



LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Financial Statements and
Supplementary Financial Information

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

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KPMG LLP
1 East Pratt Street
Baltimore, MD 21202-1128

Independent Auditors' Report

The Board of Directors
LifeBridge Health, Inc. and Subsidiaries:

We have audited the accompanying consolidated financial statements of LifeBridge Health, Inc. and Subsidiaries (the Corporation), which comprise the consolidated balance sheets as of June 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this responsibility 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.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of LifeBridge Health, Inc. and Subsidiaries as of June 30, 2014 and 2013, and the results of their operations, changes in their net assets and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Supplemental Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

October 17, 2014

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2014 and 2013

(Dollars in thousands)

Assets	<u>2014</u>	<u>2013</u>
Current assets:		
Cash and cash equivalents	\$ 219,711	181,529
Investments	12,675	10,641
Assets limited as to use, current portion	11,873	11,777
Patient service receivables, net of allowance for doubtful accounts of \$35,085 in 2014 and \$25,280 in 2013	121,324	121,993
Other receivables	6,559	5,223
Inventory	22,665	23,393
Prepaid expenses	10,719	10,915
Pledges receivable, current portion	4,298	3,829
Total current assets	<u>409,824</u>	<u>369,300</u>
Long-term investments	374,695	330,737
Donor-restricted investments	12,676	10,641
Reinsurance recovery receivable	13,365	23,914
Assets limited as to use, net of current portion	34,157	39,165
Pledges receivable, net of current portion	3,434	5,219
Property and equipment, net	459,638	475,155
Deferred financing costs, net of accumulated amortization of \$633 in 2014 and \$515 in 2013	2,319	2,437
Beneficial interest in split interest agreement	4,633	4,088
Investment in unconsolidated affiliates	18,720	4,930
Other assets	16,939	8,524
Total assets	<u>\$ 1,350,400</u>	<u>1,274,110</u>

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2014 and 2013

(Dollars in thousands)

Liabilities and Net Assets	2014	2013
Current liabilities:		
Accounts payable and accrued liabilities	\$ 86,384	92,457
Accrued salaries, wages and benefits	63,781	55,121
Advances from third-party payors	35,966	34,756
Current portion of long-term debt and capital lease obligations	6,198	6,275
Other current liabilities	9,382	1,169
Total current liabilities	201,711	189,778
Other long-term liabilities	100,147	130,334
Long-term debt and capital lease obligations, net of current portion	323,414	329,450
Total liabilities	625,272	649,562
Net assets:		
Unrestricted	660,970	563,128
Noncontrolling interest in consolidated subsidiaries	(192)	(310)
Total unrestricted net assets	660,778	562,818
Temporarily restricted	49,703	47,190
Permanently restricted	14,647	14,540
Total temporarily and permanently restricted net assets	725,128	624,548
Total liabilities and net assets	\$ 1,350,400	1,274,110

See accompanying notes to consolidated financial statements.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2014 and 2013

(Dollars in thousands)

	<u>2014</u>	<u>2013</u>
Unrestricted revenues, gains and other support:		
Patient service revenue (net of contractual allowances and discounts)	\$ 1,073,738	1,034,653
Provision for bad debts	56,245	52,021
Net patient service revenue	1,017,493	982,632
Net assets released from restrictions used for operations	3,935	3,542
Other operating revenue	56,357	47,784
Total operating revenues	<u>1,077,785</u>	<u>1,033,958</u>
Expenses:		
Salaries and employee benefits	598,683	582,499
Supplies	174,446	170,434
Purchased services	173,441	161,712
Depreciation, amortization and gain/loss on sale of assets	62,053	59,950
Repairs and maintenance	18,912	19,274
Interest	18,997	19,916
Total expenses	<u>1,046,532</u>	<u>1,013,785</u>
Operating income	<u>31,253</u>	<u>20,173</u>
Other income, net:		
Investment income	22,460	16,173
Unrealized gains on trading investments	31,232	17,323
Other	9	7
Total other income, net	<u>53,701</u>	<u>33,503</u>
Excess of revenues over expenses	<u>\$ 84,954</u>	<u>53,676</u>

See accompanying notes to consolidated financial statements.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2014 and 2013

(Dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total net assets</u>
Net assets at June 30, 2012	\$ 480,560	45,891	14,538	540,989
Excess of revenues over expenses	53,676	—	—	53,676
Unrealized gain (loss) on investments	—	3,506	(9)	3,497
Net assets released from restrictions used for the purchase of property and equipment	10,816	(10,816)	—	—
Restricted gifts and bequests	—	11,990	14	12,004
Net assets released from restrictions used for operations	—	(3,539)	(3)	(3,542)
Net change in value of beneficial interest in split interest agreement	—	158	—	158
Adjustment to pension liability	17,594	—	—	17,594
Other	172	—	—	172
Change in net assets	<u>82,258</u>	<u>1,299</u>	<u>2</u>	<u>83,559</u>
Net assets at June 30, 2013	<u>562,818</u>	<u>47,190</u>	<u>14,540</u>	<u>624,548</u>
Excess of revenues over expenses	84,954	—	—	84,954
Unrealized gain on investments	—	4,051	8	4,059
Net assets released from restrictions used for the purchase of property and equipment	5,202	(5,202)	—	—
Restricted gifts and bequests	—	7,051	102	7,153
Net assets released from restrictions used for operations	—	(3,932)	(3)	(3,935)
Net change in value of beneficial interest in split interest agreement	—	545	—	545
Adjustment to pension liability	7,623	—	—	7,623
Other	181	—	—	181
Change in net assets	<u>97,960</u>	<u>2,513</u>	<u>107</u>	<u>100,580</u>
Net assets at June 30, 2014	\$ <u>660,778</u>	<u>49,703</u>	<u>14,647</u>	<u>725,128</u>

