 201,363
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheet	\$ (45,356)	\$ (43,502)	\$ (88,858)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

	December 31, 2014		
	EGH	MEM	Total
Accumulated benefit obligation	\$ 158,120	\$ 144,094	\$ 302,214
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	\$ 140,205	\$ 129,976	\$ 270,181
Service cost	–	1,406	1,406
Interest cost	5,947	5,560	11,507
Actuarial loss	20,683	13,216	33,899
Benefits and administrative expenses paid	(5,159)	(4,224)	(9,383)
Lump-sum benefits paid	(3,556)	(1,840)	(5,396)
Projected benefit obligation at end of year	\$ 158,120	\$ 144,094	\$ 302,214
Change in plan assets:			
Fair value of plan assets at beginning of year	\$ 113,654	\$ 102,216	\$ 215,870
Actual return on plan assets	4,968	3,806	8,774
Employer contributions	3,000	3,870	6,870
Benefits and administrative fees paid	(5,159)	(4,224)	(9,383)
Lump-sum benefits paid	(3,556)	(1,840)	(5,396)
Fair value of plan assets at end of year	\$ 112,907	\$ 103,828	\$ 216,735
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheet	\$ (45,213)	\$ (40,266)	\$ (85,479)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

5. Retirement Plans (continued)

Included in unrestricted net assets are the following amounts that have not been recognized in net periodic pension cost:

	At December 31, 2015		
	EGH	MEM	Total
Prior service cost	\$ —	\$ 7	\$ 7
Actuarial net loss	62,677	48,965	111,642
	\$ 62,677	\$ 48,972	\$ 111,649

	At December 31, 2014		
	EGH	MEM	Total
Prior service cost	\$ —	\$ 9	\$ 9
Actuarial net loss	61,549	44,389	105,938
	\$ 61,549	\$ 44,398	\$ 105,947

The estimated prior service cost and actuarial net losses that will be amortized into expense over the next fiscal year are as follows:

	EGH	MEM	Total
Prior service cost	\$ —	\$ (2)	\$ (2)
Actuarial net loss	(4,760)	(3,502)	(8,262)
Estimated benefit cost amortizations in the next fiscal year	\$ (4,760)	\$ (3,504)	\$ (8,264)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

Changes in the plan's assets and benefit obligations recognized in unrestricted net assets include the following:

	Year Ended December 31, 2015		
	EGH	MEM	Total
Current year actuarial loss	\$ 1,128	\$ 4,574	\$ 5,702
Current year amortization prior service cost	–	7	7
	<u>\$ 1,128</u>	<u>\$ 4,581</u>	<u>\$ 5,709</u>

	Year Ended December 31, 2014		
	EGH	MEM	Total
Current year actuarial loss	\$ 20,783	\$ 14,930	\$ 35,713
Current year amortization prior service cost	–	9	9
	<u>\$ 20,783</u>	<u>\$ 14,939</u>	<u>\$ 35,722</u>

The components of net periodic benefit cost for the defined benefit pension plans were as follows:

	Year Ended December 31, 2015		
	EGH	MEM	Total
Service cost	\$ 620	\$ 1,406	\$ 2,026
Interest cost	5,510	5,035	10,545
Expected return on plan assets	(7,689)	(7,111)	(14,800)
Prior service credit recognized	–	2	2
Amortization of recognized losses	4,574	3,331	7,905
Benefit cost	<u>\$ 3,015</u>	<u>\$ 2,663</u>	<u>\$ 5,678</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

	Year Ended December 31, 2014		
	EGH	MEM	Total
Service cost	\$ —	\$ 1,406	\$ 1,406
Interest cost	5,947	5,560	11,507
Expected return on plan assets	(7,743)	(7,070)	(14,813)
Prior service credit recognized	—	(4)	(4)
Amortization of recognized losses	2,675	1,553	4,228
Benefit cost	<u>\$ 879</u>	<u>\$ 1,445</u>	<u>\$ 2,324</u>

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

	December 31, 2015	
	EGH	MEM
Discount rates	3.90%	3.90%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

	December 31, 2014	
	EGH	MEM
Discount rates	3.60%	3.60%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

In 2014, the mortality assumptions for the plans were updated to the RP-2014 mortality tables. In 2015, the projection scale was updated.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

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

	December 31, 2015	
	EGH	MEM
Discount rates	3.60%	3.60%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

	December 31, 2014	
	EGH	MEM
Discount rates	4.40%	4.40%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

The following is a summary of the pension plan assets' actual allocations:

Asset Category	EGH/MEM Target	2015		2014	
		EGH	MEM	EGH	MEM
Equity securities	38%	36%	36%	37%	31%
Debt securities	33	25	23	28	29
Other	29	39	41	35	40
Total	100%	100%	100%	100%	100%

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

The following table sets forth by level, within the fair value hierarchy (see Note 11), the combined MEM and EGH plan assets carried at fair value as of December 31, 2015:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Short-term investment funds ^(a)	\$ 7,760	\$ —	\$ —	\$ 7,760
Mutual funds: ^(a)				
Large cap equity	5,829	—	—	5,829
International equity	55,992	—	—	55,992
Blended fund	37,176	—	—	37,176
Total mutual funds	<u>98,997</u>	—	—	<u>98,997</u>
Common stocks ^(a)	<u>8,600</u>	—	—	<u>8,600</u>
Total assets measured on a recurring basis at fair value	<u>\$ 115,357</u>	<u>\$ —</u>	<u>\$ —</u>	<u>115,357</u>
Investments recorded at fair value based on NAV				<u>86,006</u>
Total assets measured at fair value				<u>\$ 201,363</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

The following table sets forth by level, within the fair value hierarchy (see Note 11), the combined MEM and EGH plan assets carried at fair value as of December 31, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
Short-term investment funds ^(a)	\$ 6,035	\$ —	\$ —	\$ 6,035
Mutual funds: ^(a)				
Large cap equity	10,467	—	—	10,467
International equity	53,061	—	—	53,061
Blended fund	48,909	—	—	48,909
Total mutual funds	118,472	—	—	118,472
Common stocks ^(a)	8,643	—	—	8,643
Total assets measured on a recurring basis at fair value	<u>\$ 127,115</u>	<u>\$ —</u>	<u>\$ —</u>	127,115
Investments recorded at fair value based on NAV				89,620
Total assets measured at fair value				<u>\$ 216,735</u>

