



UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2015 AND 2014

CPAs / ADVISORS



UNION HOSPITAL INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Union Hospital
Terre Haute, Indiana

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Union Hospital, Inc. and Subsidiaries (the Corporation), which comprise the consolidated balance sheet as of December 31, 2015 and 2014, and the related consolidated statement of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Corporation's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

Board of Directors
Union Hospital
Terre Haute, 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 Corporation as of December 31, 2015 and 2014, and the changes in its net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

REPORT ON CONSOLIDATING INFORMATION

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

EMPHASIS OF A MATTER

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

Blue & Co., LLC

Indianapolis, Indiana
April 21, 2016

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2015 AND 2014

ASSETS		
	2015	2014
Current assets		
Cash and cash equivalents	\$ 42,055,967	\$ 23,049,403
Funds held by trustee, current portion	6,162,514	6,162,344
Board designated funds, current portion	1,363,310	230,101
Patient accounts receivable, net	52,250,773	49,566,578
Inventories	4,550,182	4,194,640
Prepaid expenses and other current assets	6,032,607	3,710,413
Total current assets	112,415,353	86,913,479
Investments limited as to use, less current portion		
Funds held by trustee	24,344,185	24,297,655
Board designated funds	52,682,991	51,917,456
Permanently restricted	1,548,109	1,573,096
Total investments limited as to use	78,575,285	77,788,207
Property and equipment		
Land and improvements	38,516,464	37,907,574
Buildings and fixed equipment	343,176,373	340,845,060
Movable equipment	132,580,686	128,308,379
	514,273,523	507,061,013
Less allowances for depreciation	259,053,753	240,675,269
	255,219,770	266,385,744
Construction in progress	5,985,110	6,484,459
Total property and equipment, net	261,204,880	272,870,203
Other assets		
Due from Union Hospital Foundation, Inc.	2,950,678	2,586,708
Deferred financing costs, net	2,696,320	2,869,080
Intangible assets, net	4,206,301	746,695
Investment in joint ventures	3,043,627	3,200,290
	12,896,926	9,402,773
Total assets	\$ 465,092,444	\$ 446,974,662

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2015 AND 2014

LIABILITIES AND NET ASSETS

	2015	2014
Current liabilities		
Accounts payable and other current liabilities	\$ 23,809,716	\$ 18,051,633
Salaries, wages and related liabilities	19,955,536	21,104,493
Accrued interest	5,134,370	5,147,347
Estimated third party settlements	3,175,827	3,492,214
Current portion of long-term debt	5,020,634	3,757,832
Total current liabilities	<u>57,096,083</u>	<u>51,553,519</u>
Long-term liabilities		
Long-term debt, less current portion	263,158,871	263,753,153
Pension liability and related obligations	7,609,122	4,970,222
Other long-term liabilities	1,694,951	2,279,176
Total long-term liabilities	<u>272,462,944</u>	<u>271,002,551</u>
Total liabilities	329,559,027	322,556,070
Net assets		
Unrestricted	130,138,207	119,517,634
Noncontrolling interests in UHT, LLC	436,746	433,826
Total unrestricted net assets	<u>130,574,953</u>	<u>119,951,460</u>
Temporarily restricted	3,410,355	2,894,036
Permanently restricted	1,548,109	1,573,096
Total net assets	<u>135,533,417</u>	<u>124,418,592</u>
Total liabilities and net assets	<u>\$ 465,092,444</u>	<u>\$ 446,974,662</u>

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
Operating revenue		
Net patient service revenue (net of contractual allowances and discounts including charity care provisions of \$23,500,305 and \$36,142,024 in 2015 and 2014, respectively)	\$ 441,530,792	\$ 443,332,657
Less provision for bad debts	30,970,409	36,621,868
Net patient service revenue net of provision for bad debts	410,560,383	406,710,789
Other revenue	8,812,683	8,371,849
Total operating revenue	419,373,066	415,082,638
Operating expenses		
Physician, mid-level, and other provider salaries and wages	30,564,633	32,765,377
Other salaries and wages	99,047,361	103,623,730
Employee benefits	26,008,435	26,607,831
Medical supplies and drugs	59,647,028	56,934,327
Physician services	5,940,891	3,891,585
Contract services - management service organization support staff	6,376,123	6,068,417
Contract services - other	67,439,997	66,654,533
Rent and leases	8,609,211	11,239,113
Utilities, supplies, and other	26,545,712	28,938,586
Hospital assessment fee	13,612,043	20,118,404
Depreciation and amortization	19,657,191	24,390,760
Interest	15,882,021	16,060,600
Total operating expenses	379,330,646	397,293,263
Income from operations before reduction in force and pension settlement	40,042,420	17,789,375
Reduction in force and pension settlement	(3,990,490)	(5,886,973)
Income from operations reduction in force and pension settlement	36,051,930	11,902,402
Non-operating gains (losses)		
Investment income	1,716,476	3,585,365
Loss on investment in UAPC	(5,256,471)	(2,586,229)
Other	299,940	136,630
Total non-operating gains (losses)	(3,240,055)	1,135,766
Excess of revenue over expenses	32,811,875	13,038,168
Other changes in unrestricted net assets		
Pension related changes other than net pension cost	(7,790,558)	(3,950,552)
Distribution to owners	(1,191,422)	(321,449)
Net unrealized loss on investments	(1,875,949)	(2,093,812)
Net assets released for property and equipment	45,092	59,466
Transfers to Union Health System	(11,375,545)	(10,730,850)
Change in unrestricted net assets	10,623,493	(3,999,029)
Temporarily restricted net assets		
Other changes in receivable from Union Hospital Foundation, Inc.	561,411	(160,889)
Net assets released for property and equipment	(45,092)	(59,466)
Change in temporarily restricted net assets	516,319	(220,355)
Permanently restricted net assets		
Net investment income (loss)	(24,987)	81,411
Change in net assets	11,114,825	(4,137,973)
Net assets		
Beginning of year	124,418,592	128,556,565
End of year	\$ 135,533,417	\$ 124,418,592

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
Operating activities		
Change in net assets	\$ 11,114,825	\$ (4,137,973)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	18,581,045	21,442,037
Amortization	1,076,146	2,948,723
Provision for bad debts	30,970,409	36,621,868
Distribution to owners	1,191,422	321,449
Transfers to Union Health System	11,375,545	10,730,850
Loss on property disposals	43,930	12,472
Net unrealized loss on investments	1,875,949	2,093,812
Changes in operating assets and liabilities		
Patient accounts receivable	(33,654,604)	(18,464,269)
Other current and noncurrent assets	(2,648,035)	4,502,143
Accounts payable and other current liabilities	5,536,972	(8,719,376)
Salaries, wages and related liabilities	(1,148,957)	672,856
Other long-term liabilities	1,759,523	(805,868)
Estimated third-party payor settlements	(316,387)	(57,464)
Accrued interest	(12,977)	61,032
Net cash flows from operating activities	45,744,806	47,222,292
Investing activities		
Purchases of property and equipment	(6,628,091)	(11,570,891)
Proceeds from sale of property and equipment	184,702	97,988
Payments for CT and MRI service line	-0-	(1,200,000)
Purchase of investments	(25,499,618)	(80,322,738)
Proceeds from sale of investments	21,703,212	71,309,266
Net cash flows from investing activities	(10,239,795)	(21,686,375)
Financing activities		
Repayments on long-term debt	(4,354,331)	(15,424,820)
Proceeds from long-term debt	422,851	13,217,297
Distribution to owners	(1,191,422)	(321,449)
Transfers to Union Health System	(11,375,545)	(10,730,850)
Net cash flows from financing activities	(16,498,447)	(13,259,822)
Change in cash and cash equivalents	19,006,564	12,276,095
Cash and cash equivalents		
Beginning of year	23,049,403	10,773,308
End of year	\$ 42,055,967	\$ 23,049,403
Noncash investing activities		
Issuance of capital leases	\$ 295,152	\$ 241,156
Capital acquisitions included in accounts payable	\$ 221,111	\$ 321,955
Financed acquisition of medical practice service line	\$ 4,600,000	\$ -0-
Supplemental cash flow information		
Cash paid for interest	\$ 15,894,998	\$ 15,999,568