See accompanying notes to consolidated financial statements.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2014 and 2013

(Dollars in thousands)

	2014	2013
Cash flows from operating activities:		
Change in net assets	\$ 100,580	83,559
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	62,076	60,027
Gain on disposal of equipment	(23)	(77)
Change in pension liability	(7,623)	(17,594)
Provision for bad debts	56,245	52,021
Realized and unrealized gains on investments	(51,925)	(27,081)
Restricted gifts and bequests	(7,153)	(12,004)
Change in beneficial interest of split interest agreement	(545)	(158)
Earnings on investments in unconsolidated affiliates	(3,229)	(7)
Change in operating assets and liabilities:		
Increase in patient service receivables, net	(55,576)	(60,507)
(Increase) decrease in other receivables	(1,336)	101
Decrease in pledges receivable	1,316	2,884
Decrease in inventory	728	74
Decrease (increase) in prepaid expenses	196	(1,393)
Decrease (increase) in reinsurance recovery receivable	10,549	(3,453)
Increase in other assets	(10,159)	—
Increase in accounts payable and accrued liabilities, and accrued salaries, wages, and benefits	7,390	10,152
Increase (decrease) in advances from third-party payors	1,210	(7,557)
(Decrease) increase in other current and long-term liabilities	(14,351)	1,834
Net cash provided by operating activities	88,370	80,821
Cash flows from investing activities:		
Change in donor-restricted investments	2,024	1,608
Change in long-term investments	1,874	(7,683)
Change in assets limited as to use	4,912	6,202
Investment in/distributions from unconsolidated affiliates, net	(10,561)	(2,302)
Additions to operating property	(47,128)	(62,048)
Proceeds from the sale of property	17	87
Acquisition of physician practices	(2,482)	—
Change in other assets	—	(505)
Net cash used in investing activities	(51,344)	(64,641)
Cash flows from financing activities:		
Payment on debt and capital lease obligations	(5,997)	(5,863)
Proceeds from issuance of debt	—	3
Restricted gifts and bequests	7,153	12,004
Net cash provided by financing activities	1,156	6,144
Net increase in cash and cash equivalents	38,182	22,324
Cash and cash equivalents:		
Beginning of year	181,529	159,205
End of year	\$ 219,711	181,529
Supplemental cash flow disclosures:		
Cash paid during the year for interest	\$ 19,060	19,974
Cash paid during the year for income taxes	86	130
Accounts payable related to purchase of operating property	5,487	9,842

See accompanying notes to consolidated financial statements.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(1) Organization

On October 1, 1998, Sinai Health System, Inc. merged with Northwest Health System, Inc. to form LifeBridge Health, Inc. (LifeBridge). LifeBridge's subsidiaries include Sinai Hospital of Baltimore, Inc. (Sinai), Northwest Hospital Center, Inc. (Northwest), Levindale Hebrew Geriatric Center and Hospital, Inc. (Levindale), Children's Hospital of Baltimore City, Inc. (Children's Hospital), The Baltimore Jewish Eldercare Foundation, Inc. (BJEF), LifeBridge Anesthesia Associates, LLC (LAA), LifeBridge Insurance Company, Ltd. (LifeBridge Insurance), LifeBridge Investments, Inc. (LB Investments), and LifeBridge Community Physicians, Inc. (Community Physicians). Sinai and Levindale are constituent agencies of THE ASSOCIATED: Jewish Community Federation of Baltimore, Inc. (AJCF), a charitable corporation.

All entities are tax-exempt under IRS regulations unless specifically noted below.

Investments is a for-profit corporation that holds, directly and indirectly, interests in a variety of for-profit businesses. Investments' subsidiaries include:

- *Practice Dynamics, Inc.*
- *LifeBridge Health and Fitness, LLC*
- *Sinai Eldersburg Real Estate, LLC*
- *David L. Zisow M.D., LLC*
- *General Surgery Specialists, LLC*
- *BW Primary Care, LLC*
- *LifeBridge Community Practices, LLC*
- *The Center for Urologic Specialties, LLC*
- *LifeBridge Roundwood Practices, LLC*
- *HomeCare Maryland, LLC*

Community Physicians is a for-profit corporation that provides physician and related services through several subsidiaries, including:

- *LifeBridge Cardiology of Carroll County, LLC*
- *LifeBridge Suburban Physician Group, LLC*
- *Woodholme Cardiology, LLC*
- *LifeBridge Metropolitan Physician Group, LLC*
- *LifeBridge Community Pulmonology, LLC*
- *LifeBridge Cardiology of Mays Chapel, LLC*
- *LifeBridge Cardiology of Bel Air, LLC*