^(a) Pricing for common stocks, mutual funds, and short-term investments is based on the open market and is valued on a daily basis.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

5. Retirement Plans (continued)

In addition to understanding fair value methodologies, long/short funds, MLP, REIT, fund of funds, hedge funds, and other funds may be subject to redemption and/or liquidity restrictions. Those funds that have restrictions are summarized below, as follows:

Type of Fund	Fair Value at December 31		Redemption Restrictions	Liquidity Time Frame
	2015	2014		
Mutual funds				
International equities	\$ 2,167	\$ 2,595	None	Under 95 days
Long/short funds				
Commingled	2,941	3,769	None	Under 95 days
Long/short		249	None	Annual
Master limited partnership	11,333	12,749	1-year lock	Under 95 days
REIT	10,917	7,180	redemption fee	Under 95 days
			None	Under 95 days
Hedge funds				
Multi-strategy hedge funds	14,597	13,379	1-year lock varying	Under 95 days
Multi-strategy hedge funds	1,716	3,324	redemption fees	Under 95 days
Long/short hedge funds	3,504	2,800	None	Under 95 days
Long/short hedge funds	5,064	2,417	1-year lock	Under 95 days
International	474	2,055	redemption fee	Under 95 days
International	5,079	7,645	1-year lock	Under 95 days
Other hedge funds	5,049	4,868	redemption fee	Under 95 days
Other hedge funds	2,897	2,316	None	Under 95 days
Other hedge funds	2,237	1,358	1-year lock	Under 95 days
			redemption fee	Under 95 days
			18-month lock	Under 95 days
			redemption fee	Under 95 days
Fund of funds				
Fund of funds	—	3,144	1-year redemption	Under 95 days
Fund of funds	2,240	1,995	restriction	Under 95 days
			None	Under 95 days

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

5. Retirement Plans (continued)

The Corporation employs a total return investment approach, whereby a mix of equities and fixed-income investments is used to maximize the long-term return on plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan-funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity, fixed income, and alternative investments. Equity investments are diversified across U.S. and non-U.S. corporate stocks, as well as growth, value, and small and large capitalizations.

Other assets, such as hedge funds, are used to enhance long-term returns while improving portfolio diversification. The Corporation's external investment managers may use derivatives to gain market exposure in an efficient and timely manner. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements, and periodic asset/liability studies.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years ending December 31:

	EGH	MEM	Total
2016	\$ 11,153	\$ 8,682	\$ 19,835
2017	11,206	9,343	20,549
2018	10,761	9,418	20,179
2019	10,940	9,736	20,676
2020	10,152	9,106	19,258
2021–2024	48,908	47,158	96,066

The Corporation anticipates contributing the following to the plan assets from employer assets in 2016:

	EGH	MEM	Total
Anticipated 2016 total contributions	\$ 6,000	\$ 6,000	\$ 12,000

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

6. Lease Obligations

The Corporation leases certain office space and equipment under non-cancelable operating leases. At December 31, 2015, the minimum future rental payments under these leases are as follows:

2016	\$	5,256
2017		2,468
2018		2,383
2019		1,680
2020		1,323
Thereafter		5,184
	\$	<u>18,294</u>

Rental expense for the years ended December 31, 2015 and 2014, was approximately \$7,369 and \$6,993, respectively, which is included in supplies and other expense.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

7. Long-Term Debt

Long-term debt consists of the following at December 31:

	<u>2015</u>	<u>2014</u>
Tax-exempt bonds issued on behalf of BHS by the Indiana Finance Authority:		
BHS Revenue Bonds, Series 2013A, bearing interest at fixed rates between 2.00% and 5.00%, due in varying annual installments on August 15 of each year through 2034	\$ 100,830	\$ 105,625
BHS Revenue Note, Series 2013B, bearing interest at a fixed rate of 1.17% at December 31, 2015, due in monthly installments through 2020	4,710	5,764
Tax-exempt bonds issued on behalf of BHS by the Hospital Authority of St. Joseph County:		
BHS Revenue Bonds, Series 2013C, bearing interest at fixed rates between 3.75% and 5.00%, due in varying annual installments on August 15 of each year through 2044	46,130	46,130
Tax-exempt bonds issued on behalf of MHSB by the Hospital Authority of St. Joseph County:		
MHSB Revenue Bonds, Series 2008A, bearing interest at variable rates retaining the hedge from Series 2006 with a floating fixed interest rate swap of 3.52% at December 31, 2015 and 2014, due in varying annual installments on August 15 of each year through 2033	37,660	37,865

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

7. Long-Term Debt (continued)

	<u>2015</u>	<u>2014</u>
Tax-exempt bonds issued on behalf of EGH by the Hospital Authority of Elkhart County:		
EGH Revenue Bonds, Series 2008, bearing interest at variable rates of 0.01% and 0.04% at December 31, 2015 and 2014, respectively, due annually on May 1 of each year through 2033	\$ 42,100	\$ 42,970
Mortgage – bearing interest at variable rates of 1.86% and 2.41% at December 31, 2015 and 2014, respectively, London Interbank Offered Rate (LIBOR) plus 1.5% and 2.25%, respectively, due in varying annual installments on the last day of every month through 2020	858	1,014
Capital leases	<u>2,645</u>	<u>3,104</u>
	234,933	242,472
Unamortized premium	<u>15,183</u>	<u>16,018</u>
	250,116	258,490
Less current portion	<u>8,231</u>	<u>8,693</u>
	<u>\$ 241,885</u>	<u>\$ 249,797</u>

The Indiana Finance Authority, on behalf of BHS, issued revenue refunding bonds Series 2013A (2013A) in the principal amount of \$116,705. The interest rate for 2013A is a fixed rate varying between 2.00% and 5.00%. The proceeds from 2013A were utilized to refund the MHSB Revenue Bonds, Series 2008B; MHSB Revenue Bonds, Series 1998A; and the EGH Revenue Bonds, Series 1998.