See accompanying notes to consolidated financial statements.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

1. ORGANIZATION

Nature of Operations

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

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

During January 2014, UHT was formed for the purpose of providing physical, occupational, and speech therapy, and related rehabilitation services. The Corporation ownership interest in UHT is 51%. The Corporation maintains substantial participation in the operations of UHT in addition to an economic interest in UHT's financial position. The 49% non-controlling interest is owned by Clinical Management Solutions, LLC. All material intercompany accounts and transactions have been eliminated.

During 2010, the Corporation became part of an affiliated group. Union Health System, Inc. (UHS), an Indiana not-for-profit corporation, is the sole member of the Corporation. UHS and the Corporation are 50% members of Union Associated Physicians Clinic, LLC (UAPC). Associated Physicians and Surgeons (AP&S) provides certain personnel, equipment, supplies and other administrative support to UAPC. The Corporation has entered into transactions with the affiliated group as is disclosed in Note 3. The Corporation is consolidated into the affiliated group financial statements. These financial statements reflect only the financial position, results of operations, changes in net assets and cash flows of the Corporation.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Use of Estimates

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

Cash and Cash Equivalents

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

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 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 and changes in net assets follows:

	2015	2014
Inpatient revenue	\$ 487,506,041	\$ 481,948,741
Outpatient revenue	735,019,006	701,687,624
Physician revenue	49,300,938	57,043,622
Gross patient revenue	1,271,825,985	1,240,679,987
Charity care revenue foregone	23,500,305	36,142,024
Contractual adjustments	806,794,888	761,205,306
Total adjustments	830,295,193	797,347,330
Net patient service revenue	441,530,792	443,332,657
Less provision for bad debts	30,970,409	36,621,868
	\$ 410,560,383	\$ 406,710,789

A summary of gross patient service revenue at established rates by payor source for 2015 and 2014, respectively, is as follows:

	2015	2014
Medicare	49%	47%
Medicaid	18%	17%
Commercial insurance	3%	10%
Other managed care	26%	20%
Self-pay and other	4%	6%
	100%	100%

There is a single insurance and managed care provider that constituted 17% of patient service revenue at established rates for the years ended December 31, 2015 and 2014.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

During 2015, the Corporation's allowance for uncollectible accounts for patient and physician services decreased approximately \$1,700,000 from approximately \$18,200,000 to approximately \$16,500,000. This decrease is due to shift from self-pay charges to Medicaid charges during the year ended December 31, 2015 in conjunction with the state's extended Medicaid coverage program. As of December 31, 2015, the allowance for uncollectible accounts of \$16,500,000 was comprised of approximately \$10,800,000 reserved for self-pay balances and approximately \$5,700,000 reserved for third-party payor balances. During 2014, the allowance for uncollectible accounts increased approximately \$3,800,000 from approximately \$14,400,000 to approximately \$18,200,000. This was comprised of approximately \$10,500,000 reserved for self-pay balances and approximately \$7,700,000 reserved for third-party payor balances.

The Corporation grants credit to patients, substantially all of whom are local residents of the communities served. The Corporation does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The Corporation has not changed its charity care or uninsured discount policies during 2015 or 2014.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

At December 31, 2015 and 2014, gross accounts receivable from patients and third party were comprised of the following:

	2015	2014
Medicare	34%	32%
Medicaid	22%	17%
Commercial insurance	20%	22%
Other managed care	11%	12%
Self-pay and other	13%	17%
	<u>100%</u>	<u>100%</u>

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

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

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

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

Management believes that adequate provisions have been made for any adjustments which may result from such final settlements. Differences between prior estimates and subsequent actual settlements are immaterial to these financial statements for 2015 and 2014.

Charity Care and Community Benefit

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

Of the Corporation's total expenses reported, an estimated \$7,057,000 and \$11,618,000 arose from providing services to charity patients during the years ended December 31, 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 Corporation's total expenses divided by gross patient service revenue.

The Corporation also provides programs and services to address the needs of the communities it serves, generally at no, or low, cost to those being served. Specific community needs being addressed by the Corporation include, among others, low-weight births and infant mortality, high incidence of, and deaths from, certain diseases and chronic illnesses, underserved populations, adequacy of the supply of physicians and other health care providers, and certain behavioral risk factors. The Corporation's programs and services include, among others, services to low-income women in need of prenatal care, health screenings for underserved women, wellness and injury prevention programs, chronic disease management assistance, educational programs, rural health care access and availability initiatives, transportation services for elderly and low-income patients, and access to support groups for critically and chronically ill patients and their families.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Assistance is also provided to senior citizens and other patients and their families for the submission of forms for insurance, financial counseling, and application to the Medicare and Medicaid programs for health service coverage. The Corporation periodically reviews, modifies, and reports on its Community Health Assessment and Plan of Action for the communities served.

Hospital Assessment Fee (HAF) Program

The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana inpatient providers. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates.

During the years ended December 31, 2015 and 2014, the Corporation recognized HAF Program expense of approximately \$13,600,000 and \$20,100,000, respectively, which resulted in increased Medicaid reimbursement. The HAF Program was approved for extension in March 2014 by CMS for the period July 1, 2013 through June 30, 2017.

Inventories

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

Investments Limited as to Use

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

Investments are generally commingled for investment purposes and consist of short-term investments (principally money market deposit accounts), certificates of deposit, U.S. government obligations, mutual funds, corporate obligations, and common stocks.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

Property and Equipment

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

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs are capitalized as a component of the cost of constructing the assets. Repair and maintenance costs are expensed when incurred.

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

Intangible Assets

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

Unamortized Debt Issuance Costs

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Medical Malpractice Insurance

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

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

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

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

Pension Plans

A noncontributory, defined-benefit pension plan covers substantially all employees. Plan benefits are based on years of service and the employee's compensation. During 2010, the Corporation froze the defined benefit plan and initiated a discretionary match component to the 403b defined contribution plan. During 2011, the Corporation offered a voluntary early retirement program for eligible employees to receive monthly annuities, removal of early retirement penalties and reductions, and health benefits for eighteen months per COBRA requirements for the employee and dependents. See footnote 10 for additional details on the Corporation's pension plans.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Financial Statement Presentation

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

Net Assets

Unrestricted net assets represent the part of the net assets of the Corporation that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations. Temporarily restricted net assets are those assets whose use by the Corporation has been limited by donors primarily for a specified time period or purpose. When a donor restriction expires or is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released for property and equipment. Property and equipment donated to the Hospital are recorded as additions to temporarily restricted net assets at their fair value at the date of receipt and as a transfer to unrestricted net assets when the assets are placed in service. Temporarily restricted net assets include approximately \$2,951,000 and \$2,587,000 of funds held by the Foundation for the benefit of the Corporation at December 31, 2015 and 2014, respectively. These amounts represent contributions received on behalf of the Corporation by the Foundation and other amounts the Foundation has granted to the Corporation and are included within Due from Union Hospital Foundation Inc. on the consolidated balance sheets. Other miscellaneous funds are held as temporarily restricted net assets. Permanently restricted net assets are those that the donor has requested to be held in perpetuity. In accordance with donor stipulations, certain investment income earned on permanently restricted net assets is unrestricted. Accordingly, such income is recorded in the unrestricted net asset class as it is earned.