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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(Dollars in thousands)

- *LifeBridge Community Pediatrics, LLC*
- *LifeBridge Primary Care of Eldersburg, LLC*
- *LifeBridge Community Gastroenterology, LLC*
- *LifeBridge Potomac Professionals, LLC*

(2) Significant Accounting Policies

(a) *Basis of Presentation*

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. All majority owned and direct member entities are consolidated. The accompanying consolidated financial statements include the accounts of LifeBridge Health, Inc. and Subsidiaries (the Corporation). All entities where the Corporation exercises significant influence, but does not have control, are accounted for under the equity method. All other unconsolidated entities are accounted for under the cost method. All significant intercompany accounts and transactions have been eliminated.

(b) *Cash and Cash Equivalents*

Cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less at the date of purchase.

(c) *Assets Limited as to Use*

Assets limited as to use primarily consists of assets held by trustees under bond indenture agreements, a self-insured workers' compensation reserve fund, and designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation have been reclassified in the consolidated balance sheets at June 30, 2014 and 2013.

(d) *Inventory*

Inventories, which consist primarily of medical supplies and pharmaceuticals, are stated at the lower of cost (using the moving average cost method of valuation) or market.

(e) *Investments, Long-Term Investments and Donor-Restricted Investments*

The Corporation's investment portfolio is considered a trading portfolio and is classified as current or noncurrent assets based on management's intention as to use. All debt and equity securities are reported in the consolidated balance sheets at fair value, principally based on quoted market prices.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

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(Dollars in thousands)

The Corporation has investments in alternative investments, primarily funds of hedge funds, totaling \$125,198 and \$106,030 at June 30, 2014 and 2013, respectively. These funds utilize various types of debt and equity securities and derivative instruments in their investment strategies. Also included in alternative investments are BJEF's and BJHF's funds that are invested on their behalf by the Associated Jewish Charities (AJC), an affiliate of AJCF. The underlying investments for these funds include cash of \$2,215, equities of \$25,366, private equity of \$3,104, fixed income of \$4,302, inflation hedging funds of \$3,796, and alternative investments of \$18,362. Alternative investments are recorded under the equity method.

Investments in unconsolidated affiliates are accounted for under the cost or equity method of accounting as appropriate and are included in other assets and investment in unconsolidated affiliates, respectively, in the consolidated balance sheets. The Corporation's equity income or loss is recognized in other operating revenue within the excess of revenue over expenses in the accompanying consolidated statements of operations and changes in net assets.

Investments also include assets restricted by donor, and assets designated by the Board of Directors for future capital improvements and other purposes over which it retains control and may, at its discretion, use for other purposes. Purchases and sales of securities are recorded on a trade-date basis.

Investment income (interest and dividends) including realized gains and losses on investment sales is reported as other income (expense) within the excess of revenues over expenses in the accompanying consolidated statements of operations and changes in net assets unless the income or loss is restricted by the donor or law. Investment income on funds held in trust for self-insurance purposes is included in other operating revenue. Investment income and net gains (losses) that are restricted by the donor are recorded as a component of changes in temporarily or permanently restricted net assets, in accordance with donor-imposed restrictions. Realized gains and losses are determined based on the specific security's original purchase price. Unrealized gains and losses are included in other income (expense), net within the excess of revenue over expenses.

Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, establishes 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 measurements) and lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2 Inputs – Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

- Level 3 Inputs – Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

The hierarchy requires the use of observable market data when available. Assets and liabilities are classified in their entirety based on the lowest level input that is significant to the fair value measurements.

(f) *Property and Equipment*

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter of the period of the lease term or the estimated useful life of the equipment. Maintenance and repair costs are expensed as incurred. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(g) *Deferred Financing Costs and Other Assets*

Deferred financing costs and other assets consist primarily of deferred financing costs, notes receivable, and the cash surrender value of split dollar life insurance. The deferred financing costs are amortized using the effective-interest method over the term of the related debt. Amortization expense was \$118 and \$119 for the years ended June 30, 2014 and 2013, respectively. Such amortization is included in depreciation and amortization in the consolidated financial statements.

(h) *Beneficial Interest in Split Interest Agreement*

CHSF holds a 25% interest in a trust, of which management has estimated the present value of the future income stream. CHSF will receive 25% of the net annual income over the next 10 years. At the end of this period in 2024, the trust will terminate, and 25% of the principal will be distributed to CHSF. Management has reported the beneficial interest at fair value based on the fair value of the underlying trust investments.

(i) *Advances from Third-Party Payors*

Advances from third-party payors are representative of advance funding from CareFirst BlueCross BlueShield, Medicaid, Aetna, United/MAMSI, and other insurance providers.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(j) Self-Insurance Programs

The Corporation maintains self-insurance programs for professional and general liability, workers' compensation, and employee health benefits. The provision for estimated self-insurance program claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The estimates are based on historical trends, claims asserted, and reported incidents.