The Indiana Finance Authority, on behalf of BHS, issued a revenue note Series 2013B (2013B) in the principal amount of \$7,492. The interest rate for 2013B is a fixed rate of 1.17%. Proceeds from the bond were utilized for the purchase of a helicopter.

The Hospital Authority of St. Joseph County, on behalf of BHS, issued revenue bonds Series 2013C (2013C) in the principal amount of \$46,130. The interest rate for 2013C is a fixed rate varying between 3.75% and 5.00%. The proceeds from 2013C were utilized to refund the MHSB Revenue Bonds, Series 2007. The remaining proceeds are set aside in externally designated investments for future projects.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

7. Long-Term Debt (continued)

The Hospital Authority of St. Joseph County, on behalf of MHSB, issued revenue refunding bonds in the principal amount of \$78,495. The interest rate for the Series 2008A is a weekly interest rate determined by the remarketing agent. The 2008 bond issue is secured by an irrevocable direct-pay letter of credit issued by JPMorgan Chase Bank (JPMorgan). The JPMorgan letters of credit expire on July 31, 2018. As long as no default has occurred, draws on the direct-pay letter of credit made for failed remarketing will be required to be repaid in 12 equal quarterly installments commencing 12 months after the date of draw.

The Series 2008A Bonds are subject to mandatory redemption through the operation of a sinking fund on each August 15 commencing with the year 2011 up to and including the year 2033 in amounts sufficient to redeem the principal amounts.

The Hospital Authority of Elkhart County issued \$47,800 of Series 2008 Hospital Revenue Bonds (the Series 2008 Bonds). EGH borrowed the proceeds of the sale of the Series 2008 Bonds and evidenced this loan with a loan agreement, issued under a Trust Indenture dated December 1, 2008.

The proceeds of the Series 2008 Bonds were issued to retire interest and principal payments of previously outstanding bonds. The Series 2008 Bonds require EGH to hold a letter of credit with JPMorgan. The letter of credit expires on July 31, 2018, and decreases by the principal payments made by EGH on the Series 2008 Bonds. The Series 2008 Bonds mature in May 2033.

As long as no default has occurred, draws on the direct-pay letter of credit made for failed remarketing will be required to be repaid in eight equal quarterly installments commencing on the last business day of the fourth calendar quarter after the stated expiration date of the letter of credit (July 31, 2018).

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

7. Long-Term Debt (continued)

The Corporation is the Obligated Group Agent for the Obligated Group under the Master Trust Indentures. The Obligated Group includes the Corporation, MHSB, EGH, and BMG. MHF and BHV constitute designated affiliates under the terms of the Master Trust Indentures. The bonds are secured by pledged revenues of the Obligated Group and contain various covenants, including achievement of specified financial ratios and limitations on additional debt.

The loan agreements require maintenance of certain debt service coverage ratios, limit additional borrowings, and require compliance with various other restrictive covenants. The Corporation was in compliance with all covenants during 2015 and 2014.

Interest capitalized for the years ended December 31, 2015 and 2014, was approximately \$1,550 and \$912, respectively.

Maturities of long-term debt and capital lease obligations for each of the next five years are as follows:

2016	\$	8,231
2017		8,695
2018		8,649
2019		8,092
2020		7,267

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

8. Lines of Credit

The Corporation has a \$2,000 revolving line of credit with 1st Source Bank. The line of credit was renewed and extended through May 31, 2016. Of the \$2,000 revolving line of credit, \$50 for the years ended December 31, 2015 and 2014, was segregated for the beneficiary of a self-insurance trust. Conversely, \$1,950 was available to be drawn upon at December 31, 2015 and 2014. No draws were taken by MHSB in either 2015 or 2014. The interest rate on the line of credit is the prime rate minus 0.5%. No amounts were outstanding on the line of credit as of December 31, 2015 or 2014.

The Corporation has a \$7,000 revolving line of credit with Merrill Lynch. The line of credit is due on demand and can be terminated by either party with notice. Advances on the line can be made with a variable rate of LIBOR plus 1.25%, at a fixed rate as agreed upon by the parties for a 12-month period or at an agreed-upon term rate for periods greater than 12 months. At any time MHSB may request that variable rate advances be converted into fixed or term rates. No draws were taken by MHSB in either 2015 or 2014. No amounts were outstanding on the line of credit as of December 31, 2015 or 2014.

9. Interest Rate and Basis Swaps

MHSB has various derivative instruments to manage the exposure on interest rates and MHSB's interest expense. Through the use of derivative financial instruments, MHSB is exposed to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of the derivative contract is positive, the counterparty owes MHSB, which creates credit risk to MHSB. When the fair value of the derivative contract is negative, MHSB owes the counterparty, and there is no credit risk to MHSB at that point in time. MHSB minimizes the credit risk in derivative instruments by entering into transactions that require the counterparty to post collateral for the benefit of the fair value of the derivative contract. Market risk is the adverse effect on the value of the financial instrument that results from a change in interest rates. The management of market risk associated with interest rate changes is defined in MHSB's Swap Management Policy (the Policy). The Policy includes continuous monitoring of market conditions, emergent opportunities, and risks. Swap management is meant to be long-term in nature, and any modifications to the program are reviewed for the long-term costs and benefits. Management also mitigates risk through periodic reviews of its derivative position in the context of its total blended cost of capital.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

9. Interest Rate and Basis Swaps (continued)

The derivative instruments require adherence to collateral posting thresholds. For the years ended December 31, 2015 and 2014, the mark-to-market valuation on the swap portfolio was below the required collateral posting threshold of \$30,000 with PNC Bank, \$25,000 with Morgan Stanley, \$25,000 with Wells Fargo, and \$25,000 with Deutsche Bank.

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2015:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
March 2006	\$ 37,660	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	8,100	65% of 30-day LIBOR plus 0.45%	3.8100%	August 2034

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2014:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
March 2006	\$ 37,865	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	8,350	65% of 30-day LIBOR plus 0.45%	3.8100	August 2034

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

9. Interest Rate and Basis Swaps (continued)

The following is a summary of the outstanding basis rate swaps as of December 31, 2015 and 2014:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
January 2007	\$ 42,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.0715%	January 2041
August 2007	54,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index + 0.0715%	August 2041
March 2001	140,000	75.125% of 3M LIBOR	SIFMA tax-exempt index	March 2031
July 2009	63,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	81,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index + 0.17%	August 2041

Net interest paid or received under the above swap agreements is included in interest expense. The net differential for the Corporation as a result of the swap agreements amounted to payments of approximately \$218 and \$306 for the years ended December 31, 2015 and 2014, respectively, and is reflected as an increase to interest expense. The swap agreements do not qualify for hedge accounting; therefore, the change in the fair value of the swap agreements is recorded as an unrealized non-operating gain of approximately \$7,827 and \$9,008 for the years ended December 31, 2015 and 2014, respectively.