Health Insurance

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately \$330,233,000 and \$347,622,000 for the years ended December 31, 2015 and 2014, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to approximately \$53,088,000 and \$55,559,000 for the years ended December 31, 2015 and 2014, respectively.

Income Taxes

The Corporation is organized as a not-for-profit corporation under Section 501(c) (3) of the United States Internal Revenue Code. As such, the Corporation is generally exempt from income taxes. However, the Hospital and UHC 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 Corporation and recognize a tax liability if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Corporation, and has concluded that as of December 31, 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 Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Filings are current through 2014. The impact of the IPACS, COH, and UHTs' tax consequences is immaterial to these financial statements.

Operating Indicator

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

Performance Indicator

Consistent with industry standards, the Corporation's performance indicator, excess of revenue over expenses, includes all changes in unrestricted net assets other than net unrealized depreciation and temporary losses on investments, investment returns restricted by donors, distribution to owners, changes in pension plan funded status, contributions of property and equipment, and equity transactions.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Advertising Costs

Advertising costs are expensed as incurred. Total expense for the years ended December 31, 2015 and 2014 were approximately \$230,000 and \$409,000, respectively.

Electronic Health Records (EHR) Incentive Payments

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

The Corporation recognizes EHR incentive payments as grant income, under the ratable recognition method, when there is reasonable assurance that the Corporation will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the consolidated financial statement effects of the grants must be both recognizable and measurable. During December 31, 2015 and 2014, the Corporation recognized gains and (losses) of approximately (\$265,000) and \$1,164,000, respectively, in EHR (refunds)/incentive payments.

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

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

Reduction in Force and Pension Settlement

During calendar year 2014, the Corporation executed a reduction in force affecting certain employees as part of its ongoing cost containment program. Affected employees were paid severance packages. Total costs associated with the reduction in force amounted to approximately \$-0- and \$698,000 for the years ended December 31, 2015 and 2014, respectively.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

During the years ended December 31, 2015 and 2014, in response to employee benefit cost control, the Corporation, with the approvals of the Pension Committee and Board of Directors, elected to distribute lump sum payments to qualified individuals participating in the pension plan creating recognition of an operating expense. Qualified individuals included all participating employees age 62 and older, any terminated and fully vested participants, and any new retirees. Settlement costs associated with the lump sum payments amounted to approximately \$3,991,000 and \$5,189,000 for the years ended December 31, 2015 and 2014, respectively.

Reclassifications

Certain amounts from the 2014 financial statements were reclassified to the current year presentation. There were no changes to net assets, as previously reported.

Subsequent Events

The Corporation has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is April 21, 2016.

3. AFFILIATED ENTITY AND RELATED PARTY TRANSACTIONS

As part of the affiliation with UHS and UAPC, the Corporation purchased certain intangible assets, including medical records and other assets, from AP&S in the amount of \$7,345,000. The intangible assets were amortized over 5 years and were fully amortized as of December 31, 2014. The Corporation transferred approximately \$11,376,000 and \$10,731,000 during the years ended December 31, 2015 and 2014, respectively, to UHS. The arrangement with UHS and UAPC contemplates that the Corporation will continue to transfer funds on an as needed basis to fulfill the contract obligation for on-going operational support to the affiliated group. The Corporation purchased the CT and MRI service line of UAPC for \$3,600,000 which is to be paid \$100,000 monthly. As of December 31, 2014, the Corporation has paid \$3,600,000 under this agreement with a balance remaining of \$-0-.

The Corporation provided management and other services for the Foundation and other related organizations for the years ended December 31, 2015 and 2014. These amounts are immaterial to the financial statements as a whole.

The Corporation received approximately \$45,000 and \$59,000 in contributions from the Foundation for the years ended December 31, 2015 and 2014, respectively. These amounts are recorded within other revenue in the consolidated statements of operations and changes in net assets.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The Corporation collaborates with physicians and physician groups including UAPC, to improve the quality of services, eliminate duplication of services, and to improve standards of care by entering into certain contractual agreements. While certain of the agreements are amended and/or terminated from time to time, the Corporation has had agreements for chemotherapy, ambulatory surgery, cardiac catheterization, laboratory, and radiation oncology therapy services. The costs for these services are included in contract services in the consolidated statements of operations and changes in net assets totaling approximately \$52,768,000 and \$59,917,000 for the years ended December 31, 2015 and 2014, respectively.

The Corporation contracts with AP&S Clinic for management services, which are provided to UAPC. Management expenses totaled approximately \$6,376,000 and \$6,068,000 for the years ended December 31, 2015 and 2014, respectively, and are included in contract services – management service organization support staff in the consolidated statements of operations and changes in net assets.

4. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at December 31, 2015 and 2014 is as follows:

	2015	2014
Soarian software	\$ 5,230,175	\$ 5,025,025
Other renovations and upgrades	754,935	1,459,434
	<u>\$ 5,985,110</u>	<u>\$ 6,484,459</u>

At December 31, 2015 the Corporation has outstanding commitments of \$14,200,000. Approximately \$10,500,000 of the commitments are earmarked for implementation of a new patient account software with expected completion in phases through 2018. Commitments for all other remaining construction project costs total approximately \$3,700,000 at December 31, 2015 and are expected to be expended through 2017.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

5. INVESTMENTS

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

	2015	2014
Money market deposit accounts and certificates of deposit	\$ 39,186,778	\$ 37,087,301
US Government obligations	7,922,194	12,044,043
Mutual funds	3,220,783	1,877,882
Common stocks	11,184,353	11,126,149
Corporate obligations	24,587,001	22,045,277
	86,101,109	84,180,652
Less current portion of:		
Debt service	6,162,514	6,162,344
Board designated	1,363,310	230,101
	\$ 78,575,285	\$ 77,788,207

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

	2015	2014
Investment income included within non-operating gains (losses) and net investment income on permanently restricted net assets:		
Investment income	\$ 1,691,489	\$ 3,666,776
Other changes in net assets:		
Unrealized loss on investments	(1,875,949)	(2,093,812)
	\$ (184,460)	\$ 1,572,964

The following schedule summarizes the fair value of securities included in investments by board designated and held by trustee that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of December 31, 2015 and 2014. The schedule further segregates the securities that have been in a gross unrealized position as of December 31, 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.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of December 31, 2015 and 2014:

Description of securities	December 31, 2015					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 741,164	\$ 203,979	\$ 2,239,521	\$ 293,877	\$ 2,980,685	\$ 497,856
Mutual funds	781,858	25,889	358,743	9,655	1,140,601	35,544
Government obligations	1,099,133	4,100	2,659,373	10,052	3,758,506	14,152
Corporate obligations	21,819,363	990,766	2,520,102	174,699	24,339,465	1,165,465
Total temporarily impaired securities	<u>\$ 24,441,518</u>	<u>\$ 1,224,734</u>	<u>\$ 7,777,739</u>	<u>\$ 488,283</u>	<u>\$ 32,219,257</u>	<u>\$ 1,713,017</u>

Description of securities	December 31, 2014					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 1,248,155	\$ 121,736	\$ -0-	\$ -0-	\$ 1,248,155	\$ 121,736
Mutual funds	363,705	8,238	64,964	2,446	428,669	10,684
Government obligations	7,305,571	20,327	-0-	-0-	7,305,571	20,327
Corporate obligations	20,132,130	379,154	-0-	-0-	20,132,130	379,154
Total temporarily impaired securities	<u>\$ 29,049,561</u>	<u>\$ 529,455</u>	<u>\$ 64,964</u>	<u>\$ 2,446</u>	<u>\$ 29,114,525</u>	<u>\$ 531,901</u>

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

- 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 December 31, 2015 and 2014.

- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Corporation are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily (NAV) and to transact at that price. The mutual funds held by the Corporation are deemed to be actively traded.
- *US Government obligations*: Valued based upon the active market on which the individual securities are traded.
- *Corporate obligations*: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2015 and 2014 are as follows:

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
Investments limited as to use				
Common stocks				
Consumer	\$ 2,887,765	\$ 2,887,765	\$ -0-	\$ -0-
Energy	1,715,925	1,715,925	-0-	-0-
Financial	2,075,851	2,075,851	-0-	-0-
Healthcare	1,217,437	1,217,437	-0-	-0-
Industrials	1,556,503	1,556,503	-0-	-0-
Information technology	1,537,717	1,537,717	-0-	-0-
Materials	193,155	193,155	-0-	-0-
Total common stocks	<u>11,184,353</u>	<u>11,184,353</u>	<u>-0-</u>	<u>-0-</u>
Mutual funds				
Fixed income funds	1,510,001	1,510,001	-0-	-0-
Large cap funds	214,081	214,081	-0-	-0-
Mid cap funds	80,683	80,683	-0-	-0-
Small cap funds	24,919	24,919	-0-	-0-
International funds	326,696	326,696	-0-	-0-
Index funds	1,064,403	1,064,403	-0-	-0-
Total mutual funds	<u>3,220,783</u>	<u>3,220,783</u>	<u>-0-</u>	<u>-0-</u>
US Government obligations	7,922,194	7,922,194	-0-	-0-
Corporate obligations				
Low yield	6,551,711	-0-	6,551,711	-0-
Mid yield	12,757,460	-0-	12,757,460	-0-
High yield	5,277,830	-0-	5,277,830	-0-
Total corporate obligations	<u>24,587,001</u>	<u>-0-</u>	<u>24,587,001</u>	<u>-0-</u>
	46,914,331	<u>22,327,330</u>	<u>24,587,001</u>	<u>-0-</u>
Money market deposit accounts	32,910,311			
Certificates of deposit*	6,276,467			
Total investments limited as to use	<u>\$ 86,101,109</u>			

* Certificates of deposit are reported at contract value

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

	December 31, 2014			
	Total	Level 1	Level 2	Level 3
Investments limited as to use				
Common stocks				
Consumer	\$ 3,037,412	\$ 3,037,412	\$ -0-	\$ -0-
Energy	1,715,275	1,715,275	-0-	-0-
Financial	1,813,185	1,813,185	-0-	-0-
Healthcare	1,265,451	1,265,451	-0-	-0-
Industrials	1,667,262	1,667,262	-0-	-0-
Information technology	1,514,333	1,514,333	-0-	-0-
Materials	113,231	113,231	-0-	-0-
Total common stocks	11,126,149	11,126,149	-0-	-0-
Mutual funds				
Fixed income funds	936,499	936,499	-0-	-0-
Large cap funds	212,798	212,798	-0-	-0-
Mid cap funds	99,137	99,137	-0-	-0-
Small cap funds	30,569	30,569	-0-	-0-
International funds	508,805	508,805	-0-	-0-
Index funds	90,074	90,074	-0-	-0-
Total mutual funds	1,877,882	1,877,882	-0-	-0-
US Government obligations	12,044,043	12,044,043	-0-	-0-
Corporate obligations				
Low yield	5,960,405	-0-	5,960,405	-0-
Mid yield	11,029,634	-0-	11,029,634	-0-
High yield	5,055,238	-0-	5,055,238	-0-
Total corporate obligations	22,045,277	-0-	22,045,277	-0-
	47,093,351	25,048,074	22,045,277	-0-
Money market deposit accounts	31,472,319			
Certificates of deposit*	5,614,982			
Total investments limited as to use	\$ 84,180,652			

* Certificates of deposit are reported at contract value

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

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments measured at fair value based on net asset value (NAVs) per share as of December 31, 2015 and 2014, respectively. The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

<u>December 31, 2015</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Mutual funds	\$ 3,220,783	Not applicable	Daily	Daily

<u>December 31, 2014</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Mutual funds	\$ 1,877,882	Not applicable	Daily	Daily

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

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

Long-term debt: Fair value of the Corporation's long-term debt, based on current quoted market value of similar debt instruments, for the Series 2011, 2007, and 1993 fixed rate tax exempt bonds and 2015 fixed rate service line loan approximated \$267,520,000 and \$264,577,000 as of December 31, 2015 and 2014, respectively. The fair value of variable rate debt (2010 loan and 2014 bonds) approximates its carrying value of \$14,815,000 and \$15,638,000 as of December 31, 2015 and 2014.

7. ENDOWMENT FUNDS

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

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

The endowment net assets by type of fund as of December 31, 2015 and 2014:

	2015	2014
Donor-restricted endowment funds		
Permanently restricted	\$ 1,548,109	\$ 1,573,096
Total endowment funds	<u>\$ 1,548,109</u>	<u>\$ 1,573,096</u>

For 2015 and 2014, the Corporation had the following endowment-related activities:

	Permanently restricted	
	2015	2014
Endowment net assets, beginning of year	\$ 1,573,096	\$ 1,491,685
Net investment income and other changes	<u>(24,987)</u>	<u>81,411</u>
Endowment net assets, end of year	<u>\$ 1,548,109</u>	<u>\$ 1,573,096</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

8. LONG-TERM DEBT

A Master Trust Indenture, as amended, provides for the issuance of long-term debt under an obligated group structure. The Obligated Group consists of the Corporation and subsidiaries. This Obligated Group is required to meet certain covenants under the Master Trust Indenture. The Obligated Group is subject to certain financial performance covenants, among other compliance requirements, that require the maintenance of debt service ratios. As of December 31, 2015, management of the Obligated Group believes that it is in compliance with all financial covenants.