(k) Other Long-Term Liabilities

Other long-term liabilities consist of self-insurance liabilities, pension plan liabilities, asset retirement obligations, and deferred compensation plan liabilities.

(l) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date those promises become unconditional. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

(m) Net Assets

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of externally imposed stipulations. Accordingly, net assets of the Corporation and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to externally imposed stipulations.

Temporarily restricted net assets – Net assets subject to externally imposed stipulations that may or will be met either by actions of the Corporation and/or the passage of time.

Permanently restricted net assets – Net assets subject to externally imposed stipulations that they be maintained by the Corporation in perpetuity.

Revenues are reported as increases in unrestricted net assets unless use of the related asset is limited by externally imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses are reported as increases or decreases in unrestricted net assets unless use of the related asset is limited by externally imposed restrictions or law. Expirations of temporary restrictions of net assets (i.e., the externally stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets if used to acquire capital assets; otherwise, they are recorded as unrestricted operating revenue.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

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(Dollars in thousands)

(n) *Net Patient Service Revenue*

Net patient service revenue for Sinai and Northwest (the Hospitals) and the chronic hospital component of Levindale is recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC) and, accordingly, reflects actual charges to patients based on rates in effect during the period in which the services are rendered. On January 29, 2014, the Corporation and the Health Services Cost Review Commission (HSCRC) agreed to implement the Global Budget Revenue (GBR) methodology, effective July 1, 2013. The Agreement will continue through June 30, 2014 and on July 1, 2014, and each year thereafter, the Agreement will renew for a one-year period unless it is canceled by the HSCRC or by the Hospital. The GBR model is a revenue constraint and quality improvement system, designed by the HSCRC to provide hospitals with strong financial incentives to manage their resources efficiently and effectively in order to slow the rate of increase in healthcare costs and improve healthcare delivery processes and outcomes. The GBR model is consistent with the Hospitals' mission to provide the highest value of care possible to their patients and the communities they serve.

The GBR agreement establishes a prospective, fixed revenue base "GBR cap" for the upcoming year. This includes both inpatient and outpatient regulated services. Under GBR, the Corporation's revenue for all HSCRC-regulated services is predetermined for the upcoming year, regardless of changes in volume, service mix intensity, or mix of inpatient or outpatient services that occurred during the year. The GBR agreement allows the Corporation to adjust unit rates, within certain limits, to achieve the overall revenue base for the Corporation at year-end. Any overcharge or undercharge versus the GBR cap is prospectively added to the subsequent year's GBR cap. Although the GBR cap does not adjust for changes in volume or service mix, the GBR cap is adjusted annually for inflation, and for changes in payor mix and uncompensated care. Beginning on July 1, 2014 and each year thereafter, the Corporation will receive an annual adjustment to its cap for the change in population in the Corporation's service area.

Contractual adjustments, which represent the difference between amounts billed as patient service revenue and amounts paid by third-party payors, are accrued in the period in which the related services are rendered. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

Medicare reimburses Northwest, Levindale and Courtland for skilled nursing services under the Medicare skilled nursing Prospective Payment System (PPS). Under PPS, the payment rate is based on patient resource utilization as calculated by a patient classification system known as Resource Utilization Groups.

Medicaid reimburses Levindale and Courtland for services rendered in their long-term care facilities based on their actual costs, up to certain predetermined limits, and the condition and requirements of the patients. Reimbursement is at an interim rate with the final settlement determined after submission of annual cost reports and audits thereof. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined. As of June 30, 2014, Levindale had open Medicaid cost reports for the years ended

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(Dollars in thousands)

June 30, 2014 and 2013, and Courtland had open Medicaid cost reports for the year ended June 30, 2014.

All other patient service revenue is recorded at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

(o) Other Operating Revenue

Other operating revenue includes revenue generated from investments in joint ventures for which the services support or complement the delivery of care. This includes income from investments in urgent care and fitness, as well as revenue from retail pharmacy and other support services.

(p) Grants

Federal grants are accounted for either as an exchange transaction or as a contribution based on terms and conditions of the grant. If the grant is accounted for as an exchange transaction, revenue is recognized as other operating revenue when earned. If the grant is accounted for as a contribution, the revenues are recognized as either other operating revenue or temporarily restricted contributions depending on the restrictions within the grant.

(q) Meaningful Use Incentives

Under certain provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), federal incentive payments are available to hospitals, physicians, and certain other professionals when they adopt, implement, or upgrade certified electronic health record (EHR) technology or become "meaningful users," as defined under ARRA, of EHR technology in ways that demonstrate improved quality, safety, and effectiveness of care. Incentive payments will be paid out over varying transitional schedules depending on the type of incentive (Medicare and Medicaid) and recipient (hospital or other eligible provider). Eligible hospitals can attest for both Medicare and Medicaid incentives, while physicians must select to attest for either Medicare or Medicaid incentives. For Medicare incentives, eligible hospitals receive payments over four years while eligible physicians receive payments over five years. For Medicaid incentives, eligible Maryland hospitals receive payments over four years and physicians receive payments over six years.

