



CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2015 AND 2014

CPAs / ADVISORS



DEACONESS HEALTH SYSTEM

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Deaconess Health System
Evansville, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Deaconess Health System (System), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the System'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 System'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.

Board of Directors
Deaconess Health System
Evansville, Indiana

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the System as of September 30, 2015 and 2014, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Blue & Co., LLC

Indianapolis, Indiana
December 10, 2015

DEACONESS HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS SEPTEMBER 30, 2015 AND 2014

	2015	2014
ASSETS		
Current assets		
Cash and cash equivalents	\$ 94,748,798	\$ 93,153,751
Funds held by trustee, current portion	33,754	4,351,171
Patient accounts receivable, less allowance for estimated uncollectible amounts of \$26,274,000 in 2015 and \$38,378,000 in 2014	119,232,560	98,767,803
Inventories	8,917,873	7,636,764
Prepaid expenses and other current assets	26,592,783	16,002,157
Total current assets	249,525,768	219,911,646
Investments limited as to use, less current portion		
Board designated funds	467,298,692	405,864,684
Board designated funds - Foundation	6,320,227	6,676,043
Donor restricted - Foundation	5,942,970	5,777,498
Total investments limited as to use	479,561,889	418,318,225
Property and equipment		
Land and improvements	22,883,049	20,620,616
Buildings and improvements	527,748,602	520,249,106
Furniture, fixtures and equipment	314,607,759	292,058,068
	865,239,410	832,927,790
Less allowances for depreciation	541,284,156	509,390,629
	323,955,254	323,537,161
Construction in progress	17,178,970	11,184,625
Total property and equipment, net	341,134,224	334,721,786
Other assets		
Deferred financing costs	1,291,553	1,187,388
Investments in joint ventures	23,741,072	25,879,283
Goodwill and other intangibles	23,205,812	22,583,543
Other	16,462,163	14,443,031
Total other assets	64,700,600	64,093,245
Total assets	<u>\$ 1,134,922,481</u>	<u>\$ 1,037,044,902</u>

See accompanying notes to consolidated financial statements.

DEACONESS HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS SEPTEMBER 30, 2015 AND 2014

LIABILITIES AND NET ASSETS

	2015	2014
Current liabilities		
Accounts payable and other accrued liabilities	\$ 47,083,959	\$ 43,483,124
Salaries, wages and related liabilities	45,732,308	45,786,745
Estimated third-party payor settlements	12,224,742	10,101,382
Accrued interest	872,898	644,442
Other current liabilities	315,322	401,362
Current portion of long-term debt	7,109,963	7,192,257
Total current liabilities	<u>113,339,192</u>	<u>107,609,312</u>
Long-term liabilities		
Long-term debt, less current portion	210,527,904	209,441,420
Other long-term liabilities	89,016,684	53,816,309
Total long-term liabilities	<u>299,544,588</u>	<u>263,257,729</u>
 Total liabilities	 412,883,780	 370,867,041
Net assets		
Unrestricted	705,122,911	648,786,632
Non-controlling interest	10,972,820	11,613,731
Total unrestricted net assets	716,095,731	660,400,363
Temporarily restricted	4,149,538	3,872,368
Permanently restricted	1,793,432	1,905,130
Total net assets	<u>722,038,701</u>	<u>666,177,861</u>
Total liabilities and net assets	<u>\$ 1,134,922,481</u>	<u>\$ 1,037,044,902</u>

See accompanying notes to consolidated financial statements.

DEACONESS HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED SEPTEMBER 30, 2015 AND 2014

	2015	2014
Unrestricted revenue and other support		
Net patient service revenue	\$ 848,115,661	\$ 778,547,104
Less provision for bad debts	21,428,973	27,689,170
Net patient service revenue net of provision for bad debts	826,686,688	750,857,934
Other revenue	39,450,912	37,231,506
Total unrestricted revenue and other support	866,137,600	788,089,440
Expenses		
Salaries and wages	306,465,106	276,581,297
Employee benefits	77,547,077	76,015,032
Supplies	140,718,620	124,348,807
Contract services	80,773,590	73,354,153
Repairs and maintenance	22,786,686	21,049,021
Depreciation	43,155,445	43,494,213
Interest	7,967,176	8,362,577
Utilities	13,327,576	13,518,495
Other	49,328,848	59,712,485
Total expenses	742,070,124	696,436,080
Income from operations	124,067,476	91,653,360
Nonoperating revenues (expenses)		
Investment income	15,939,181	13,466,528
Contributions, gifts, and bequests	1,035,710	797,403
Grants	(1,525,734)	(1,954,064)
Loss on bond defeasance	(9,816,716)	-0-
Total nonoperating revenues (expenses)	5,632,441	12,309,867
Excess revenues over expenses	129,699,917	103,963,227
Other changes in unrestricted net assets		
Net unrealized gain (loss) on investments	(19,215,137)	14,690,787
Benefit related changes other than net periodic benefit cost	(38,019,360)	7,076,110
Net assets released from restriction	197,092	467,009
Contributions from non-controlling interest	-0-	300,000
Distributions to non-controlling interest	(16,967,144)	(9,770,779)
Change in unrestricted net assets	55,695,368	116,726,354
Temporarily restricted net assets		
Contributions, gifts and bequests	475,407	430,023
Investment income	40,005	60,656
Net unrealized gain (loss) on investments	(41,150)	66,117
Net assets released from restriction	(197,092)	(467,009)
Change in temporarily restricted net assets	277,170	89,787
Permanently restricted net assets		
Change in beneficial interest in trusts	(111,698)	56,362
Change in net assets	\$ 55,860,840	\$ 116,872,503

See accompanying notes to consolidated financial statements.

DEACONESS HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS YEARS ENDED SEPTEMBER 30, 2015 AND 2014

	Unrestricted		Temporarily Restricted	Permanently Restricted	Total
	Unrestricted	Non-controlling Interest			
Net assets					
September 30, 2013	\$ 534,398,299	\$ 9,275,710	\$ 3,782,581	\$ 1,848,768	\$ 549,305,358
Excess revenues over expenses	92,154,427	11,808,800	-0-	-0-	103,963,227
Net unrealized gain on investments	14,690,787	-0-	66,117	-0-	14,756,904
Benefit related changes other than net periodic benefit cost	7,076,110	-0-	-0-	-0-	7,076,110
Net assets released from restriction	467,009	-0-	(467,009)	-0-	-0-
Investment income	-0-	-0-	60,656	-0-	60,656
Contributions, gifts, bequests and other changes	-0-	-0-	430,023	56,362	486,385
Contributions from non-controlling interest	-0-	300,000	-0-	-0-	300,000
Distributions to non-controlling interest	-0-	(9,770,779)	-0-	-0-	(9,770,779)
Change in net assets	<u>114,388,333</u>	<u>2,338,021</u>	<u>89,787</u>	<u>56,362</u>	<u>116,872,503</u>
September 30, 2014	648,786,632	11,613,731	3,872,368	1,905,130	666,177,861
Excess revenues over expenses	113,373,684	16,326,233	-0-	-0-	129,699,917
Net unrealized loss on investments	(19,215,137)	-0-	(41,150)	-0-	(19,256,287)
Benefit related changes other than net periodic benefit cost	(38,019,360)	-0-	-0-	-0-	(38,019,360)
Net assets released from restriction	197,092	-0-	(197,092)	-0-	-0-
Investment income	-0-	-0-	40,005	-0-	40,005
Contributions, gifts, bequests and other changes	-0-	-0-	475,407	(111,698)	363,709
Distributions to non-controlling interest	-0-	(16,967,144)	-0-	-0-	(16,967,144)
Change in net assets	<u>56,336,279</u>	<u>(640,911)</u>	<u>277,170</u>	<u>(111,698)</u>	<u>55,860,840</u>
September 30, 2015	<u>\$ 705,122,911</u>	<u>\$ 10,972,820</u>	<u>\$ 4,149,538</u>	<u>\$ 1,793,432</u>	<u>\$ 722,038,701</u>

See accompanying notes to consolidated financial statements.