The following is a summary of long-term debt as of December 31, 2015 and 2014:

	2015	2014
Indiana Health and Educational Facility Financing Authority or Hospital Authority of Vigo County (Indiana):		
Series 2011, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2015 through 2041. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 7.5% to 8% and averages 7.82%. Includes bond discount of approximately \$782,000 as of December 31, 2015.	\$ 53,273,124	\$ 54,201,106
Series 2007, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2027 through 2047. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 5.50% to 5.80% and averages 5.74%. Includes bond discount of approximately \$330,000 as of December 31, 2015.	176,169,586	176,155,808
Series 1993, tax-exempt fixed rate serial and term bonds, payable in annual principal installments through fiscal 2024. Interest (payable semiannually) ranges from 5.125% to 5.250% and averages 5.20% in fiscal 2015.	17,475,000	19,340,000
Series 2014A, taxable variable rate demand revenue bonds, payable in annual principal installments through fiscal 2036. Interest rate is set weekly (payable monthly) and averages 2.56% in fiscal 2015.	11,660,000	11,855,000
Loan payable in monthly principal installments commencing in fiscal 2010 through fiscal 2026. Fixed term with variable interest rate set monthly (payable monthly) using LIBOR based rates and averages 3.93% in 2015.	3,726,600	4,003,000
Loan payable for purchase of a medical group service line in June 2015, due April 2019, with monthly installments of approximately \$102,000. A fixed interest rate is set at 3.25%.	3,965,785	-0-
Capital leases and other	1,909,410	1,956,071
Total long-term debt	268,179,505	267,510,985
Less current portion	5,020,634	3,757,832
	\$ 263,158,871	\$ 263,753,153

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

Year Ending December 31,	
2016	\$ 5,020,634
2017	5,194,558
2018	5,534,583
2019	3,940,744
2020	4,412,380
Thereafter	244,076,606
	<u>\$ 268,179,505</u>

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

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

On April 25, 2014, the Corporation issued through the Hospital Authority of Vigo County (the Authority), Hospital Revenue Bonds, Series 2014A (taxable bonds) in the aggregate amount of \$12,105,000, principally to finance, or reimburse the Corporation to refund the Indiana Health Facility Financing Authority Variable Rate Demand Bonds, Series 2006B. The interest rate is variable and averages 2.56%. The term bonds expire in 2036 with principal payments beginning in 2015. During 2014, the Corporation, the Authority, and JP Morgan Chase entered into Bond Purchase Contracts (Contracts) whereby JP Morgan Chase purchased from the Authority all of the series 2014A bonds in a private placement.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Under the terms of the Contracts, JP Morgan Chase agreed to hold the Series 2014A bonds through April 23, 2021. At the end of the initial bank purchase date for the Series 2014A 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 2014A bonds cannot be remarketed at the end of the initial bank purchase date, the Corporation would be subject to payment of the remaining principal.

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

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

In June 2015, the Corporation financed the purchase of a medical group's Cardiac Cath Lab service line for approximately \$4,600,000. The terms of the loan used to finance the purchase are shown in the summary table above. Payments made during the year ended December 31, 2015 totaled approximately \$634,000. The related intangible asset, reflecting the fair value of medical records and a non-compete contract, is a component of intangible assets at net value within the consolidated balance sheets.

The Corporation leases medical equipment and software under capital leases with various expiration dates. Cost and accumulated depreciation of the equipment under capital leases was approximately \$1,323,000 and \$2,850,000, respectively, and \$595,000 and \$2,092,000, respectively, at December 31, 2015 and 2014. The following is a schedule by year of future minimum lease payments under capital leases as of December 31, 2015, that have initial or remaining lease terms in excess of one year.

Year Ending December 31,	
2016	\$ 344,328
2017	404,757
2018	77,713
2019	72,977
2020	33,681
	<u>933,456</u>
Less imputed interest	75,174
	<u>\$ 858,282</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The Corporation has operating leases for medical equipment and office space. Total rent and lease expense for the years ended December 31, 2015 and 2014 was \$8,600,000 and \$11,200,000, respectively. Future minimum lease payments under noncancelable operating leases as of December 31, 2015 that have initial or remaining lease terms in excess of one year are as follows:

Year Ending December 31,	
2016	\$ 4,861,680
2017	4,314,561
2018	3,230,125
2019	2,054,712
2020	1,195,747
Thereafter	1,192,254
	<u>\$ 16,849,079</u>

9. NONCONTROLLING INTEREST

The following table depicts the changes in consolidated net assets attributable to the controlling financial interest of the Corporation and the 49% non-controlling interest Clinical Management Solutions, LLC holds in Union Hospital Therapy, LLC (UHT).

	Controlling Interest	Noncontrolling Interest	Total
Balance December 31, 2013	\$ 128,556,565	\$ -0-	\$ 128,556,565
Change in net assets, before distribution to owners	(4,237,230)	755,275	(3,481,955)
Distribution to owners	(334,569)	(321,449)	(656,018)
Change in net assets, after distribution to owners	(4,571,799)	433,826	(4,137,973)
Balance December 31, 2014	\$ 123,984,766	\$ 433,826	\$ 124,418,592
Change in net assets, before distribution to owners	12,351,956	1,194,342	13,546,298
Distribution to owners	(1,240,051)	(1,191,422)	(2,431,473)
Change in net assets, after distribution to owners	11,111,905	2,920	11,114,825
Balance December 31, 2015	<u>\$ 135,096,671</u>	<u>\$ 436,746</u>	<u>\$ 135,533,417</u>

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

10. PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

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

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

The liability outstanding for the estimated cost for those in the program is approximately \$758,000 and \$1,340,000 as of December 31, 2015 and 2014. Of these amounts, approximately \$316,000 and \$410,000 were recorded as salaries, wages, and related liabilities and approximately \$499,000 and \$930,000 were recorded as pension liability and related obligations on the consolidated balance sheets as of December 31, 2015 and 2014, respectively.

The Corporation recognizes the unfunded status of its defined-benefit pension plan in its consolidated balance sheets and the changes therein within its consolidated statements of operations and changes in net assets. Unfunded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Prior unrecognized net actuarial losses of approximately \$35,755,000 and \$27,965,000 have been included in the unrestricted net assets at December 31, 2015 and 2014, respectively, and have not yet been recognized in net periodic pension cost. The adjustment to unrestricted net assets consisted primarily of the change in cumulative losses on the retirement plan and changes in the funded status for the years ended December 31, 2015 and 2014.

Actuarial losses included in unrestricted net assets at December 31, 2015 and 2014, and expected to be amortized in net periodic benefit cost were approximately \$2,001,000 and \$1,769,000.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The following table sets forth the defined-benefit pension plan's benefit obligations, fair value of the Plan's assets, and unfunded status at December 31, 2015 and 2014:

	2015	2014
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 99,595,005	\$ 107,416,082
Interest cost	4,778,740	5,636,449
Benefits paid	(15,093,199)	(23,094,983)
Actuarial loss	4,428,784	9,934,242
Effect of settlement/curtailment	1,328,292	(296,785)
Benefit obligation, ending of year	\$ 95,037,622	\$ 99,595,005
Changes in plan assets		
Fair value of plan assets, beginning of year	\$ 95,555,020	\$ 103,214,566
Actual return on plan assets	(1,774,505)	5,418,437
Employer contributions	9,240,000	10,017,000
Benefits paid	(15,093,199)	(23,094,983)
Fair value of plan assets, end of year	\$ 87,927,316	\$ 95,555,020
Unfunded status		
Unfunded status of the plan, end of year	\$ (7,110,306)	\$ (4,039,985)

During 2015 and 2014, a lump sum payment was offered in lieu of annuities to all participating employees age 62 and older, any terminated and fully vested participants, and any new retirees. Approximately \$10,605,000 and \$18,485,000 of lump sum payments were made during 2015 and 2014, respectively, and included as a component of benefits paid in the table above. See note 2 for additional information.

The liability recorded to account for the unfunded status of the plan at year end is recognized within the pension liability and related obligations on the consolidated balance sheet as of December 31, 2015 and 2014.

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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

	2015	2014
Components of net benefit cost		
Interest cost	\$ 4,778,740	\$ 5,636,449
Expected return on plan assets	(6,250,063)	(6,688,921)
Actuarial loss	2,000,596	1,768,887
Net periodic benefit cost	529,273	716,415
Settlement cost	3,990,490	5,188,502
Net benefit cost	\$ 4,519,763	\$ 5,904,917

The System recognized a settlement loss of approximately \$3,990,000 and \$5,189,000 during 2015 and 2014, which relates to the settlement payments made during 2015 and 2014. The losses represent a proportion of previously unrecognized losses included in unrestricted net assets. The settlement losses are included in the reduction in force and pension settlement line in the 2015 and 2014 consolidated statements of operations and changes in net assets.