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

	Balance Sheet Location	2015	2014
Derivatives not designated as hedging instruments	Interest rate and basis swap receivable	\$ 598	\$ —
Interest rate contracts	Interest rate and basis swaps payable	(20,523)	(27,752)
		<u>\$ (19,925)</u>	<u>\$ (27,752)</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

10. Investments

Total investment return for the years ended December 31 is summarized as follows:

	<u>2015</u>	<u>2014</u>
Investment return:		
Net unrealized (losses) gains on investments	\$ (23,170)	\$ 3,404
Net realized gains on investments	13,177	25,708
Net equity (deficits) earnings on alternative investments	(10,941)	916
	<u>\$ (20,934)</u>	<u>\$ 30,028</u>
Reported as:		
Investment income, net (non-operating)	\$ (20,496)	\$ 29,672
Investment income (temporarily restricted net assets)	(438)	356
	<u>\$ (20,934)</u>	<u>\$ 30,028</u>

The Corporation's investments are exposed to various kinds and levels of risk. Equity mutual funds expose the Corporation to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is the risk associated with a company's operating performance. Fixed-income securities expose the Corporation to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Liquidity risk tends to be higher for equities related to small capitalization companies. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value, resulting in additional gains and losses in the near term.

11. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

11. Fair Value of Financial Instruments (continued)

The fair value of the Corporation's long-term debt, excluding capital leases and the mortgage, is approximately \$246,304 and \$252,826 at December 31, 2015 and 2014, respectively. The valuation for the estimated fair value of long-term debt is completed by a third-party service and takes into account a number of factors, including, but not limited to, any one or more of the following: (i) general interest rate and market conditions; (ii) macroeconomic and/or deal-specific credit fundamentals; (iii) valuations of other financial instruments that may be comparable in terms of rating, structure, maturity, and/or covenant protection; (iv) investor opinions about the respective deal parties; (v) size of the transaction; (vi) cash flow projections, which, in turn, are based on assumptions about certain parameters that include, but are not limited to, default, recovery, prepayment, and reinvestment rates; (vii) administrator reports, asset manager estimates, broker quotations, and/or trustee reports; and (viii) comparable trades, where observable. Based on the inputs in determining the estimated fair value of debt, this fair value measurement would be considered Level 2.

Accounting Standards Codification (ASC) Topic 820-10-50-2 establishes a three-level valuation hierarchy. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in an active market and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

11. Fair Value of Financial Instruments (continued)

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried as of December 31, 2015 and 2014, by caption, on the consolidated balance sheets by the valuation hierarchy defined above for those instruments carried at fair value, as well as the alternative investments that are reported on the equity method of accounting. Deferred compensation investments are included in other assets on the consolidated balance sheets.

	December 31, 2015					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets						
Short-term investments ^(a)	\$ 61,512	\$ –	\$ –	\$ 61,512	\$ –	\$ 61,512
Internally designated investments:						
Mutual funds: ^(a)						
Blended fund	298,910	–	–	298,910	–	295,910
Total mutual funds	298,910	–	–	298,910	–	298,910
Common stock ^(a)	48,476	–	–	48,476	–	48,476
Alternatives:						
Blended fund	–	–	–	–	31,334	31,334
Fund of hedge funds	–	–	–	–	6,492	6,492
International equity	–	–	–	–	88,363	88,363
Private equity	–	–	–	–	14,483	14,483
Real estate	–	–	–	–	6,417	6,417
Other	–	–	–	–	15,647	15,647
Long/short hedge	–	–	–	–	9,655	9,655
Global	–	–	–	–	4,312	4,312
Multi-strategy	–	–	–	–	23,426	23,426
Total alternatives	–	–	–	–	200,129	200,129
Total internally designated investments	347,386	–	–	347,386	200,129	547,515

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

11. Fair Value of Financial Instruments (continued)

	December 31, 2015					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets (continued)						
Restricted cash ^(a)	\$ 3,012	\$ –	\$ –	\$ 3,012	\$ –	\$ 3,012
Ext. designated investment – insurance trust:						
Fixed income ^(a)	2,656	–	–	2,656	–	2,656
Board-designated endowment:						
Mutual funds ^(a) :						
Equities	1,089	–	–	1,089	–	1,089
Blended fund	10,180	–	–	10,180	–	10,180
Fixed income ^{(a), (b)}	133	285	–	418	–	418
Equities ^(a)	924	–	–	924	–	924
Alternatives	–	–	–	–	6,866	6,866
Total board-designated endowment	12,326	285	–	12,611	6,866	19,477
Endowment:						
Mutual funds ^(a) :						
Fixed income	351	–	–	351	–	351
Equities	1,112	–	–	1,112	–	1,112
Blended fund	485	–	–	485	–	485
Money market ^(a)	131	–	–	131	–	131
Hedge funds	–	–	–	–	396	396
Common collective trust funds ^(d)	–	3,742	–	3,742	–	3,742
Total endowment	2,079	3,742	–	5,821	396	6,217
Swaps ^(c)	–	–	598	598	–	598
Total	\$ 428,971	\$ 4,027	\$ 598	\$ 433,596	\$ 207,391	\$ 640,987
Liabilities						
Swaps ^(c)	\$ –	\$ –	\$ (20,523)	\$ (20,523)	\$ –	\$ (20,523)
Total	\$ –	\$ –	\$ (20,523)	\$ (20,523)	\$ –	\$ (20,523)