DEACONESS HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2015 AND 2014

	2015	2014
Operating activities		
Change in net assets	\$ 55,860,840	\$ 116,872,503
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	43,155,445	43,494,213
Provision for bad debts	21,428,973	27,689,170
Net unrealized (gain) loss on investments	19,256,287	(14,756,904)
Net realized gain on investments	(2,317,827)	(1,947,045)
Unrealized loss on interest rate swap	576,597	151,759
Loss on disposal of assets	12,158	708,812
Loss on bond defeasance	9,816,716	-0-
Amortization of deferred financing costs and original issue discount/premium	(131,257)	(77,885)
Restricted contributions, gifts and bequests	(475,407)	(430,023)
Contributions from non-controlling interest	-0-	(300,000)
Distributions to non-controlling interest	16,967,144	9,770,779
Changes in operating assets and liabilities		
Patient accounts receivable	(41,893,730)	(34,530,770)
Inventories	(1,281,109)	(1,246,537)
Prepaid expenses and other current assets	(10,590,626)	(2,390,663)
Investments in joint ventures and other assets	119,079	(4,398,143)
Accounts payable and other accrued liabilities	1,521,835	8,860,588
Salaries, wages and related liabilities	(54,437)	3,105,654
Estimated third-party payor settlements	2,123,360	1,695,011
Accrued interest	228,456	(15,086)
Other current liabilities	(86,040)	401,362
Other long-term liabilities	34,623,778	(7,512,003)
Net cash flows from operating activities	148,860,235	145,144,792
Investing activities		
Purchases of property and equipment	(47,508,041)	(34,838,401)
Proceeds from disposal of property and equipment	7,000	1,800
Net transfers from trustee assets for principal, interest and construction draws	4,317,417	(8)
Purchases of board designated funds	(257,317,696)	(216,892,358)
Proceeds from sale of board designated funds	181,036,124	166,360,521
Purchase of assets	(622,269)	(366,062)
Other investing activities	-0-	(594,913)
Net cash flows from investing activities	(120,087,465)	(86,329,421)
Financing activities		
Contributions from non-controlling interest	-0-	300,000
Distributions to non-controlling interest	(16,967,144)	(9,770,779)
Restricted contributions, gifts and bequests	475,407	430,023
Payments on long-term debt	(7,451,106)	(9,487,860)
Proceeds from long-term debt	48,270,000	-0-
Payments to refinance long-term debt	(43,900,000)	-0-
Cash paid for bond call premium and other	(8,505,374)	-0-
Cash received for bond premium	1,289,953	-0-
Cash paid for deferred financing costs	(389,459)	-0-
Net cash flows from financing activities	(27,177,723)	(18,528,616)
Change in cash and cash equivalents	1,595,047	40,286,755
Cash and cash equivalents		
Beginning of year	93,153,751	52,866,996
End of year	\$ 94,748,798	\$ 93,153,751

See accompanying notes to consolidated financial statements.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Deaconess Health System (System) is an integrated multi-facility health system providing comprehensive health care services to southern Indiana, southeastern Illinois and western Kentucky, employing over 5,000 within the Tri-State area.

Deaconess Health System, Inc. was formed to coordinate management and strategic planning and provide operational facilities for entities within the System, the most significant of which are Deaconess Hospital, Inc. (Hospital) and Deaconess Clinic, Inc. (Clinic), not-for-profit corporations whose missions are to provide quality health care services with a compassionate and caring spirit to persons, families and communities of the Tri-State area.

The board of Deaconess Health System, Inc. is granted the authority to provide overall direction and control of the entities through their respective bylaws. Deaconess Health System, Inc. wholly owns the Clinic, Deaconess Care Integration, LLC, DCI Commercial ACO, LLC and OneCare, LLC and is the sole corporate member of the Hospital.

The Clinic is comprised of Deaconess employed physicians practicing primary care and multi-specialty medicine within outpatient physician offices located throughout southern Indiana, southeastern Illinois and western Kentucky and two urgent care centers located in Evansville, Indiana. The facilities provide illness and injury care, preventative care, lab and x-ray services. The Clinic also encompasses the Deaconess Clinical Research Institute which provides drug research studies for the pharmaceutical industry.

Deaconess Care Integration, LLC was formed in 2012 as an accountable care organization with the purpose of developing a care delivery model focused on quality metrics and reductions in cost for the Medicare population.

DCI Commercial ACO, LLC was formed in 2014 as a counterpart to Deaconess Care Integration, LLC, but with a focus on the commercial populations. Its purpose is to assist commercial clients with value based coverage programs.

OneCare, LLC was formed in 2014 to develop a network of participating health care providers and pursue contracts, in concert with the aforementioned ACO's, with provider-owned health plans, commercial payors, employers, providers, suppliers and other third parties to provide high quality, cost-effective and coordinated health care services to their enrollees.

The Hospital, located in Evansville, Indiana, is comprised of two general acute care facilities, a mental health facility and two outpatient primary care facilities for seniors. The inpatient services have a combined capacity of 514 intensive care, pediatric, medical/surgical, orthopedic and neurosurgical beds.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The Hospital wholly owns Regional Emergency Staffing Department, LLC and Ready Development, LLC and holds majority ownership interests in the following entities:

- The Heart Hospital at Deaconess Gateway, LLC – 51%
- Progressive Health of Indiana, LLC – 51%
- Tri-State Radiation Oncology, LLC – 51%
- Deaconess Health Plans, LLC – 94%
- Mainspring Managers, LLC – 51%
- Vasmed, LLC – 51%

Regional Emergency Department Staffing, LLC assists hospitals in staffing emergency room departments and in improving the overall quality of services rendered in emergency room departments.

Ready Development, LLC was formed to purchase and develop real estate for future use.

The Heart Hospital at Deaconess Gateway, LLC is a 24 bed hospital providing preventative care, medical care, emergent care, diagnostic testing, cardiovascular procedures, cardiovascular surgery and cardiac rehabilitation on an outpatient and inpatient basis.

Progressive Health of Indiana, LLC provides physical, occupational and speech therapy services throughout southern Indiana.

Tri-State Radiation Oncology, LLC provides oncology and cancer services, including radiation therapy, pain management, counseling and rehabilitation.

Deaconess Health Plans, LLC is a preferred provider organization – managed care network formed to encourage collaboration in providing patient service and cost management.

Mainspring Managers, LLC was formed during 2014 to provide neurology services to treat brain, spinal cord and nervous system injuries, diseases and disorders.

Vasmed, LLC was formed during 2015 to provide services and manage the vascular service line of the Hospital.