The Corporation recognizes EHR incentives when the payment is received. During the years ended June 30, 2014 and 2013, certain hospitals and physicians satisfied the meaningful use criteria. As a result, the Corporation recognized \$4,494 and \$6,571 of EHR incentives during fiscal years 2014 and 2013, respectively, in other operating revenue.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(r) ***Charity Care and Bad Debt***

Sinai, Northwest, Levindale and Courtland provide care to patients who meet certain criteria under their charity care policies without charge or at amounts less than their established rates. Because the facilities do not pursue the collection of amounts determined to qualify as charity care, those amounts are not reported as revenue. The amount of charity care provided during the years ended June 30, 2014 and 2013, based on patient charges foregone, was \$20,368 and \$16,794, respectively. The total direct and indirect costs to provide the care amounted to approximately \$16,918 and \$14,112 for the years ended June 30, 2014 and 2013, respectively.

All patient accounts are handled consistently and appropriately to maximize cash flow and to identify bad debt accounts timely. Active accounts are considered bad debt accounts when they meet specific collection activity guidelines and/or are reviewed by the appropriate management and deemed to be uncollectible. Every effort is made to identify and pursue all account balance liquidation options, including but not limited to third party payor reimbursement, patient payment arrangements, Medicaid eligibility and financial assistance. Third party receivable management agencies provide extended business office services and insurance outsource services to ensure maximum effort is taken to recover insurance and self-pay dollars before transfer to bad debt. Contractual arrangements with third party collection agencies are used to assist in the recovery of bad debt after all internal collection efforts have been exhausted. In so doing, the collection agencies must operate consistently with the goal of maximum bad debt recovery and strict adherence with Fair Debt Collections Practices Act (FDCPA) rules and regulations, while maintaining positive patient relations.

	2014	2013
Beginning allowance	\$ 25,280	23,560
Plus provision for bad debt	56,245	52,021
Less bad debt write-offs, net of recoveries	(46,440)	(50,301)
Ending allowance	\$ 35,085	25,280

(s) ***Income Taxes***

LifeBridge and its not-for-profit subsidiaries have been recognized by the Internal Revenue Service as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code.

LifeBridge Insurance, Community Physicians, and Investments and its incorporated subsidiaries account for income taxes in accordance with Financial Accounting Standards Board (FASB) ASC Topic 740, *Income Taxes*. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment

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date. Any changes to the valuation allowance on the deferred tax asset are reflected in the year of the change. The Corporation accounts for uncertain tax positions in accordance with ASC Topic 740.

(t) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(u) Excess of Revenues over Expenses

The accompanying consolidated statements of operations include excess of revenue over expenses. Changes in unrestricted net assets that are excluded from excess of revenues over expenses, consistent with industry practice, include changes in the funded status of defined-benefit pension plans, permanent transfers of assets to and from affiliates for other than goods and services, the cumulative effect of a change in accounting principles, and contributions received for additions of long-lived assets.

(v) Employee Pension Plan

Pension benefits are administered by the Corporation. The Corporation accounts for its defined-benefit pension plans within the framework of ASC Topic 958, *Not-for-Profit Entities, Section 715, Compensation-Retirement Benefits* (Topic 958, Section 715), which requires the recognition of the overfunded or underfunded status of a defined-benefit pension plan as an asset or liability. The plans are subject to annual actuarial evaluations, which involve various assumptions creating changes in elements of expense and liability measurement. Key assumptions include the discount rate, the expected rate of return on plan assets, retirement, mortality, and turnover. The Corporation evaluates these assumptions annually and modifies them as appropriate.

Additionally, Topic 958, Section 715 requires the measurement date for plan assets and liabilities to coincide with the employer's year-end and requires the disclosure in the notes to the consolidated financial statements of additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation.

(w) Reclassifications

Certain prior year amounts in the consolidated financial statements have been reclassified to conform to current period presentation.

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(3) Investments

Investments, which consist of assets limited as to use, donor-restricted investments, and long-term investments in the accompanying consolidated balance sheets, are stated at fair value or under the equity method, as appropriate, as of June 30, 2014 and 2013, and consist of the following:

	2014	2013
Assets limited as to use:		
Self-insurance fund:		
Equity securities	\$ 8,346	9,788
U.S. Treasury	10,273	12,648
Alternative investments	4,372	4,605
Government securities	2,006	1,912
Fixed income	9,160	10,212
Self-insurance fund	34,157	39,165
Debt service fund:		
Cash and cash equivalents	10,221	4,951
Government securities	1,652	6,826
Assets limited as to use	46,030	50,942
Less current portion	(11,873)	(11,777)
Assets limited as to use, net of current portion	\$ 34,157	39,165
Donor-restricted investments:		
Cash and cash equivalents	\$ 3,617	2,153
Equity securities	969	230
U.S. Treasury	2,057	1,844
Mutual funds	3,055	3,007
Government securities	2,282	2,184
Fixed income	696	1,223
Donor-restricted investments	\$ 12,676	10,641
Beneficial interest in split interest agreement	\$ 4,633	4,088

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There are other investments restricted by donors that are included in long-term investments, pledges receivable, and beneficial interest as of June 30, 2014 and 2013. Of these amounts, \$39,309 and \$37,953 are included in long-term investments as of June 30, 2014 and 2013, respectively:

	2014	2013
Current and long-term investments:		
Cash and cash equivalents	\$ 4,249	4,093
Mutual funds	110,780	148,633
Equity securities	136,221	74,151
Government securities	2,097	1,999
Fixed income	13,197	11,077
Alternative investments	120,826	101,425
Current and long-term investments	387,370	341,378
Less current portion	12,675	10,641
Long-term investments	\$ 374,695	330,737

Investment income and gains and losses on long-term investments, donor-restricted investments, and assets limited as to use are comprised of the following for the years ended June 30, 2014 and 2013:

	2014	2013
Investment income:		
Interest income and dividends	\$ 9,259	9,912
Realized gains on sale of securities	13,201	6,261
Investment income	22,460	16,173
Unrealized gains (losses) on trading securities	31,232	17,323
Other changes in net assets:		
Changes in unrealized gains on temporarily and permanently restricted net assets	4,059	3,497
Total investment return	\$ 57,751	36,993

(4) Pledges Receivable

Contributions and pledges to raise funds are recorded as temporarily restricted net assets until the donor-intended purpose is met and the cash is collected. Future pledges are discounted at the Treasury bill rate to reflect the time value of money, and an allowance for potentially uncollectible pledges has been established.

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Sinai, Northwest, and Levindale have recorded total pledges as of June 30, 2014 and 2013 as follows:

	2014	2013
Gross pledges receivable	\$ 11,128	13,071
Less:		
Discount for time value of money	(1,261)	(1,557)
Allowance for uncollectible accounts	(2,135)	(2,466)
	\$ 7,732	9,048

Total future payments are as follows:

Less than one year	\$ 5,849
One to five years	4,405
Five years and thereafter	874
	\$ 11,128

(5) Property and Equipment

As described in note 11, Sinai and Levindale lease under lease agreements with an affiliate of AJCF all land, land improvements, buildings, and fixed equipment located at those entities' primary locations; LifeBridge entities own all the movable equipment. Property and equipment are classified as follows at June 30:

	Estimated useful life	2014	2013
Land		\$ 2,838	2,747
Land improvements	8 to 20 years	11,964	11,629
Building and improvements	10 to 40 years	663,248	658,381
Fixed equipment	8 to 20 years	52,702	52,579
Movable equipment	3 to 15 years	305,244	292,369
Construction in progress		42,934	29,764
		1,078,930	1,047,469
Less accumulated depreciation		(619,292)	(572,314)
Property and equipment, net		\$ 459,638	475,155

Depreciation, amortization, and gain/loss on sale of assets were \$62,053 and \$59,950 for the years ended June 30, 2014 and 2013, respectively. Of this, depreciation expense was \$58,296 and \$58,915 for the years ended June 30, 2014 and 2013, respectively.

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Included in property and equipment is building and equipment, net of accumulated amortization, of \$9,849 and \$11,186 for the years ended June 30, 2014 and 2013, respectively, financed with capital lease obligations. Accumulated amortization related to the building and equipment under capital leases was \$16,583 and \$14,964 at June 30, 2014 and 2013, respectively.

(6) Investments in Joint Ventures

Investments in joint ventures and partnerships, accounted for under the equity method, consist of the following at June 30, 2014 and 2013:

Joint Venture	Business purpose	2014		2013	
		Percentage ownership	Balance	Percentage ownership	Balance
Acute Diagnostics & Services, LLC	Sleep Management Services	50%	\$ 243	50%	\$ 114
Cherrywood Manor, LP	Nursing Home	25	861	25	781
LifeBridge Sports Medicine & Rehabilitation, LLC	Physical Therapy	50	1,217	50	936
MNR Industries, LLC	Urgent Care Centers	40	12,873	—	—
National Respiratory Care, LLC	Durable Medical Equipment	50	676	50	536
PLMD, LLC	Ambulance Services	25	512	25	491
Riverside Health of Maryland, Inc.	Medicaid Managed Care Plan	20	2,314	20	2,048
WL Energy Management Services, LLC	Consulting	48	24	48	24
	Total		<u>\$ 18,720</u>		<u>\$ 4,930</u>

For those joint ventures and partnerships accounted for using the equity method, LifeBridge recorded equity in earnings of joint ventures and partnerships. For those joint ventures and partnerships accounted for using the cost method, LifeBridge recorded dividend income. Such amounts are included in other operating revenue in the consolidated statements of operations.

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(7) Long-Term Debt and Capital Lease Obligations

As of June 30, long-term debt and capital lease obligations consist of the following:

	2014	2013
Maryland Health and Higher Educational Facilities Authority:		
Revenue Bonds Series 2008	\$ 269,405	272,370
Revenue Bonds Series 2011	49,130	49,920
Capital leases	8,299	10,540
Other	343	343
	327,177	333,173
Less current portion	(6,198)	(6,275)
Unamortized premium	2,482	2,602
Unamortized discount	(47)	(50)
Long-term debt, net	\$ 323,414	329,450

In January 2008, the Maryland Health and Higher Educational Facilities Authority (MHHEFA or the Authority) issued \$285,815 in bonds (Series 2008 Bonds) on behalf of LifeBridge and several of its subsidiaries (the Obligated Group). The Obligated Group includes LifeBridge, Sinai, Northwest, Levindale, CHSF, and BJHF. Each member of the Obligated Group is jointly and severally liable for repayment of the obligations under the Master Loan Agreement.