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

11. Fair Value of Financial Instruments (continued)

	December 31, 2014					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets						
Short-term investments ^(a)	\$ 85,919	\$ —	\$ —	\$ 85,919	\$ —	\$ 85,919
Internally designated investments:						
Mutual funds: ^(a)						
International equity	12,443	—	—	12,443	—	12,443
Blended fund	272,143	—	—	272,143	—	272,143
Total mutual funds	284,586	—	—	284,586	—	284,586
Common stock ^(a)	79,037	—	—	79,037	—	79,037
Alternatives:						
Blended fund	—	—	—	—	34,762	34,762
Fund of hedge funds	—	—	—	—	11,293	11,293
International equity	—	—	—	—	17,521	17,521
MLP	—	—	—	—	31,270	31,270
Private equity	—	—	—	—	22,699	22,699
Real estate	—	—	—	—	6,630	6,630
Real assets	—	—	—	—	17,492	17,492
Commingled funds	—	—	—	—	9,834	9,834
Other	—	—	—	—	18,918	18,918
Long/short hedge	—	—	—	—	10,138	10,138
Global	—	—	—	—	4,131	4,131
Multi-strategy	—	—	—	—	21,887	21,887
Total alternatives	—	—	—	—	206,575	206,575
Total internally designated investments	363,623	—	—	363,623	206,575	570,198

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)
(In Thousands)

11. Fair Value of Financial Instruments (continued)

	December 31, 2014					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets (continued)						
Restricted cash ^(a)	\$ 6,144	\$ –	\$ –	\$ 6,144	\$ –	\$ 6,144
Ext. designated investment – insurance trust:						
Fixed income ^(a)	2,619	–	–	2,619	–	2,619
Board-designated endowment:						
Mutual funds: ^(a)						
Equities	1,147	–	–	1,147	–	1,147
Blended fund	11,949	–	–	11,949	–	11,949
Fixed income ^{(a), (b)}	174	250	–	424	–	424
Equities ^(a)	3,584	–	–	3,584	–	3,584
Alternatives	–	–	–	–	3,697	3,697
Total board-designated endowment	16,854	250	–	17,104	3,697	20,801
Endowment:						
Mutual funds: ^(a)						
Fixed income	491	–	–	491	–	491
Equities	1,236	–	–	1,236	–	1,236
Money market ^(a)	114	–	–	114	–	114
Common collective trust funds ^(d)	–	4,769	–	4,769	–	4,769
Total endowment	1,841	4,769	–	6,610	–	6,610
Total	\$ 477,000	\$ 5,019	\$ –	\$ 482,019	\$ 210,272	\$ 692,291
Liabilities						
Swaps ^(c)	\$ –	\$ –	\$ (27,752)	\$ (27,752)	\$ –	\$ (27,752)
Total	\$ –	\$ –	\$ (27,752)	\$ (27,752)	\$ –	\$ (27,752)

^(a) Pricing for mutual funds, short-term investments, equities, and government obligations is based on the open market and is valued on a daily basis.

^(b) Pricing is based on the fair value of the securities and is valued on a monthly basis. Information used to value this account is provided by International Data Corp. (IDC). In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue from the IDC data to appropriately value the holding.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

11. Fair Value of Financial Instruments (continued)

^(c) Pricing is based on discounted cash flows to reflect a credit spread adjustment to the LIBOR discount curve in order to reflect “nonperformance” risk. The credit spread adjustment is derived from how other comparable entities’ bonds price and trade in the market. As the credit spread adjustment is a significant component of the swap valuation and is an unobservable input, the swaps have been classified as Level 3.

^(d) Pricing is based on the market value of the securities and is valued on a monthly basis.

The table below sets forth a summary of changes in the fair value of the Corporation’s Level 3 swaps for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Balance, beginning of the year	\$ (27,752)	\$ (36,760)
Unrealized gains, net	7,827	9,008
Balance, end of the year	<u>\$ (19,925)</u>	<u>\$ (27,752)</u>

For the year ended December 31, 2015, the Corporation recorded approximately \$7,827 in non-operating gains, which relates to gains of \$8,507 due to the change in the swaps’ value and loss of \$680 to reflect the fair value of the uncollateralized portion of the swap balance. For the year ended December 31, 2014, the Corporation recorded approximately \$9,008 in non-operating gains, which relates to gains of \$11,684 due to the change in the swaps’ value and loss of \$2,676 to reflect the fair value of the uncollateralized portion of the swap balance.

12. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to this and general and administrative functions for the years ended December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Health care services	\$ 544,677	\$ 561,548
Affiliated health services	168,767	164,804
General and administrative	156,241	131,262
	<u>\$ 869,685</u>	<u>\$ 857,614</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

13. Commitments

BMG is a guarantor for a portion of a loan of an unconsolidated joint venture, Valparaiso Medical Development, LLC, in which BMG records an equity interest. The portion of debt guaranteed by BMG is a maximum of \$5,280 and \$5,520 at December 31, 2015 and 2014, respectively. No amounts have been paid or accrued pursuant to this guarantee as of December 31, 2015 or 2014. The loan is collateralized by the assets, including the facility and land, held by Valparaiso Medical Development, LLC.

The Corporation has committed to investing \$70,000 in certain hedge funds and alternative investments. During the years ended December 31, 2015 and 2014, the Corporation invested approximately \$2,072 and \$6,667, respectively. The Corporation had a remaining unfunded commitment of approximately \$34,490 at December 31, 2015.

The Corporation has entered into various construction projects, including related commitments to construction managers, architects, and other vendors. The commitments under these agreements were approximately \$138,452, of which approximately \$72,152 was paid at December 31, 2015.

14. Professional Liability Insurance

The Corporation is a defendant in certain litigation arising in the ordinary course of business. MHSB and EGH have obtained separate professional liability insurance coverage under claims-made policies. MHSB terminated self-funding of its professional and general liability coverage on November 30, 2009. EGH terminated self-funding of its professional and general liability coverage on April 1, 2012. The Indiana Medical Malpractice Act has provided recovery up to \$1,250, per occurrence, with the first \$250 covered by the respective entity. MHSB maintains a trust fund for its self-insurance program, which it will continue to maintain until all claims have been settled. The fair value of the trust fund at December 31, 2015 and 2014, was approximately \$2,656 and \$2,618, respectively. The amount of malpractice and general liability claims, including a component for incurred but not reported claims, was approximately \$5,496 and \$5,794, gross of an insurance recoverable at December 31, 2015 and 2014, respectively, which is included in pension and other liabilities. The interest rate used to discount these claims was 3.0% at December 31, 2015 and 2014. In addition, at December 31, 2015 and 2014, the Corporation recognized a recoverable insurance asset of approximately \$4,120 and \$4,080, respectively, which is included in deferred charges and other assets.