The following is a schedule, by year, of expected benefit payments, which reflect expected future service. The year ending December 31, 2016 is higher than subsequent years due to the early withdrawal election mentioned in Note 2:

Year Ending December 31,	
2016	\$ 7,788,077
2017	6,999,876
2018	6,682,220
2019	7,266,629
2020	7,052,834
2021-2025	30,794,663
	\$ 66,584,299

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The weighted-average assumptions used to determine the Plan's projected benefit obligation (PBO) and net periodic benefit costs (NPBC) for the years ended December 31, 2015 and 2014, are as follows:

	2015	2014
Discount rate	4.9%	5.0%
Expected return on plan assets	5.3%	6.5%
Rate of compensation increase - NPBC	Not Applicable	Not Applicable

The principal long-term determinant of a portfolio's investment return is its asset allocation. 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.

The Plan's weighted-average asset allocations at December 31, 2015 and 2014, by asset category, are as follows:

	2015	2014
Mutual funds - equity funds	57%	45%
Mutual funds - bond funds	41%	54%
Other	2%	1%
	100%	100%

The following is an analysis of fair value of the major classes of plan assets as of December 31, 2015 and 2014:

	Fair Value	
	2015	2014
Money market mutual funds	\$ 1,669,279	\$ 776,352
Mutual funds - equity funds	49,412,765	42,333,703
Mutual funds - bond funds	35,631,026	51,230,237
Private equity funds	1,214,246	1,214,728
Total	\$ 87,927,316	\$ 95,555,020

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

See footnote 6 for information on valuation techniques for money market mutual funds and mutual funds. The private equity funds are considered level 3 assets in the fair value hierarchy, as the inputs to the valuation methodology are unobservable and significant to the fair value measurement. The fair value of the private equity funds are valued at the NAV of units of the funds. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the net asset value of the fund and, consequently, the fair value of the Corporation's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the Corporation were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.

The following is a reconciliation of the fair value of plan assets as of December 31, 2015 and 2014 determined on the basis of level 3 valuation techniques:

	Private Equity Funds	
	2015	2014
Balance, beginning of year	\$ 1,214,728	\$ 1,346,449
Return on plan assets:		
Assets held at the end of the year	(482)	(131,721)
Sales	-0-	-0-
Balance, end of year	<u>\$ 1,214,246</u>	<u>\$ 1,214,728</u>

The Plan employs an investment advisor to monitor the Plan's investment managers and make investment recommendations to the Corporation. The Corporation invests fund balances in a structured portfolio of equity and bond mutual funds and alternative investments. The target allocation strategy for the Plan is to have its investment portfolio comprise approximately 20% to 60% equity investments, 42% to 62% debt instruments, and 0% to 15% in real estate investments. Within the equity investment classification, the Plan's asset strategy encompasses equity and equity-like instruments that are expected to represent approximately 60% of the Corporation's plan asset portfolio of both public and private market investments. The largest component of these equity and equity-like instruments is public equity securities that are well diversified and invested in U.S. and international companies.

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

UNION HOSPITAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The Corporation expects to contribute approximately \$9,240,000 to the pension plan in calendar year 2016 and will meet the required funding amounts for 2015. The Corporation elected to freeze the Plan in 2010, but will continue to fund the plan as required.

The Corporation also has a 403b defined contribution plan which includes a 50% employer match up to 6% of employee deferrals in addition to an employer discretionary add-on of 1.67% for the years ended December 31, 2015 and 2014. The related contributions for the plan approximated \$3,316,000 and \$4,116,000 for the years ended December 31, 2015 and 2014, respectively.

11. INVESTMENTS IN JOINT VENTURES

The Corporation owns 50% of UAPC. The Corporation accounted for the investment under the equity method of accounting, as the governance structure is such that the Corporation cannot exercise control. The Corporation's 50% interest in UAPC amounts to approximately \$27,400 and \$573,000 as of December 31, 2015 and 2014, respectively. The interest is recorded in investments in joint ventures on the consolidated balance sheets and the corporation's loss on its investment in UAPC is recorded as loss on investment in UAPC on the consolidated statements of operations and changes in net assets.

The Corporation owns approximately 18% of the Indiana Healthcare Reciprocal Risk Retention Group (IHRRRG). The Corporation accounted for the investment under the equity method of accounting, as the governance structure is such that the Corporation cannot exercise control. The Corporation's 18% interest in IHRRRG amounts to approximately \$3,016,000 and \$2,627,000 as of December 31, 2015 and 2014, respectively. The interest is recorded in investments in joint ventures on the consolidated balance sheets and the Corporation's gain on its investment in IHRRRG is recorded in other non-operating gains (losses) on the consolidated statements of operations and changes in net assets.

The Corporation has ownership interest in other joint ventures accounted for under the equity method, the effects of which are immaterial to the consolidated financial statements as a whole.

12. COMMITMENTS AND CONTINGENCIES

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

CONSOLIDATING INFORMATION

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2015

	Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Union Hospital, Inc. and Subsidiaries
Assets						
Current assets						
Cash and cash equivalents	\$ 41,044,989	\$ 1,010,978	\$ -0-	\$ -0-	\$ -0-	\$ 42,055,967
Funds held by trustee, current portion	6,162,514	-0-	-0-	-0-	-0-	6,162,514
Board designated funds, current portion	1,363,310	-0-	-0-	-0-	-0-	1,363,310
Patient accounts receivable, net	51,863,375	-0-	387,398	-0-	-0-	52,250,773
Inventories	4,550,182	-0-	-0-	-0-	-0-	4,550,182
Prepaid expenses and other current assets	4,846,981	113,091	448,931	1,409,959	(786,355)	6,032,607
Total current assets	109,831,351	1,124,069	836,329	1,409,959	(786,355)	112,415,353
Investments limited as to use, less current portion						
Funds held by trustee	24,344,185	-0-	-0-	-0-	-0-	24,344,185
Board designated funds	52,682,991	-0-	-0-	-0-	-0-	52,682,991
Permanently restricted	1,548,109	-0-	-0-	-0-	-0-	1,548,109
Total investments limited as to use	78,575,285	-0-	-0-	-0-	-0-	78,575,285
Property and equipment						
Land and improvements	38,516,464	-0-	-0-	-0-	-0-	38,516,464
Buildings and fixed equipment	343,168,721	7,652	-0-	-0-	-0-	343,176,373
Movable equipment	132,459,685	58,303	62,698	-0-	-0-	132,580,686
	514,144,870	65,955	62,698	-0-	-0-	514,273,523
Less allowances for depreciation	258,959,593	46,586	47,574	-0-	-0-	259,053,753
	255,185,277	19,369	15,124	-0-	-0-	255,219,770
Construction in progress	5,985,110	-0-	-0-	-0-	-0-	5,985,110
Total property and equipment, net	261,170,387	19,369	15,124	-0-	-0-	261,204,880
Other assets						
Due from Union Hospital Foundation, Inc.	2,950,678	-0-	-0-	-0-	-0-	2,950,678
Deferred financing costs, net	2,696,320	-0-	-0-	-0-	-0-	2,696,320
Intangible assets, net	4,206,301	-0-	-0-	-0-	-0-	4,206,301
Investment in joint ventures	4,970,828	-0-	-0-	-0-	(1,927,201)	3,043,627
	14,824,127	-0-	-0-	-0-	(1,927,201)	12,896,926
Total assets	\$ 464,401,150	\$ 1,143,438	\$ 851,453	\$ 1,409,959	\$ (2,713,556)	\$ 465,092,444