Principles of Consolidation

The consolidated financial statements include the accounts of Deaconess Health System and its wholly owned and controlled subsidiaries. All material inter-company accounts and transactions have been eliminated in consolidation.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Investments in Joint Ventures

Investments in organizations where the System's ownership percentage is equal to or less than 50% are included in investments in joint ventures on the consolidated balance sheets. Investments in joint ventures approximated \$23,741,000 and \$25,879,000 as of September 30, 2015 and 2014, respectively. The System's portion of income from unconsolidated organizations is reported with other operating revenue and was approximately \$15,255,000 and \$16,757,000 for 2015 and 2014, respectively. A summary of the significant investments in joint ventures follows:

- The Hospital holds a 50% ownership in the Deaconess Women's Hospital of Southern Indiana, LLC d/b/a The Women's Hospital which is a 74-bed facility dedicated to comprehensive women's care, including obstetrics, neonatal intensive care, cancer treatment and infertility and imaging services.
- The Hospital holds a 50% ownership interest in Evansville Surgery Center Associates, LLC providing two locations of multispecialty outpatient surgery centers dedicated to the diagnosis and preoperative, intraoperative and postoperative care of patients.
- The Hospital holds a 50% ownership interest in Deaconess VNA Plus, LLC which was formed during 2014 to provide home health and hospice care services.
- The Hospital holds 33.3% of the membership shares in The Healthcare Group, LLC, a preferred provider organization – managed care network. The Healthcare Group, LLC encourages collaboration in providing patient service and cost management.
- The Hospital holds a 22% ownership interest in HealthSouth/Deaconess, LLC, d/b/a HealthSouth Deaconess Rehabilitation Hospital, an 80-bed comprehensive facility dedicated to improving, maintaining or restoring physical strength, cognition and mobility through therapeutic methods and technologies for rehabilitation.
- The Hospital holds a 12.5% ownership interest in the Indiana Healthcare Reciprocal Risk Retention Group which was formed to provide liability insurance, reinsurance and risk management services to the members.

Use of Estimates

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

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Charity Care, Community Benefit and Assistance to the Uninsured

The System provides care to patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the System. Essentially, these policies define charity services as those services for which no payment or reduced payment based upon a graduated scale, is anticipated, up to 300% of Federal Poverty Income Guidelines, published by the Department of Health and Human Services and where incurred charges are considered significant when compared to the income of the patient. Because collection of amounts determined to qualify as charity care is not pursued, such amounts are not reported as revenue.

The System's charity care policy reflects the current economic conditions and other factors unique to the System's customer base. Charity care provided during 2015 and 2014, measured at established rates, was approximately \$46,899,000 and \$60,560,000, respectively. In addition, other programs and services for the benefit of the community are provided. The costs of these programs are included in operating expenses. The System receives reimbursements from certain governmental payors to assist in the funding of charity care.

Of the System's total expenses reported, an estimated \$14,439,000 and \$19,761,000 arose from providing services to charity patients during 2015 and 2014, respectively. The estimated costs of providing patient assistance services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses to gross patient service revenue.

The System has a policy for uninsured patients with discounted rates similar to contractual payors. Uninsured self pay discounts provided to patients were approximately \$28,202,000 and \$26,189,000 in 2015 and 2014, respectively.

Cash and Cash Equivalents

Cash and cash equivalents are defined as investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by arrangements under trust agreements, board designation or by donors. The System maintains its cash in accounts, which at times may exceed federally insured limits. The policy of the System is to collateralize deposits. The System has not experienced any losses in such accounts and believes that it is not exposed to any significant credit risk on cash and cash equivalents.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Additional cash flows information for 2015 and 2014 is as follows;

	2015	2014
Supplemental cash flows information:		
Cash paid for interest	\$ 7,739,000	\$ 8,378,000
Property and equipment in liabilities	\$ 2,079,000	\$ 2,920,000
Equipment acquired through capital leases	\$ 1,190,000	\$ 3,048,000

Patient Accounts Receivable and Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Estimated retroactive adjustments under reimbursement agreements with certain third-party payors are included with estimated third-party payor settlements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Patient accounts receivable are reduced by an allowance for uncollectible accounts based on the System's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to its service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary. For receivables associated with self-pay payments the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

During 2015, the System's allowance for uncollectible accounts changed approximately \$12,104,000 from \$38,378,000 to \$26,274,000. The uncollectible allowance for self-pay balances decreased approximately \$11,423,000. The change is mainly the result of shifts in payor mix due to health care reform and an increase in insurance coverage for patients who were previously uninsured. The uncollectible allowance reserved for self-pay balances related to third party payors decreased approximately \$681,000. The change is mainly the result of shifts in payor mix due to health care reform and an increase in insurance coverage for patients who were previously uninsured.

The System's self-pay related write-offs decreased by approximately \$4,047,000 in 2015 compared to an increase of \$180,000 in 2014. The decrease in 2015 was the result of positive trends experienced in the collection of amounts from self-pay patients and shifts in payor mix due to health care reform and an increase in insurance coverage for patients who were previously uninsured.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

As of September 30, 2015, the allowance for uncollectible accounts of approximately \$26,274,000 was comprised of \$18,062,000 reserved for self-pay balances and \$8,212,000 reserved for self-pay balances related to third party payors. As of September 30, 2014, the allowance for uncollectible accounts of approximately \$38,378,000 was comprised of \$29,485,000 reserved for self-pay balances and \$8,893,000 reserved for self-pay balances related to third party payors.

Medicaid expansion was approved for the State of Indiana in February 2015. This, combined with Medicaid expansion in the surrounding states of Illinois and Kentucky and other health care reform initiatives, has increased insurance coverage for patients who were previously uninsured. The System did not change its policy related to charity care during 2015 and 2014. In May 2015, the System changed its policy related to uninsured discounts based on the Affordable Care Act. There were no changes to the policy for uninsured discounts during 2014.

Inventories

Inventories (principally pharmaceuticals and medical supplies) are stated at the lower of cost (first in, first out) or market.

Property and Equipment and Depreciation

Property and equipment are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets, ranging from 3 to 40 years, using the straight-line method. Equipment under capital leases are amortized on the straight-line method over the lease term or the estimated useful life of the equipment, if shorter.

Investments Limited as to Use

Investments are stated at fair value. Dividends, interest income and realized gains and losses on sales of investments are recorded as nonoperating investment income. Unrealized gains (losses) on investments are reported as other changes in net assets in the consolidated statements of operations.

Investments consist of short-term investments (principally cash equivalents), US Government and government agency obligations, marketable debt securities (corporate bonds and fixed income mutual funds), marketable equity securities (common and preferred corporate stock), equity mutual funds, private equity funds, and mortgage backed securities. Fair values for investments are based on quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

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

These estimated values may differ significantly from the values that would have been used had a ready market for the investments in the investment funds existed and the difference could be material. Private equity investments totaled approximately \$19,237,000 and \$14,315,000 (4.0% and 3.4% of investment portfolio) as of September 30, 2015 and 2014, respectively.

Investments limited as to use include assets held by trustees under indenture agreements, amounts set aside by the Board of Directors for future capital improvements, retirement of debt over which the Board retains control and may at its discretion subsequently designate for other purposes and amounts designated by for the Foundation and donor restrictions. Amounts required to meet current liabilities of the System have been classified as current assets.