The proceeds of the Series 2008 Bonds were loaned to the Obligated Group pursuant to a Master Loan Agreement. As security for the performance of the bond obligation under the Master Loan Agreement, the Authority maintains a security interest in the revenue of the obligors. The agreement provides for principal payments on July 1 of each year, beginning on July 1, 2008 and continuing through 2047. The Series 2008 loan bears interest at a weighted fixed rate of 5.35%.

In March 2011, the Authority issued \$50,695 in bonds (Series 2011 Bonds) to the Obligated Group members pursuant to the Master Loan Agreement. As security for the performance of the bond obligation under the Master Loan Agreement, the Authority maintains a security interest in the revenue of the obligors. The agreement provides for principal payments on July 1 of each year, beginning on July 1, 2011 and continuing through 2041, when the remaining principal balance is due in full. The Series 2011 loan bears interest at a weighted fixed rate of 5.99%.

The Master Loan Agreement requires the Obligated Group to adhere to limitations on mergers, disposition of assets, and additional indebtedness and certain financial covenants. The financial covenants include a rate covenant, which requires the Obligated Group to achieve a debt service coverage ratio of 1.10; a liquidity covenant, which requires the Obligated Group to maintain 65 days cash on hand; and a debt to capitalization covenant, which requires the Obligated Group to maintain a debt to capitalization ratio of not more than 65%, all measured as of June 30 in each fiscal year. In the fiscal year ended June 30, 2014, the Obligated Group met all of its covenants.

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The Corporation is obligated under several noncancelable capital leases for hospital equipment and office building space.

The total future principal payments on long-term debt and capital lease payments are as follows:

	Long-term debt	Capital lease obligations
Years ending June 30:		
2015	\$ 3,935	\$ 3,295
2016	4,132	3,183
2017	4,330	2,115
2018	4,540	1,023
2019	4,770	1,023
Thereafter	296,828	1,954
	\$ 318,535	12,593
Less interest portion		(4,294)
		\$ 8,299

(8) Line of Credit

Sinai maintains a \$5,000 line of credit with M&T Bank. As of June 30, 2014 and 2013, there were no balances outstanding on this line of credit.

(9) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at June 30:

	2014	2013
Healthcare services:		
Capital equipment/construction	\$ 24,790	24,360
Other healthcare services:		
Service grants	149	113
Donor-specified healthcare services	11,939	10,676
Enrichment and research	12,825	12,041
	\$ 49,703	47,190

Permanently restricted net assets of \$14,647 and \$14,540 at June 30, 2014 and 2013, respectively, are restricted to investments to be held in perpetuity, the income from which is expendable to support healthcare services.

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(10) Employee Benefit Plans

The Corporation sponsors noncontributory defined-benefit pension plans (the Plans) covering full-time, nonunion and union employees. Annual contributions to the Plans are made at a level equal to or greater than the funding requirement as determined by the Plans' consulting actuary. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

The following tables set forth the Plans' funded status and amounts recognized in the accompanying consolidated financial statements as of June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
	June 30, 2014	June 30, 2013
Measurement date		
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 159,218	158,868
Service cost	6,769	7,517
Interest cost	7,138	6,478
Actuarial loss	7,531	(6,907)
Benefits paid	(5,462)	(6,313)
Expenses paid from assets	(407)	(425)
Benefit obligation at end of year	<u>174,787</u>	<u>159,218</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	130,332	108,818
Actual return on plan assets	22,519	14,744
Company contributions	10,086	13,508
Benefits paid	(5,462)	(6,313)
Expenses paid from assets	(407)	(425)
Fair value of plan assets at end of year	<u>157,068</u>	<u>130,332</u>
Funded status	<u>\$ (17,719)</u>	<u>(28,886)</u>

Amounts recognized in the consolidated financial statements consist of the following at June 30:

	<u>2014</u>	<u>2013</u>
Amounts recognized in the consolidated balance sheets:		
Other long-term liabilities	\$ 17,719	28,886
Amounts recognized in unrestricted net assets:		
Net actuarial loss	\$ 27,984	35,518
Prior service cost	132	221
	<u>\$ 28,116</u>	<u>35,739</u>

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The Corporation has estimated \$8,787 for its defined-benefit contributions for the fiscal year ending June 30, 2015. The accumulated benefit obligation is \$158,145 and \$145,392 at June 30, 2014 and 2013, respectively.

Net periodic pension expense for the years ended June 30, 2014 and 2013 was as follows:

	<u>2014</u>	<u>2013</u>
Service cost	\$ 6,769	7,517
Interest cost	7,138	6,478
Expected return on plan assets	(9,413)	(8,112)
Amortization of net loss	2,042	3,613
Amortization of prior service cost	89	442
Net periodic benefit cost	<u>\$ 6,625</u>	<u>9,938</u>

The estimated net actuarial loss and prior service cost to be amortized from unrestricted net assets into net periodic pension benefit cost over the next fiscal year are \$89 and \$1,109, respectively.