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued) (In Thousands)

15. Income Taxes

The Corporation and its related affiliates, except for BHV, have been determined to qualify as exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) of the Code.

Most of the income received by the Corporation and its related affiliates, except for BHV, is exempt from taxation, as the income is related to the mission of the organization. Accordingly, there is no material provision for income tax for these entities. However, some of the income received by exempt entities is subject to taxation as unrelated business income. The Corporation and its subsidiaries file federal and various state income tax returns in the United States.

16. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31:

	<u>2015</u>	<u>2014</u>
Net assets currently available for:		
General – health care	\$ 7,605	\$ 7,869
Capital	3,545	5,833
Programs	209	260
Education	302	288
Other	1,045	1,088
	<u>\$ 12,706</u>	<u>\$ 15,338</u>

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

	<u>2015</u>	<u>2014</u>
Endowment investments providing income for health care educational purposes	\$ 191	\$ 191
Endowment for charity care at EGH	400	400
	<u>\$ 591</u>	<u>\$ 591</u>

Beacon Health System, Inc. and Affiliated Corporations

Notes to Consolidated Financial Statements (continued)

(In Thousands)

17. Subsequent Events

The Corporation evaluated events and transactions occurring subsequent to December 31, 2015, through March 3, 2016, the date of issuance of the accompanying consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements, other than those previously disclosed.

Supplementary Information



Ernst & Young LLP
155 North Wacker Drive
Chicago, IL 60606-1787

Tel: +1 312 879 2000
Fax: +1 312 879 4000
ey.com

Report of Independent Auditors on Supplementary Information

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

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The following financial information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

March 3, 2016

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet

(In Thousands)

December 31, 2015

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Assets								
Current assets:								
Cash and cash equivalents	\$ 63,838	\$ -	\$ 45,400	\$ 4,020	\$ 446	\$ 1,223	\$ 12,245	\$ 504
Short-term investments	61,512	-	21,775	-	1,045	-	-	38,692
Patient accounts receivable, net	163,256	(3,870)	101,236	13,633	-	6,035	45,300	922
Due from third-party payors	12,487	-	11,180	-	-	-	1,307	-
Other receivables	9,949	-	4,270	1,023	838	256	3,306	256
Inventories	24,111	-	15,145	-	-	1,066	7,900	-
Prepaid expenses	9,416	-	1,133	399	-	190	1,335	6,359
Due from affiliates	-	(1,676)	504	632	-	-	-	540
Total current assets	344,569	(5,546)	200,643	19,707	2,329	8,770	71,393	47,273
Assets limited as to use:								
Internally designated investments	547,515	-	-	-	-	-	-	547,515
Restricted cash	3,012	-	-	-	3,012	-	-	-
Externally designated investments – insurance trust	2,656	-	2,626	20	-	10	-	-
Board-designated endowment	19,477	-	-	-	19,477	-	-	-
Endowment and temporarily restricted investments	6,217	-	-	-	-	-	6,217	-
	578,877	-	2,626	20	22,489	10	6,217	547,515
Property and equipment:								
Land	45,749	-	22,038	3,883	-	-	3,825	16,003
Buildings and improvements	633,254	-	408,979	36,253	-	9,060	174,699	4,263
Furniture and equipment	447,712	-	285,458	29,988	429	8,546	87,082	36,209
Construction-in-progress	105,257	-	19,307	3,687	-	-	79,677	2,586
	1,231,972	-	735,782	73,811	429	17,606	345,283	59,061
Less allowances for depreciation and amortization	605,738	-	396,771	26,374	412	11,863	145,889	24,429
	626,234	-	339,011	47,437	17	5,743	199,394	34,632
Unamortized bond issuance costs, net	2,077	-	1,386	-	-	-	691	-
Deferred charges and other assets	31,564	(12,367)	4,727	16,958	2,125	7,308	4,187	8,626
Interest rate swap	598	-	598	-	-	-	-	-
Interest in net assets of recipient organization	-	(6,889)	6,889	-	-	-	-	-
Total assets	\$ 1,583,919	\$ (24,802)	\$ 555,880	\$ 84,122	\$ 26,960	\$ 21,831	\$ 281,882	\$ 638,046

Beacon Health System, Inc. and Affiliated Corporations

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

December 31, 2015

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Liabilities and net assets								
Current liabilities:								
Accounts payable	\$ 49,184	\$ –	\$ 20,872	\$ 6,932	\$ 23	\$ 712	\$ 14,005	\$ 6,640
Accrued salaries and benefits	35,096	(3,870)	17,097	6,539	–	1,826	8,667	4,837
Accrued expenses	4,522	–	2,161	–	–	12	953	1,396
Due to third-party payors	11,265	–	7,916	–	–	–	3,349	–
Due to affiliates	–	(1,676)	–	–	83	1,520	73	–
Current maturities of long-term debt	8,231	–	5,525	64	–	–	2,642	–
Total current liabilities	108,298	(5,546)	53,571	13,535	106	4,070	29,689	12,873
Non-current liabilities:								
Long-term debt, less current maturities	241,885	–	163,693	203	–	–	77,989	–
Pension and other liabilities	100,437	–	7,759	43,529	–	14	47,354	1,781
Interest rate and basis swaps	20,523	–	20,523	–	–	–	–	–
	362,845	–	191,975	43,732	–	14	125,343	1,781
Total liabilities	471,143	(5,546)	245,546	57,267	106	4,084	155,032	14,654
Net assets:								
Unrestricted:								
Undesignated	1,080,002	(12,367)	303,445	26,855	297	17,747	120,633	623,392
Board-designated endowment	19,477	–	–	–	19,477	–	–	–
Total unrestricted	1,099,479	(12,367)	303,445	26,855	19,774	17,747	120,633	623,392
Temporarily restricted	12,706	(6,889)	6,889	–	6,889	–	5,817	–
Permanently restricted	591	–	–	–	191	–	400	–
Total net assets	1,112,776	(19,256)	310,334	26,855	26,854	17,747	126,850	623,392
Total liabilities and net assets	\$ 1,583,919	\$ (24,802)	\$ 555,880	\$ 84,122	\$ 26,960	\$ 21,831	\$ 281,882	\$ 638,046