Foundation

The Hospital also encompasses a charitable Foundation supported by donations from the community. The Foundation, a department of the Hospital, has a separate advisory board that carries out the mission of supporting medical, charitable and educational activities as designated by the donors.

Deferred Financing Costs

Costs incurred in connection with the issuance of debt are amortized over the term of the related debt using the bonds outstanding method. Estimated annual amortization is approximately \$200,000.

Business Combinations and Goodwill and Other Intangibles

The System accounts for a business combination using the acquisition method of accounting, and accordingly, the net assets of the acquired entity are recorded at their estimated fair values at the date of acquisition. Goodwill represents the excess of the purchase price over the fair value of net assets, including amounts assigned to identifiable intangible assets, if any. Goodwill is tested for impairment on an annual basis, or whenever an event occurs or circumstances indicate the carrying value of the goodwill may be impaired. The System performed the required annual impairment test for goodwill as of September 30, 2015 and 2014 using the income approach of calculating the present value of the future cash flows. The System determined no impairment of goodwill existed as of September 30, 2015 and 2014.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

During 2015 and 2014, the System purchased the assets (mainly property and equipment) of several healthcare entities for approximately \$1,200,000 and \$450,000, respectively, and recorded goodwill and other intangibles of approximately \$622,000 and \$366,000, respectively, related to the purchases. As of September 30, 2015 and 2014, the System recorded goodwill and other intangibles of approximately \$23,206,000 and \$22,584,000, respectively, related to the acquisition of majority owned entities.

Medical Malpractice

Malpractice insurance coverage is provided under a claims-made policy. Should the claims-made policy be terminated, the System has the option to purchase insurance for claims having occurred during its term but reported subsequently. Prior to July 1, 1999, the Indiana Medical Malpractice Act (Act) provided for a maximum recovery of \$750,000 per occurrence (\$3,000,000 annual aggregate) for professional liability, \$100,000 of which would be paid through the System's malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund (Fund). For claims on or after July 1, 1999, the Act provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) with the first \$250,000 covered by the System's insurance and the remainder by the Fund.

The System is a member in a Vermont captive insurance company, Indiana Healthcare Reciprocal Risk Retention Group, to fund the System's required portion of the professional, physician insurance coverage pursuant to the Act as well as its general liability insurance and excess coverage. This provides protection from liability in an amount not to exceed \$250,000 per incident and aggregate liability protection not to exceed \$7,500,000 per year. In addition, the System maintains a commercial umbrella/excess liability policy with a limit of \$15,000,000 each occurrence, \$15,000,000 aggregate per member and \$30,000,000 total policy aggregate.

Other Long-Term Liabilities

Other long-term liabilities include obligations related to the unfunded status of defined benefit plans, other employee benefit programs and derivative liabilities related to an interest rate swap.

Performance Indicator

The consolidated statements of operations contain a performance indicator, excess revenues over expenses. Consistent with industry practice, unrealized gain and loss on other than trading investments, benefit related changes other than net periodic benefit cost, equity transfers, contributions restricted for long-term purposes and certain other items are excluded from the performance indicator.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Income Taxes

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

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System and recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by various Federal and state taxing authorities. Management has analyzed the tax positions taken by the System and has concluded that as of September 30, 2015 and 2014, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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

These entities have filed their Federal and state income tax returns for periods through their most recent fiscal year ends (primarily December 31, 2014). These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

Contribution Revenues and In-Kind Donations

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received are included in nonoperating revenues (expenses) in the accompanying consolidated financial statements. In-kind donations are recorded as revenue and expense in the accompanying consolidated financial statements. These donations consist mainly of medical supplies and services which are recorded at their estimated fair values.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Temporarily Restricted Net Assets

Temporarily restricted net assets include those assets whose use by the System has been temporarily limited primarily for capital projects or a specified time period or purpose.

The following is a summary of temporarily restricted net assets as of September 30, 2015 and 2014:

	2015	2014
Patient medical care	\$ 1,215,861	\$ 1,134,647
Education and scholarship	701,495	654,638
Capital projects	710,991	663,500
Other System support	1,521,191	1,419,583
	<u>\$ 4,149,538</u>	<u>\$ 3,872,368</u>

Permanently Restricted Net Assets

Permanently restricted net assets are contributed with donor restrictions requiring they be held in perpetuity with income used to support the System's activities. The following is a summary of permanently restricted net assets as of September 30, 2015 and 2014:

	2015	2014
Beneficial interest in trusts	\$ 1,101,352	\$ 1,213,050
Other	692,080	692,080
	<u>\$ 1,793,432</u>	<u>\$ 1,905,130</u>

Electronic Health Records (EHR) Incentive Payments

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

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The System recognizes EHR incentive payments as grant income, under the ratable recognition method, when there is reasonable assurance that the System will comply with the conditions of the meaningful use objectives and any other specific requirements. In addition, the financial statement effects of the income must be both recognizable and measurable. During 2015 and 2014, the System recognized approximately \$1,459,000 and \$2,987,000, respectively, in EHR incentive payments as income.

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

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

Advertising Costs

Advertising costs are expensed as incurred. Total expense for 2015 and 2014 was approximately \$1,810,000 and \$1,971,000, respectively.

Functional Expenses

The System provides health care services to patients in the community and the surrounding areas. Health care services and other certain related expenses approximated 93% of total expenses in 2015 and 2014. General and administrative expenses approximated 6% in 2015 and 2014. Fundraising expenses comprised less than 1% of total expenses in 2015 and 2014.

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

Reclassification

Certain 2014 amounts in the consolidated financial statements have been reclassified to conform to the 2015 presentation. The reclassifications have no effect on previously reported net assets or change in net assets.

Subsequent Events

The System evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is December 10, 2015.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

2. NET PATIENT SERVICE REVENUE

Entities within the System have agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

Inpatient acute care services, outpatient services and physician services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Certain outpatient services and defined medical education costs related to Medicare beneficiaries are paid based on cost reimbursement methodologies. The System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. Inpatient non-acute care services are generally reimbursed based upon cost reimbursement methodologies.

Medicaid and Hospital Assessment Fee Program

Medicaid services are paid at prospectively determined rates per day or per discharge for inpatients or per occasion of service for outpatients. To the extent that services to Medicare and Medicaid program beneficiaries are reimbursed based on cost reimbursement methodologies, final settlement is determined after submission of annual cost reports and audits thereof by the fiscal intermediary.

The Hospital Assessment Fee (HAF) Program was established in 2012 to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share payments for Indiana hospitals as reflected in the HAF Program expense reported in the consolidated statements of operations. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. During 2015 and 2014, the Hospital recognized HAF Program expense of approximately \$19,089,000 and \$31,200,000, respectively, which resulted in Medicaid rate increases. HAF Program expense is included in other expenses on the consolidated statements of operations while the Medicaid rate increases are recorded in net patient service revenue. The HAF Program has been approved by the Centers for Medicare and Medicaid Services through June 30, 2017.

Estimates for final settlements of all unaudited Medicare and Medicaid cost reports through September 30, 2015 have been recorded. Cost reports through September 30, 2013 have been audited and settled as of September 30, 2015.