See Report of Independent Auditors on Pages 1 - 2.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2015

	Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Union Hospital, Inc. and Subsidiaries
Liabilities and net assets						
Current liabilities						
Accounts payable and other current liabilities	\$ 23,999,985	\$ 356,765	\$ 91,501	\$ 147,820	\$ (786,355)	\$ 23,809,716
Salaries, wages and related liabilities	19,611,466	73,997	-0-	270,073	-0-	19,955,536
Estimated third party settlements	3,175,827	-0-	-0-	-0-	-0-	3,175,827
Accrued interest	5,134,370	-0-	-0-	-0-	-0-	5,134,370
Current portion of long-term debt	5,020,634	-0-	-0-	-0-	-0-	5,020,634
Total current liabilities	56,942,282	430,762	91,501	417,893	(786,355)	57,096,083
Long-term liabilities						
Long-term debt, less current portion	263,058,123	-0-	-0-	100,748	-0-	263,158,871
Pension liability and related obligations	7,609,122	-0-	-0-	-0-	-0-	7,609,122
Other long-term liabilities	1,694,951	-0-	-0-	-0-	-0-	1,694,951
Total long-term liabilities	272,362,196	-0-	-0-	100,748	-0-	272,462,944
Total liabilities	329,304,478	430,762	91,501	518,641	(786,355)	329,559,027
Net assets						
Unrestricted	130,138,208	712,676	759,952	454,572	(1,927,201)	130,138,207
Noncontrolling interests in UHT, LLC	-0-	-0-	-0-	436,746	-0-	436,746
Total unrestricted net assets	130,138,208	712,676	759,952	891,318	(1,927,201)	130,574,953
Temporarily restricted	3,410,355	-0-	-0-	-0-	-0-	3,410,355
Permanently restricted	1,548,109	-0-	-0-	-0-	-0-	1,548,109
Total net assets	135,096,672	712,676	759,952	891,318	(1,927,201)	135,533,417
Total liabilities and net assets	\$ 464,401,150	\$ 1,143,438	\$ 851,453	\$ 1,409,959	\$ (2,713,556)	\$ 465,092,444

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2014

	Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Union Hospital, Inc. and Subsidiaries
Assets						
Current assets						
Cash and cash equivalents	\$ 21,616,569	\$ 886,432	\$ -0-	\$ 546,402	\$ -0-	\$ 23,049,403
Funds held by trustee, current portion	6,162,344	-0-	-0-	-0-	-0-	6,162,344
Board designated funds, current portion	230,101	-0-	-0-	-0-	-0-	230,101
Patient accounts receivable, net	49,301,576	-0-	265,002	-0-	-0-	49,566,578
Inventories	4,194,640	-0-	-0-	-0-	-0-	4,194,640
Prepaid expenses and other current assets	3,153,277	93,440	535,544	679,068	(750,916)	3,710,413
Total current assets	84,658,507	979,872	800,546	1,225,470	(750,916)	86,913,479
Investments limited as to use, less current portion						
Funds held by trustee	24,297,655	-0-	-0-	-0-	-0-	24,297,655
Board designated	51,917,456	-0-	-0-	-0-	-0-	51,917,456
Permanently restricted	1,573,096	-0-	-0-	-0-	-0-	1,573,096
Total investments limited as to use	77,788,207	-0-	-0-	-0-	-0-	77,788,207
Property and equipment						
Land and improvements	37,907,574	-0-	-0-	-0-	-0-	37,907,574
Buildings and fixed equipment	340,837,408	7,652	-0-	-0-	-0-	340,845,060
Movable equipment	128,192,232	58,303	57,844	-0-	-0-	128,308,379
	506,937,214	65,955	57,844	-0-	-0-	507,061,013
Less allowances for depreciation	240,594,292	36,910	44,067	-0-	-0-	240,675,269
	266,342,922	29,045	13,777	-0-	-0-	266,385,744
Construction in progress	6,484,459	-0-	-0-	-0-	-0-	6,484,459
Total property and equipment, net	272,827,381	29,045	13,777	-0-	-0-	272,870,203
Other assets						
Due from Union Hospital Foundation, Inc.	2,586,708	-0-	-0-	-0-	-0-	2,586,708
Deferred financing costs, net	2,869,080	-0-	-0-	-0-	-0-	2,869,080
Intangible assets, net	746,695	-0-	-0-	-0-	-0-	746,695
Investment in joint ventures	5,056,016	-0-	-0-	-0-	(1,855,726)	3,200,290
	11,258,499	-0-	-0-	-0-	(1,855,726)	9,402,773
Total assets	\$ 446,532,594	\$ 1,008,917	\$ 814,323	\$ 1,225,470	\$ (2,606,642)	\$ 446,974,662

See Report of Independent Auditors on Pages 1 - 2.

UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2014

	Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Union Hospital, Inc. and Subsidiaries
Liabilities and net assets						
Current liabilities						
Accounts payable and other current liabilities	\$ 18,373,413	\$ 358,797	\$ 1,239	\$ 69,100	\$ (750,916)	\$ 18,051,633
Salaries, wages and related liabilities	20,779,389	59,013	-0-	266,091	-0-	21,104,493
Estimated Third party settlements	3,492,214	-0-	-0-	-0-	-0-	3,492,214
Accrued interest	5,147,347	-0-	-0-	-0-	-0-	5,147,347
Current portion of long-term debt	3,757,832	-0-	-0-	-0-	-0-	3,757,832
Total current liabilities	<u>51,550,195</u>	<u>417,810</u>	<u>1,239</u>	<u>335,191</u>	<u>(750,916)</u>	<u>51,553,519</u>
Long-term liabilities						
Long-term debt, less current portion	263,748,233	-0-	-0-	4,920	-0-	263,753,153
Pension liability and related obligations	4,970,222	-0-	-0-	-0-	-0-	4,970,222
Other long-term liabilities	2,279,176	-0-	-0-	-0-	-0-	2,279,176
Total long-term liabilities	<u>270,997,631</u>	<u>-0-</u>	<u>-0-</u>	<u>4,920</u>	<u>-0-</u>	<u>271,002,551</u>
Total liabilities	322,547,826	417,810	1,239	340,111	(750,916)	322,556,070
Net assets						
Unrestricted	119,517,636	591,107	813,084	451,533	(1,855,726)	119,517,634
Noncontrolling interests in UHT, LLC	-0-	-0-	-0-	433,826	-0-	433,826
Total unrestricted net assets	<u>119,517,636</u>	<u>591,107</u>	<u>813,084</u>	<u>885,359</u>	<u>(1,855,726)</u>	<u>119,951,460</u>
Temporarily restricted	2,894,036	-0-	-0-	-0-	-0-	2,894,036
Permanently restricted	1,573,096	-0-	-0-	-0-	-0-	1,573,096
Total net assets	<u>123,984,768</u>	<u>591,107</u>	<u>813,084</u>	<u>885,359</u>	<u>(1,855,726)</u>	<u>124,418,592</u>
Total liabilities and net assets	<u>\$ 446,532,594</u>	<u>\$ 1,008,917</u>	<u>\$ 814,323</u>	<u>\$ 1,225,470</u>	<u>\$ (2,606,642)</u>	<u>\$ 446,974,662</u>