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet

(In Thousands)

December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Assets								
Current assets:								
Cash and cash equivalents	\$ 96,532	\$ –	\$ 28,348	\$ 12,681	\$ 490	\$ 2,486	\$ 46,901	\$ 5,626
Short-term investments	85,919	–	51,005	–	1,088	–	1	33,825
Patient accounts receivable, net	140,259	(3,781)	79,539	14,646	–	7,286	42,339	230
Due from third-party payors	18,253	–	17,200	–	–	–	1,053	–
Other receivables	11,884	–	3,989	1,372	463	400	5,264	396
Inventories	22,868	–	14,162	–	–	1,314	7,392	–
Prepaid expenses	12,088	–	1,559	406	–	191	1,123	8,809
Due from affiliates	–	(14,249)	3,583	–	–	–	368	10,298
Total current assets	387,803	(18,030)	199,385	29,105	2,041	11,677	104,441	59,184
Assets limited as to use:								
Internally designated investments	570,198	–	–	–	–	–	–	570,198
Restricted cash	6,144	–	–	–	6,144	–	–	–
Externally designated investments – insurance trust	2,619	–	2,588	20	–	11	–	–
Board-designated endowment	20,801	–	–	–	20,801	–	–	–
Endowment and temporarily restricted investments	6,610	–	–	–	–	–	6,610	–
	606,372	–	2,588	20	26,945	11	6,610	570,198
Property and equipment:								
Land	43,597	–	21,923	2,430	–	–	4,105	15,139
Buildings and improvements	614,625	–	399,389	28,767	–	9,061	174,923	2,485
Furniture and equipment	408,363	–	273,487	17,044	425	7,715	78,909	30,783
Construction-in-progress	63,954	–	9,389	12,555	2	45	38,756	3,207
	1,130,539	–	704,188	60,796	427	16,821	296,693	51,614
Less allowances for depreciation and amortization	554,795	–	367,487	22,338	402	11,006	133,213	20,349
	575,744	–	336,701	38,458	25	5,815	163,480	31,265
Unamortized bond issuance costs, net	2,188	–	1,458	–	–	–	730	–
Deferred charges and other assets	30,695	(12,367)	4,738	17,008	1,570	7,526	4,378	7,842
Interest in net assets of recipient organization	–	(9,128)	9,128	–	–	–	–	–
Total assets	\$ 1,602,802	\$ (39,525)	\$ 553,998	\$ 84,591	\$ 30,581	\$ 25,029	\$ 279,639	\$ 668,489

Beacon Health System, Inc. and Affiliated Corporations

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

December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Liabilities and net assets								
Current liabilities:								
Accounts payable	\$ 60,246	\$ –	\$ 27,145	\$ 6,374	\$ 23	\$ 1,043	\$ 16,945	\$ 8,716
Accrued salaries and benefits	48,204	(3,781)	22,173	9,402	59	2,672	11,528	6,151
Accrued expenses	4,961	–	2,277	–	–	153	776	1,755
Due to third-party payors	9,737	–	5,900	–	–	–	3,837	–
Due to affiliates	–	(14,249)	–	293	–	13,956	–	–
Current maturities of long-term debt	8,693	–	6,107	70	–	–	2,516	–
Total current liabilities	131,841	(18,030)	63,602	16,139	82	17,824	35,602	16,622
Non-current liabilities:								
Long-term debt, less current maturities	249,797	–	168,613	274	–	–	80,910	–
Pension and other liabilities	97,245	–	8,288	40,295	–	15	47,211	1,436
Interest rate and basis swaps	27,752	–	27,752	–	–	–	–	–
	374,794	–	204,653	40,569	–	15	128,121	1,436
Total liabilities	506,635	(18,030)	268,255	56,708	82	17,839	163,723	18,058
Net assets:								
Unrestricted:								
Undesignated	1,059,437	(12,367)	276,615	27,883	379	7,190	109,306	650,431
Board-designated endowment	20,801	–	–	–	20,801	–	–	–
Total unrestricted	1,080,238	(12,367)	276,615	27,883	21,180	7,190	109,306	650,431
Temporarily restricted	15,338	(9,128)	9,128	–	9,128	–	6,210	–
Permanently restricted	591	–	–	–	191	–	400	–
Total net assets	1,096,167	(21,495)	285,743	27,883	30,499	7,190	115,916	650,431
Total liabilities and net assets	\$ 1,602,802	\$ (39,525)	\$ 553,998	\$ 84,591	\$ 30,581	\$ 25,029	\$ 279,639	\$ 668,489

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2015

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Unrestricted revenue, gains, and other support								
Net patient service revenue	\$ 934,934	\$	\$ 500,889	\$ 103,230	\$	\$ 34,864	\$ 290,363	\$ 5,588
Provision for bad debts	(73,035)	-	(36,369)	(5,818)	-	(1,471)	(29,377)	-
Net patient service revenue, less provision for bad debts	861,899	-	464,520	97,412	-	33,393	260,986	5,588
Other revenue	40,567	(9,054)	21,919	9,340	854	2,884	13,089	1,535
Net assets released from restrictions used for operations	332	-	289	-	-	-	-	43
	902,798	(9,054)	486,728	106,752	854	36,277	274,075	7,166
Expenses								
Salaries and wages	379,739	-	140,824	113,888	-	22,420	79,854	22,753
Employee benefits	93,500	-	37,736	19,821	-	4,866	23,161	7,916
Supplies and other	223,052	(8,595)	122,377	19,449	302	6,943	72,146	10,430
Management fees	-	-	25,686	10,474	238	2,432	16,847	(55,677)
Professional fees and purchased services	115,892	(459)	46,722	4,569	705	1,263	39,505	23,587
Depreciation and amortization	52,517	-	28,913	4,059	10	1,284	14,959	3,292
Interest	4,985	-	4,770	8	-	-	207	-
	869,685	(9,054)	407,028	172,268	1,255	39,208	246,679	12,301
Income (loss) from operations	33,113	-	79,700	(65,516)	(401)	(2,931)	27,396	(5,135)
Non-operating								
Investment (losses) income, net	(20,496)	-	(37)	30	(449)	3	4	(20,047)
Unrealized gains on swap transactions	7,827	-	7,827	-	-	-	-	-
Loss on bond refunding	-	-	-	-	-	-	-	-
Revenue and gains in excess of (less than) expenses	20,444	-	87,490	(65,486)	(850)	(2,928)	27,400	(25,182)