Entities within the System also entered into payment agreements with certain other commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations for 2015 and 2014 is as follows:

	2015	2014
Patient service revenue	\$ 2,410,248,955	\$ 2,134,381,143
Adjustments		
Charity care revenue foregone	46,899,146	60,560,255
Uninsured self pay discounts	28,202,055	26,189,119
Contractual adjustments	1,487,032,093	1,269,084,665
Total adjustments	1,562,133,294	1,355,834,039
Net patient service revenue	848,115,661	778,547,104
Less provision for bad debts	21,428,973	27,689,170
Net patient service revenue net of provision for bad debts	\$ 826,686,688	\$ 750,857,934

Changes to any previous year's estimated settlement are reflected in the period the intermediary finalizes its audit of cost reports, or when additional information becomes available. Settlements related to prior year cost reports and other estimated third-party items resulted in an increase of approximately \$181,000 in 2015 and a decrease of approximately \$490,000 in 2014 to net patient service revenue.

The following is mix of gross patient accounts receivable and gross patient service revenue as of September 30, 2015 and 2014 and for the years ended:

	Receivable		Revenue	
	2015	2014	2015	2014
Medicare	26%	35%	47%	47%
Medicaid	19%	9%	12%	11%
Commercial and managed care	39%	37%	37%	36%
Self pay and other	16%	19%	4%	6%
	100%	100%	100%	100%

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

3. INVESTMENTS

Investments at fair value consisted of the following as of September 30:

	2015	2014
Board designated funds		
Cash	\$ 970,316	\$ 2,457,555
Common stocks	87,739,131	73,838,322
Mutual funds	248,023,112	218,604,380
US Government and government agency obligations	28,510,520	18,817,536
Corporate bonds	66,625,887	58,875,634
Mortgage backed securities	16,192,721	18,956,718
Private equity	19,237,005	14,314,539
	467,298,692	405,864,684
Funds held by trustee		
Cash	33,754	4,351,171
Less current portion	33,754	4,351,171
	-0-	-0-
Board designated - Foundation and donor restricted - Foundation		
Cash	262,743	172,634
Common stocks	2,031,091	2,109,534
Mutual funds	8,419,049	8,744,203
US Government and government agency obligations	986,976	1,025,095
Accrued interest and other	563,338	402,075
	12,263,197	12,453,541
Investments limited as to use, net	\$ 479,561,889	\$ 418,318,225

Investments reported as current assets are those that the System has made available for use in operations within the next twelve months. Investments limited as to use that are required for obligations classified as current liabilities are also reported in current assets.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

A detail of investment income for unrestricted and donor restricted for 2015 and 2014 is as follows:

	2015	2014
Interest and dividends	\$ 14,237,956	\$ 11,731,898
Unrealized loss on interest rate swap	(576,597)	(151,759)
Net realized gain	2,317,827	1,947,045
Investment income, net	\$ 15,979,186	\$ 13,527,184

See Note "Derivative Financial Instruments – Interest Rate Swaps" for additional information on unrealized loss on interest rate swap.

The following schedule summarizes the fair value of securities included in investments limited as to use that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of September 30, 2015 and 2014. The schedule further segregates the securities that have been in a gross unrealized position as of September 30, 2015 and 2014, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to several securities which industry experts expect recovery in the short-term future. These individual investments have projected recoveries in value in 2016. The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of September 30, 2015 and 2014.

Description of Securities	September 30, 2015					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stocks	\$ 30,174,568	\$ 2,822,027	\$ 1,499,998	\$ 2,190,175	\$ 31,674,566	\$ 5,012,202
Mutual funds	14,563,049	553,104	82,597,464	6,000,288	97,160,513	6,553,392
Corporate bonds	2,033,382	214,235	-0-	-0-	2,033,382	214,235
Mortgage backed securities	847,328	11,407	680,722	23,596	1,528,050	35,003
Total temporarily impaired securities	\$ 47,618,327	\$ 3,600,773	\$ 84,778,184	\$ 8,214,059	\$ 132,396,511	\$ 11,814,832

Description of Securities	September 30, 2014					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stocks	\$ 2,139,234	\$ 441,264	\$ 1,924,398	\$ 342,465	\$ 4,063,632	\$ 783,729
Mutual funds	1,352,032	61,780	64,500,748	2,142,825	65,852,780	2,204,605
Corporate bonds	2,987,829	229,195	-0-	-0-	2,987,829	229,195
Mortgage backed securities	808,938	23,109	649,880	47,803	1,458,818	70,912
Total temporarily impaired securities	\$ 7,288,033	\$ 755,348	\$ 67,075,026	\$ 2,533,093	\$ 74,363,059	\$ 3,288,441

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

4. FAIR VALUE MEASUREMENTS

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

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of September 30, 2015 and 2014:

- *Common stocks*: Valued based on the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds*: Valued based on quoted net asset value (NAV) of the shares held by the System at year-end. The NAV is based on the value of the underlying assets owned by the fund, minus its liabilities and then divided by the number of shares outstanding. The NAV is quoted in an active market.
- *US Government and government agency obligations*: Valued based on the closing price reported on the active market on which the securities are traded.
- *Corporate bonds and mortgage backed securities*: Valued using pricing models maximizing the use of observable inputs for similar securities.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

- *Private equity investments*: Valued at the NAV of units of the fund. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The private equity investments consist of investments in a variety of domestic and foreign equity and debt securities, managed accounts and other investment vehicles that employ diversified styles and strategies. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the NAV of the fund and, consequently, the fair value of the System's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported NAV. It is therefore reasonably possible that if the System were to sell these investments in the secondary market, a buyer may require a discount to the reported NAV, and the discount could be significant.
- *Derivative (Interest rate swap agreement)*: Valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap. See the note disclosure "Derivatives Financial Instruments – Interest Rate Swaps" for additional information related to derivatives.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2015 and 2014 are as follows:

	September 30, 2015			
	Total	Level 1	Level 2	Level 3
Assets				
Investments limited as to use				
Common stocks				
Consumer	\$ 22,523,531	\$ 22,523,531	\$ -0-	\$ -0-
Financial services	11,051,305	11,051,305	-0-	-0-
Industrial and materials	22,292,503	22,292,503	-0-	-0-
Technology	14,479,246	14,479,246	-0-	-0-
Healthcare	8,520,370	8,520,370	-0-	-0-
Other	10,903,267	10,903,267	-0-	-0-
Total common stocks	89,770,222	89,770,222	-0-	-0-
Mutual funds				
Intermediate term bond	164,146,536	164,146,536	-0-	-0-
International equity	32,541,890	32,541,890	-0-	-0-
Large cap	57,673,650	57,673,650	-0-	-0-
Mid cap	665,455	665,455	-0-	-0-
Other	1,414,630	1,414,630	-0-	-0-
Total mutual funds	256,442,161	256,442,161	-0-	-0-
US Government and government agency obligations				
	29,497,496	29,497,496	-0-	-0-
Corporate bonds				
Consumer	14,256,616	-0-	14,256,616	-0-
Financial services	18,856,722	-0-	18,856,722	-0-
Industrial and materials	16,739,329	-0-	16,739,329	-0-
International	6,011,660	-0-	6,011,660	-0-
Other	10,761,560	-0-	10,761,560	-0-
Total corporate bonds	66,625,887	-0-	66,625,887	-0-
Mortgage backed securities				
	16,192,721	-0-	16,192,721	-0-
Private equity				
	19,237,005	-0-	19,237,005	-0-
	477,765,492	\$ 375,709,879	\$ 102,055,613	\$ -0-
Cash				
	1,266,813			
Accrued interest and other				
	563,338			
	\$ 479,595,643			
Liabilities				
Derivative				
	\$ 969,960	\$ -0-	\$ 969,960	\$ -0-