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2015

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Total Union Hospital, Inc. and Subsidiaries
Operating revenue								
Net patient service revenue	\$ 412,703,317	\$ 27,259,059	\$ 439,962,376	\$ -0-	\$ 1,568,416	\$ -0-	\$ -0-	\$ 441,530,792
Less provision for bad debts	27,731,084	3,239,325	30,970,409	-0-	-0-	-0-	-0-	30,970,409
Net patient service revenue net of provision for bad debts	384,972,233	24,019,734	408,991,967	-0-	1,568,416	-0-	-0-	410,560,383
Other revenue	9,437,724	391,635	9,829,359	1,289,064	-0-	8,232,484	(10,538,224)	8,812,683
Total operating revenue	394,409,957	24,411,369	418,821,326	1,289,064	1,568,416	8,232,484	(10,538,224)	419,373,066
Operating expenses								
Physician, Mid-level, and other provider salaries and wages	25,296,053	514,464	25,810,517	405,846	-0-	4,348,270	-0-	30,564,633
Other salaries and wages	91,370,543	7,676,818	99,047,361	-0-	-0-	-0-	-0-	99,047,361
Employee benefits	23,342,587	1,846,021	25,188,608	73,439	-0-	746,388	-0-	26,008,435
Medical supplies and drugs	57,317,668	2,165,068	59,482,736	-0-	164,292	-0-	-0-	59,647,028
Physician services	5,890,704	50,187	5,940,891	-0-	-0-	-0-	-0-	5,940,891
Contract services - management service organization support staff	6,376,123	-0-	6,376,123	-0-	-0-	-0-	-0-	6,376,123
Contract services - other	64,256,564	3,131,760	67,388,324	72,272	1,129,952	-0-	(1,150,551)	67,439,997
Rent and leases	8,061,992	541,286	8,603,278	18,433	4,176	-0-	(16,676)	8,609,211
Utilities, supplies, and other	31,560,675	2,645,795	34,206,470	690,666	319,621	699,952	(9,370,997)	26,545,712
Hospital assessment fee	13,107,733	504,310	13,612,043	-0-	-0-	-0-	-0-	13,612,043
Depreciation and amortization	18,565,968	1,078,040	19,644,008	9,676	3,507	-0-	-0-	19,657,191
Interest	15,880,782	797	15,881,579	-0-	-0-	442	-0-	15,882,021
Total operating expenses	361,027,392	20,154,546	381,181,938	1,270,332	1,621,548	5,795,052	(10,538,224)	379,330,646
Income from operations before reduction in force and pension settlement	33,382,565	4,256,823	37,639,388	18,732	(53,132)	2,437,432	-0-	40,042,420
Reduction in force and pension settlement	(3,990,490)	-0-	(3,990,490)	-0-	-0-	-0-	-0-	(3,990,490)
Income from operations after reduction in force and pension settlement	29,392,075	4,256,823	33,648,898	18,732	(53,132)	2,437,432	-0-	36,051,930
Non-operating gains (losses)								
Investment income	1,612,880	759	1,613,639	102,837	-0-	-0-	-0-	1,716,476
Loss on investment in UAPC	(5,256,471)	-0-	(5,256,471)	-0-	-0-	-0-	-0-	(5,256,471)
Other	1,614,374	(2,908)	1,611,466	-0-	-0-	-0-	(1,311,526)	299,940
Total non-operating gains (losses)	(2,029,217)	(2,149)	(2,031,366)	102,837	-0-	-0-	(1,311,526)	(3,240,055)
Excess of revenue over expenses	\$ 27,362,858	\$ 4,254,674	\$ 31,617,532	\$ 121,569	\$ (53,132)	\$ 2,437,432	\$ (1,311,526)	\$ 32,811,875

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UNION HOSPITAL INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2014

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Total Union Hospital, Inc. and Subsidiaries
Operating revenue								
Net patient service revenue	\$ 413,149,684	\$ 28,606,517	\$ 441,756,201	\$ -0-	\$ 1,576,456	\$ -0-	\$ -0-	\$ 443,332,657
Less provision for bad debts	33,135,941	3,485,927	36,621,868	-0-	-0-	-0-	-0-	36,621,868
Net patient service revenue net of provision for bad debts	380,013,743	25,120,590	405,134,333	-0-	1,576,456	-0-	-0-	406,710,789
Other revenue	8,670,912	393,247	9,064,159	1,174,456	-0-	5,808,709	(7,675,475)	8,371,849
Total operating revenue	388,684,655	25,513,837	414,198,492	1,174,456	1,576,456	5,808,709	(7,675,475)	415,082,638
Operating expenses								
Physician, Mid-level, and other provider salaries and wages	28,061,204	1,164,675	29,225,879	353,850	-0-	3,185,648	-0-	32,765,377
Other salaries and wages	95,483,672	8,140,058	103,623,730	-0-	-0-	-0-	-0-	103,623,730
Employee benefits	24,276,997	1,771,455	26,048,452	67,386	-0-	491,993	-0-	26,607,831
Medical supplies and drugs	54,435,799	2,310,469	56,746,268	-0-	188,059	-0-	-0-	56,934,327
Physician services	3,883,845	7,740	3,891,585	-0-	-0-	-0-	-0-	3,891,585
Contract services - management service organization support staff	6,068,417	-0-	6,068,417	-0-	-0-	-0-	-0-	6,068,417
Contract services - other	64,093,507	2,556,274	66,649,781	65,652	820,534	-0-	(881,434)	66,654,533
Rent and leases	10,575,303	657,877	11,233,180	17,947	4,176	-0-	(16,190)	11,239,113
Utilities, supplies, and other	31,400,262	2,892,175	34,292,437	640,602	194,985	588,413	(6,777,851)	28,938,586
Hospital assessment fee	19,003,089	1,115,315	20,118,404	-0-	-0-	-0-	-0-	20,118,404
Depreciation and amortization	23,317,503	1,059,995	24,377,498	9,754	3,508	-0-	-0-	24,390,760
Interest	16,059,310	12	16,059,322	-0-	-0-	1,278	-0-	16,060,600
Total operating expenses	376,658,908	21,676,045	398,334,953	1,155,191	1,211,262	4,267,332	(7,675,475)	397,293,263
Income from operations before reduction in force and pension settlement	12,025,747	3,837,792	15,863,539	19,265	365,194	1,541,377	-0-	17,789,375
Reduction in force and pension settlement	(5,886,973)	-0-	(5,886,973)	-0-	-0-	-0-	-0-	(5,886,973)
Income form operations reduction in force and pension settlement	6,138,774	3,837,792	9,976,566	19,265	365,194	1,541,377	-0-	11,902,402
Nonoperating gains (losses)								
Investment income	3,501,321	418	3,501,739	83,626	-0-	-0-	-0-	3,585,365
Loss on investment in UAPC	(2,586,229)	-0-	(2,586,229)	-0-	-0-	-0-	-0-	(2,586,229)
Other	1,391,422	(603)	1,390,819	-0-	-0-	-0-	(1,254,189)	136,630
Total nonoperating gains (losses)	2,306,514	(185)	2,306,329	83,626	-0-	-0-	(1,254,189)	1,135,766
Excess of revenue over expenses	\$ 8,445,288	\$ 3,837,607	\$ 12,282,895	\$ 102,891	\$ 365,194	\$ 1,541,377	\$ (1,254,189)	\$ 13,038,168

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