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2015

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Unrestricted net assets								
Revenue and gains in excess of (less than) expenses	\$ 20,444	\$ -	\$ 87,490	\$ (65,486)	\$ (850)	\$ (2,928)	\$ 27,400	\$ (25,182)
Net assets released from restrictions used for capital purposes	5,456	-	5,453	-	-	-	-	3
Net assets released from board-designated endowment	(815)	-	-	-	(815)	-	-	-
Other	(142)	-	(66,113)	69,032	257	13,485	(14,943)	(1,860)
Postretirement benefit adjustments other than periodic costs	(5,702)	-	-	(4,574)	-	-	(1,128)	-
Increase (decrease) in unrestricted net assets	19,241	-	26,830	(1,028)	(1,408)	10,557	11,329	(27,039)
Temporarily restricted net assets								
Contributions temporarily restricted for use	3,594	-	-	-	3,594	-	-	-
Investment income	(438)	-	-	-	(43)	-	(395)	-
Net assets released from restrictions used for operating and capital purposes	(5,788)	-	-	-	(5,788)	-	-	-
Change in interest in recipient organization	-	2,239	(2,239)	-	-	-	-	-
Increase (decrease) in temporarily restricted net assets	(2,632)	2,239	(2,239)	-	(2,237)	-	(395)	-
Increase (decrease) in net assets	16,609	2,239	24,591	(1,028)	(3,645)	10,557	10,934	(27,039)
Net assets at beginning of year	1,096,167	(21,495)	285,743	27,883	30,499	7,190	115,916	650,431
Net assets at end of year	<u>\$ 1,112,776</u>	<u>\$ (19,256)</u>	<u>\$ 310,334</u>	<u>\$ 26,855</u>	<u>\$ 26,854</u>	<u>\$ 17,747</u>	<u>\$ 126,850</u>	<u>\$ 623,392</u>

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Unrestricted revenue, gains, and other support								
Net patient service revenue	\$ 938,468	\$ (37)	\$ 496,271	\$ 99,221	\$ –	\$ 36,126	\$ 306,887	\$ –
Provision for bad debts	(68,927)	–	(35,599)	(4,604)	–	(1,613)	(27,111)	–
Net patient service revenue, less provision for bad debts	869,541	(37)	460,672	94,617	–	34,513	279,776	–
Other revenue	43,902	(8,284)	25,507	6,728	796	2,443	13,652	3,060
Net assets released from restrictions used for operations	322	–	241	–	11	–	–	70
	913,765	(8,321)	486,420	101,345	807	36,956	293,428	3,130
Expenses								
Salaries and wages	361,661	(11)	138,415	99,571	–	23,340	80,012	20,334
Employee benefits	93,030	–	38,865	17,137	22	5,344	23,096	8,566
Supplies and other	232,821	(7,853)	126,232	18,228	280	9,390	78,441	8,103
Management fees	–	–	24,578	7,086	231	1,916	16,402	(50,213)
Professional fees and purchased services	113,630	(457)	47,555	8,736	670	1,447	37,741	17,938
Depreciation and amortization	50,547	–	27,565	3,022	17	1,356	15,875	2,712
Interest	5,925	–	4,801	2	–	–	1,122	–
	857,614	(8,321)	408,011	153,782	1,220	42,793	252,689	7,440
Income (loss) from operations	56,151	–	78,409	(52,437)	(413)	(5,837)	40,739	(4,310)
Non-operating								
Investment income, net	29,672	–	9,455	34	619	1	8,965	10,598
Unrealized gains on swap transactions	9,008	–	9,008	–	–	–	–	–
Loss on bond refunding	–	–	–	–	–	–	–	–
Revenue and gains in excess of (less than) expenses	94,831	–	96,872	(52,403)	206	(5,836)	49,704	6,288

Beacon Health System, Inc. and Affiliated Corporations

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

Year Ended December 31, 2014

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Memorial Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.
Unrestricted net assets								
Revenue and gains in excess of (less than) expenses	\$ 94,831	\$ –	\$ 96,872	\$ (52,403)	\$ 206	\$ (5,836)	\$ 49,704	\$ 6,288
Net assets released from restrictions used for capital purposes	392	–	387	5	–	–	–	–
Net assets released from board-designated endowment	(771)	–	–	–	(771)	–	–	–
Other	–	–	(439,296)	69,211	361	–	(224,892)	594,616
Postretirement benefit adjustments other than periodic costs	(35,714)	–	–	(14,931)	–	–	(20,783)	–
Increase (decrease) in unrestricted net assets	58,738	–	(342,037)	1,882	(204)	(5,836)	(195,971)	600,904
Temporarily restricted net assets								
Contributions temporarily restricted for use	3,334	–	–	–	3,334	–	–	–
Investment income	356	–	–	–	24	–	332	–
Net assets released from restrictions used for operating and capital purposes	(714)	–	–	–	(714)	–	–	–
Change in interest in recipient organization	–	(2,644)	2,644	–	–	–	–	–
Increase (decrease) in temporarily restricted net assets	2,976	(2,644)	2,644	–	2,644	–	332	–
Increase (decrease) in net assets	61,714	(2,644)	(339,393)	1,882	2,440	(5,836)	(195,639)	600,904
Net assets at beginning of year	1,034,453	(18,851)	625,136	26,001	28,059	13,026	311,555	49,527
Net assets at end of year	<u>\$ 1,096,167</u>	<u>\$ (21,495)</u>	<u>\$ 285,743</u>	<u>\$ 27,883</u>	<u>\$ 30,499</u>	<u>\$ 7,190</u>	<u>\$ 115,916</u>	<u>\$ 650,431</u>

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2015 Ernst & Young LLP.
All Rights Reserved.

ey.com