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

	September 30, 2014			
	Total	Level 1	Level 2	Level 3
Assets				
Investments limited as to use				
Common stocks				
Consumer	\$ 19,055,471	\$ 19,055,471	\$ -0-	\$ -0-
Financial services	9,349,681	9,349,681	-0-	-0-
Industrial and materials	18,860,016	18,860,016	-0-	-0-
Technology	12,249,805	12,249,805	-0-	-0-
Healthcare	7,208,446	7,208,446	-0-	-0-
Other	9,224,437	9,224,437	-0-	-0-
Total common stocks	75,947,856	75,947,856	-0-	-0-
Mutual funds				
Intermediate term bond	145,523,974	145,523,974	-0-	-0-
International equity	28,849,985	28,849,985	-0-	-0-
Large cap	51,130,526	51,130,526	-0-	-0-
Small cap	589,959	589,959	-0-	-0-
Other	1,254,139	1,254,139	-0-	-0-
Total mutual funds	227,348,583	227,348,583	-0-	-0-
US Government and government agency obligations				
	19,842,631	19,842,631	-0-	-0-
Corporate bonds				
Consumer	12,598,216	-0-	12,598,216	-0-
Financial services	16,663,215	-0-	16,663,215	-0-
Industrial and materials	14,792,127	-0-	14,792,127	-0-
International	5,312,354	-0-	5,312,354	-0-
Other	9,509,722	-0-	9,509,722	-0-
Total corporate bonds	58,875,634	-0-	58,875,634	-0-
Mortgage backed securities				
	18,956,718	-0-	18,956,718	-0-
Private equity				
	14,314,539	-0-	14,314,539	-0-
	415,285,961	<u>\$ 323,139,070</u>	<u>\$ 92,146,891</u>	<u>\$ -0-</u>
Cash				
	6,981,360			
Accrued interest and other				
	402,075			
	<u>\$ 422,669,396</u>			
Liabilities				
Derivative				
	<u>\$ 393,363</u>	<u>\$ -0-</u>	<u>\$ 393,363</u>	<u>\$ -0-</u>

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The following table summarizes the private equity investments measured at fair value based on NAV per share as of September 30, 2015 and 2014:

September 30, 2015				
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity	\$ 19,237,005	None	Monthly	45 days
September 30, 2014				
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity	\$ 14,314,539	None	Monthly	45 days

The System's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2015 and 2014.

Realized gain and loss are reported in the consolidated statements of operations as a component of investment income. Net realized gains of approximately \$2,318,000 and \$1,947,000 were recorded during 2015 and 2014, respectively.

The market value of investments exceeded the cost by approximately \$21,274,000 and \$40,530,000 as of September 30, 2015 and 2014, respectively. The unrealized gain or loss is included in earnings for the period attributable to the change in unrealized gain or loss relating to assets held as of September 30, 2015 and 2014 and is reported in the consolidated statements of operations as net unrealized gain or loss on investments. During 2015, the System recognized an unrealized loss of approximately of \$19,256,000. During 2014, the System recognized an unrealized gain of approximately \$14,757,000.

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

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

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

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

Long-term debt: See Long-Term Debt Note for fair value of the System's long-term debt.

5. LONG-TERM DEBT

The following is a summary of long-term debt as of September 30, 2015 and 2014:

	2015	2014
Hospital Revenue Bonds, Series 2009A Term bonds, refunded during 2015	\$ -0-	\$ 43,900,000
Hospital Revenue Bonds, Series 2011A Term bonds, payable through March 2029 in amounts ranging from \$770,000 to \$1,630,000 with interest; fixed rates ranging from 2.50% to 6.00%	16,740,000	17,620,000
Hospital Revenue Bonds, Series 2012A Term bonds, paid in full during 2015	-0-	1,615,000
Hospital Revenue Bonds, Series 2012B Term bonds, payable through January 2022 in amounts ranging from \$880,000 to \$1,755,000 with interest; fixed rate 2.30%	10,060,000	11,145,000
Hospital Revenue Bonds, Series 2012C Term bonds, payable through January 2019 in amounts ranging from \$1,100,000 to \$1,625,000 with interest; fixed rate 2.28%	5,875,000	7,090,000
Hospital Revenue Bonds, Series 2013A Term bonds, payable through March 2035 in amounts ranging from \$470,000 to \$8,070,000 with interest; fixed rates ranging from 3.00% to 5.00%	67,005,000	67,005,000
Hospital Revenue Bonds, Series 2013B Term bonds, payable through March 2029 in amounts ranging from \$1,000,000 to \$1,735,000 with interest; variable based on 70% of BBA LIBOR rate, 1.289% as of September 30, 2015	19,390,000	20,440,000

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

	2015	2014
Hospital Revenue Bonds, Series 2013C		
Term bonds, payable through March 2036 in amounts ranging from \$250,000 to \$2,840,000 with interest: variable based on 67% of BBA LIBOR rate plus 90 basis points, 1.032% as of September 30, 2015	\$ 40,180,000	\$ 40,180,000
Refunding Revenue Bonds, Series 2015A		
Term bonds, payable from March 2017 through March 2039 in amounts ranging from \$140,000 to \$20,255,000 with interest; fixed rates ranging from 3.00% to 5.00%	48,270,000	-0-
Original issue premiums (discounts), net	4,991,701	2,803,522
Capital lease obligations, payable in installments ranging from \$22,000 to \$368,000 annually with interest ranging from 3.25% to 6.50%, expiring through July 2019, secured by equipment	3,446,245	3,863,534
Notes payable, due in monthly installments through February 2019; fixed interest at 2.58%, secured by equipment	1,679,921	971,621
	217,637,867	216,633,677
Less current portion	7,109,963	7,192,257
Long-term debt, net of current portion	\$ 210,527,904	\$ 209,441,420

The Hospital Revenue Bonds and Refunding Revenue Bonds were issued through the Indiana Finance Authority (Authority). In 2013, the System, the Authority and Fifth Third Bank entered into Bond Purchase Contracts (Contracts) whereby Fifth Third purchased from the Authority all of the Series 2012A, 2012B, 2012C and 2013B bonds in a private placement. The Series 2013C bonds were purchased from the Authority by Bank of America in a private placement.

Under the terms of the Contracts, Fifth Third and Bank of America agreed to hold the Series 2012A, 2012B and 2012C bonds through the stated bond maturity dates. The Contracts for the Series 2013B and 2013C bonds are through 2023. At the end of the Contract periods for the Series 2013B and 2013C bonds, these bonds could be remarketed to the original holders or to new investors at interest rate options as provided in the bond documents. If the Series 2013B and 2013C bonds cannot be remarketed at the end of the Contract periods, the System would be subject to payment of the remaining principal.

The System entered into an interest rate swap agreement with Fifth Third on the Series 2013B bonds. See the note disclosure "Derivatives Financial Instruments – Interest Rate Swaps" for additional information.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

During 2015, the System refunded the Hospital Revenue Bonds, Series 2009A with the Hospital Refunding Revenue Bonds Series 2015A bonds which resulted in a loss of approximately \$9,817,000, which is recorded in nonoperating revenues (expenses) on the consolidated statements of operations.

All of the Series bonds are secured by a security interest in the System's revenue. The System covenants that it will not permit any lien or security interest on the System facility other than certain permitted encumbrances. In addition, the various agreements require maintenance of certain debt service income ratios, limit additional borrowings, and require compliance with various other restrictive covenants.

The fair value of the fixed rate Hospital Revenue Bonds (Series 2011A, 2012B, 2012C, 2013A and 2015A) approximated \$157,895,000 (carrying value of \$147,950,000) as of September 30, 2015. The fair value of the fixed rate obligations is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of variable rate debt (Series 2013B and 2013C) approximates its carrying value based on the underlying nature of the related debt.

The asset cost on the capital leased assets as of September 30, 2015 and 2014 was approximately \$16,915,000 and \$16,372,000, respectively. The accumulated amortization on the capital leased assets as of September 30, 2015 and 2014 was approximately \$15,353,000 and \$14,651,000, respectively.

The net book value of the equipment securing the notes payable was approximately \$1,680,000 and \$972,000 as of September 30, 2015 and 2014, respectively.

As of September 30, 2015, the System had outstanding property and equipment commitments of approximately \$23,650,000.

Aggregate maturities of long-term debt are as follows:

Year Ending September 30,	
2016	\$ 7,109,963
2017	7,392,872
2018	7,167,900
2019	6,740,431
2020	5,045,000
Thereafter	184,181,701
	<u>\$ 217,637,867</u>

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

6. DERIVATIVE FINANCIAL INSTRUMENTS – INTEREST RATE SWAPS

Objectives and Strategies for Using Derivatives

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

As of September 30, 2015 and 2014, the System had outstanding an interest rate swap agreement with Fifth Third, having a notional amount of \$19,390,000 and \$20,440,000, respectively. The agreement effectively changes the System's interest rate exposure on its Series 2013B bonds through March 2029 to a fixed 2.78%. The interest rate swap agreement matures at the time the related long-term debt matures. The System is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the System does not anticipate nonperformance by the counterparties.

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

The asset derivatives are reported in the consolidated balance sheets as other assets and liability derivatives are reported as derivative liabilities in the other long-term liabilities. As of September 30, 2015 and 2014, the fair values of derivatives recorded in the consolidated balance sheets are as follows:

	2015	2014
	<u> </u>	<u> </u>
Other long-term liabilities		
Derivative liability	\$ 969,960	\$ 393,363

During 2015 and 2014, the amount of gain or loss recognized in the consolidated statements of operations and reported as a component of investment income under nonoperating revenues (expenses) is as follows:

	2015	2014
	<u> </u>	<u> </u>
Nonoperating revenues (expenses)		
Investment income		
Unrealized loss on derivative	\$ 576,597	\$ 151,759

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

7. BENEFIT PLANS

The System offers a noncontributory defined benefit pension plan covering eligible employees. Benefits are based on each participant's years of service and compensation. Contributions to the plan are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants. The defined benefit pension plan is closed to new participants. The System also offers a post-retirement plan to eligible participants. Under the post-retirement plan, the System contributes a fixed amount toward the participant's elected retiree medical coverage. The participant is responsible for the difference between the full cost of the elected retiree medical coverage and the System's contribution. Participants should refer to the plan documents for more complete information.

The following table sets forth the funded status of the benefit plans and amounts recognized in the consolidated financial statements as of and for the years ended September 30, 2015 and 2014.

	Pension Benefits		Post-Retirement Benefits	
	2015	2014	2015	2014
Change in benefit obligation				
Benefit obligation, beginning of year	\$ 242,263,003	\$ 230,980,957	\$ 1,327,702	\$ 1,376,320
Service cost	5,677,722	5,992,850	94,257	100,704
Interest cost	10,918,136	10,579,149	58,605	61,880
Plan amendment	-0-	-0-	(676,190)	-0-
Benefits paid	(6,333,715)	(5,355,579)	(96,227)	(91,143)
Actuarial (gain) loss	26,082,125	65,626	(666,891)	(120,059)
Benefit obligation, end of year	<u>\$ 278,607,271</u>	<u>\$ 242,263,003</u>	<u>\$ 41,256</u>	<u>\$ 1,327,702</u>
Changes in plan assets				
Fair value of plan assets, beginning of year	\$ 196,724,730	\$ 176,740,387	\$ -0-	\$ -0-
Actual return on plan assets	(801,848)	17,335,922	-0-	-0-
Employer contributions	8,004,000	8,004,000	96,227	91,143
Benefits paid	(6,333,715)	(5,355,579)	(96,227)	(91,143)
Fair value of plan assets, end of year	<u>\$ 197,593,167</u>	<u>\$ 196,724,730</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Funded status				
Funded status of the plan, end of year	<u>\$ (81,014,104)</u>	<u>\$ (45,538,273)</u>	<u>\$ (41,256)</u>	<u>\$ (1,327,702)</u>
Amounts recognized in the consolidated balance sheets consist of				
Other long-term liabilities	<u>\$ (81,014,104)</u>	<u>\$ (45,538,273)</u>	<u>\$ (41,256)</u>	<u>\$ (1,327,702)</u>
Amounts not yet reflected in net periodic benefit cost and included in other changes in unrestricted net assets				
Prior service (cost) credit	\$ -0-	\$ (1,562)	\$ 630,698	\$ (67,152)
Accumulated gain (loss)	(91,495,498)	(52,157,633)	1,189,283	553,314
Other changes in unrestricted net assets	(91,495,498)	(52,159,195)	1,819,981	486,162
Cumulative employer contributions in excess (deficit) of net periodic benefit cost	10,481,394	6,620,922	(1,861,237)	(1,813,864)
Net amount recognized in the consolidated balance sheets	<u>\$ (81,014,104)</u>	<u>\$ (45,538,273)</u>	<u>\$ (41,256)</u>	<u>\$ (1,327,702)</u>

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

Other pension disclosures for 2015 and 2014 include:

	Pension Benefits		Post-Retirement Benefits	
	2015	2014	2015	2014
Components of net periodic benefit cost				
Service cost	\$ 5,677,722	\$ 5,992,850	\$ 94,257	\$ 100,704
Interest cost	10,918,136	10,579,149	58,605	61,880
Expected return on plan assets	(15,203,039)	(14,138,568)	-0-	-0-
Amortization of prior year service cost	1,562	4,222	21,660	33,139
Amortization of (gain) loss	2,749,147	3,453,998	(30,922)	(22,916)
Net periodic benefit cost	\$ 4,143,528	\$ 5,891,651	\$ 143,600	\$ 172,807
Other changes in unrestricted net assets				
Net gain arising during year	\$ 42,087,012	\$ (3,131,728)	\$ (1,343,081)	\$ (475,939)
Amortization of prior service cost	(1,562)	(4,222)	(21,660)	(33,139)
Amortization of gain (loss)	(2,749,147)	(3,453,998)	30,922	22,916
Total other changes in unrestricted net assets	\$ 39,336,303	\$ (6,589,948)	\$ (1,333,819)	\$ (486,162)
Estimated amounts that will be amortized from other changes in unrestricted net assets over the next fiscal year				
Amortization of prior service (cost) credit	\$ -0-	\$ (1,562)	\$ 630,698	\$ (21,660)
Amortization of gain (loss)	\$ (6,493,344)	\$ (2,749,147)	\$ 740,723	\$ 30,922
Weighted-average actuarial assumptions to determine benefit obligations of September 30				
Discount rate	4.36%	4.58%	1.26%	4.58%
Rate of compensation increase	3.50%	3.50%	Not applicable	Not applicable
Measurement date	9/30/15	9/30/14	9/30/15	9/30/14
Weighted-average actuarial assumptions to determine net periodic benefit cost as of September 30				
Discount rate	4.58%	4.65%	4.58%	4.65%
Expected long-term rate of return	7.75%	8.00%	Not applicable	Not applicable
Rate of compensation increase	3.50%	3.50%	Not applicable	Not applicable
Additional year end information				
Projected benefit obligation	\$ 278,607,271	\$ 242,263,003	\$ 41,256	\$ 1,327,702
Accumulated benefit obligation	\$ 259,360,873	\$ 226,915,004	\$ 41,256	\$ 1,327,702
Fair value of plan assets	\$ 197,593,167	\$ 196,724,730	\$ -0-	\$ -0-

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The following is a schedule by year of expected benefit payments as of September 30, 2015

Year Ending September 30,	Pension Benefits	Post-Retirement Benefits
2016	\$ 7,167,198	\$ 22,309
2017	7,920,877	14,193
2018	8,870,411	4,711
2019	9,897,783	5,870
2020	10,915,920	-0-
2021-2025	71,394,262	-0-
	\$ 116,166,451	\$ 47,083

Determination of net periodic pension cost for the years ended September 30, 2015 and 2014 is based on assumptions and census data as of January 1, 2015 and 2014, respectively.

The principal long-term determinant of a portfolio's investment return is its asset allocation. The pension benefits plan allocation includes growth assets (60%) and fixed income (40%). In addition, active management strategies have added value relative to passive benchmark returns. The expected long-term rate of return assumption is based on the mix of assets in the plan, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management. This assumption is periodically benchmarked against peer plans.

The amortization of any prior service cost is determined using a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the pension benefits plan.

The pension benefits plan's weighted-average, asset allocations as of September 30, 2015 and 2014, by asset category, are as follows:

	2015	2014
Equity		
Mutual funds	37%	38%
Common/collective trusts	21%	20%
Common stocks	4%	4%
Total equity	62%	62%
Fixed income		
Mutual funds	26%	27%
Common/collective trusts	8%	7%
Total fixed income	34%	34%
Private equity	4%	4%
	100%	100%

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The allocation strategy for the pension benefits plan currently comprises approximately 50% to 70% growth investments (target of 60%) and 30% to 50% fixed-income investments (target of 40%). Within the growth investment classification, the plan asset strategy encompasses equity and equity-like instruments that are expected to represent approximately 60% of the System's plan asset portfolio of both public and private market investments. The largest component of these equity and equity-like instruments is public equity securities that are well diversified and invested in U.S. and international companies.

Fair value of mutual funds and marketable equity securities are based on the quoted prices in active markets. Common/collective trusts are valued at the NAV on a private market that is not active. However, the underlying investments are traded on an active market. The fair value of the private equity funds is valued at the percentage ownership of the NAV as reported to the plan by the individual managers.

The following is an analysis of fair value of the major classes of pension benefits plan assets of September 30, 2015 and 2014:

	2015	2014
Level 1		
Mutual funds		
Intermediate bond	\$ 52,100,219	\$ 52,614,601
Large blend	60,918,896	62,883,496
Foreign	9,898,657	10,111,255
Total mutual funds	122,917,772	125,609,352
Common stocks		
Financial services	2,724,843	1,999,554
Industrial and materials	1,106,543	1,634,932
Other	3,416,645	3,642,256
Total common stocks	7,248,031	7,276,742
Total Level 1	130,165,803	132,886,094
Level 2		
Common/collective trusts	55,724,278	53,498,523
Private equity	8,340,979	8,049,180
Total Level 2	64,065,257	61,547,703
	194,231,060	194,433,797
Cash equivalents	3,362,107	2,290,933
	\$ 197,593,167	\$ 196,724,730

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

The System expects to contribute in excess of the required funding amounts to its pension benefits plan in 2016 of approximately \$8,000,000.

The System also offers a 401k plan to eligible employees where the System makes base contributions to eligible employees based on years of service in addition to matching contributions (25% of employee deferral up to 6% of eligible earnings) based on the eligible employees' contribution to the 401k plan. Total expense for the System's contributions for eligible employees for 2015 and 2014 was approximately \$10,740,000 and \$8,096,000, respectively.

Subsequent to September 30, 2015, the System made available lump sum cash outs to certain eligible vested terminated participants for the defined benefit pension plan. Additionally, the post-retirement plan was closed to new participants subsequent to September 30, 2015.

8. RELATED PARTY TRANSACTIONS

The Hospital is a joint-owner of The Women's Hospital. The Hospital owns the building in which The Women's Hospital is located and leases the space to The Women's Hospital currently at approximately \$230,000 per month with an option to increase that amount annually through 2031. The Hospital provides ancillary services (lab, radiology) for The Women's Hospital. Ancillary services provided were approximately \$2,769,000 and \$2,781,000 in 2015 and 2014, respectively. The Hospital also has notes receivable due from The Women's Hospital for equipment. The balance of the notes receivable was approximately \$119,000 and \$54,000 as of September 30, 2015 and 2014, respectively.

The Hospital is a joint owner of Evansville Surgery Center Associates, LLC (Surgery Center). The Hospital recorded contract service expense related to the Surgery Center of approximately \$27,885,000 and \$28,607,000 in 2015 and 2014, respectively. As of September 30, 2015 and 2014, the Hospital had a liability to the Surgery Center of approximately \$3,161,000 and \$3,009,000, respectively.

The Hospital is a joint-owner of HealthSouth Deaconess Rehabilitation Hospital. The Hospital provides ancillary services (lab, radiology) to HealthSouth Deaconess Rehabilitation Hospital. Ancillary services provided were approximately \$702,000 and \$645,000 in 2015 and 2014, respectively.

Related party transactions between the System and other joint ventures in 2015 and 2014 were not significant to the System's overall consolidated financial statements.

DEACONESS HEALTH SYSTEM

NOTES TO CONSOLIDATED STATEMENTS SEPTEMBER 30, 2015 AND 2014

9. COMMITMENTS AND CONTINGENCIES

Operating leases

The System leases various equipment and facilities under operating leases expiring at various dates through 2025. Total lease expense for 2015 and 2014 was approximately \$12,523,000 and \$12,184,000, respectively. The following are the minimum lease payments for the years after September 30, 2015:

Year Ending September 30,	
2016	\$ 14,086,000
2017	14,165,000
2018	11,884,000
2019	10,717,000
2020	8,934,000
Thereafter	17,123,000
	<u>\$ 76,909,000</u>

Litigation

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

Health Insurance

The System's employee health care insurance is provided through a combination of insured, self-insured and purchased re-insurance coverage from a commercial carrier. The System maintains an estimated liability for the amount of claims incurred but not reported. Substantially all employees are covered for major medical benefits. The self-insured health coverage carries a stop-loss maximum of \$300,000 per case with no aggregate limit.