Actuarial assumptions used were as follows:

	<u>2014</u>	<u>2013</u>
Assumptions used to determine annual pension expense:		
Discount rate	4.70%	4.25%
Expected return on plan assets	7.50	7.75
Rate of compensation increase	2.50	3.00
Assumptions used to determine end-of-year liabilities:		
Discount rate	4.40%	4.70%
Expected return on plan assets	7.25	7.50
Rate of compensation increase	2.50	2.50
Plan asset allocation:		
Asset category:		
Cash and cash equivalents	1.00%	—%
Fixed income/debt securities	24.00	25.00
Equity securities	50.00	53.00
Alternative investments	25.00	22.00
Total	<u>100.00%</u>	<u>100.00%</u>

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In selecting the expected long-term rate on asset assumption, Sinai and Levindale considered the average rate of earnings on the funds invested or to be invested to provide for the benefits of these plans. This included considering the Plans' asset allocation and the expected returns likely to be earned over the life of the plans:

	Target
Target allocation on assets:	
Equity securities	45%
Alternative investments	30
Fixed income/debt securities	25

Following are the expected benefit payments to be disbursed from plan assets:

Years ending June 30:			
2015	\$	9,349	
2016		8,855	
2017		10,525	
2018		10,698	
2019		11,016	
Thereafter		60,495	

The fair values of pension plan assets held by PNC Institutional Investments by level at June 30, 2014 were as follows:

	Pension benefits – plan assets			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 5,146	—	—	5,146
Mutual funds	56,073	—	—	56,073
Fixed income	—	5,157	—	5,157
Equity securities	56,677	—	—	56,677
Alternative investments	—	—	34,015	34,015
Total assets	\$ 117,896	5,157	34,015	157,068

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The fair values of pension plan assets held by PNC Institutional Investments by level at June 30, 2013 were as follows:

	Pension benefits – plan assets			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 2,690	—	—	2,690
Mutual funds	46,724	—	—	46,724
Fixed income	—	5,049	—	5,049
Equity securities	52,459	—	—	52,459
Alternative investments	—	—	23,410	23,410
Total assets	\$ 101,873	5,049	23,410	130,332

For the years ended June 30, 2014 and 2013, there were no significant transfers into or out of Levels 1, 2, or 3.

Changes to the fair values based on the Level 3 inputs are summarized as follows:

	Total
Balance as of June 30, 2013	\$ 23,410
Additions:	
Contributions/purchases	7,558
Disbursements:	
Withdrawals/sales	(82)
Net change in value	3,129
Balance as of June 30, 2014	\$ 34,015

The following table summarizes redemption terms for the hedge fund-of-funds vehicles held as of June 30, 2014:

	Fund 1	Fund 2	Fund 3	Fund 4	Fund 5	Fund 6	Fund 7
Redemption timing:							
Redemption frequency	Quarterly	Quarterly	Quarterly	Quarterly	*	Annually	Monthly
Required notice	33 days	95 days	65 days	65 days		45 days	30 days
Audit reserve:							
Percentage held back for audit reserve	10%	10%	10%	4%		—%	—%
Gates:							
Potential gate holdback	—	—	—	—		—	—
Potential gate release time fran	—	—	—	—		—	—

* Fund 5 is currently in redemption

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Northwest has a qualified noncontributory defined-contribution pension plan (the NW Plan) covering substantially all employees who work at least 1,000 hours per year, who have completed two years of continuous service as of the beginning of the plan year, and who have attained the age of 21 as of the beginning of the plan year. Participants in the NW Plan are 100% vested. Northwest makes annual contributions to the NW Plan equivalent to 1.5% of the participants' salaries for employees who have been in the NW Plan from 1 to 5 years, 4.0% for those in the plan from 6 to 19 years, and 6.5% thereafter. It is Northwest's policy to fund pension costs as they accrue. Pension expense was approximately \$2,236 and \$2,242 for the years ended June 30, 2014 and 2013, respectively, and is included in salaries and employee benefits in the accompanying consolidated statements of operations.

Certain LifeBridge entities have supplemental 403(b) retirement plans for eligible employees. The entities may elect to match varying percentages of an employee's contribution up to a certain percentage of the employee's annual salary. The associated expense was approximately \$4,687 and \$4,638 for the years ended June 30, 2014 and 2013, respectively, and is included in salaries and employee benefits in the accompanying consolidated statements of operations.

Certain companies under Community Physicians and Investments maintain a defined-contribution plan for employees meeting certain eligibility requirements. Eligible employees can also make contributions. Under the plan, the employer may elect to match a percentage of eligible employees' contributions each year. The related expense was approximately \$1,205 and \$863 for the years ended June 30, 2014 and 2013, respectively, and is included in salaries and employee benefits in the accompanying consolidated statements of operations.

Certain LifeBridge entities maintain a nonqualified deferred compensation plan for key employees and physicians. The Corporation establishes a separate deferral account on its books for each participant for each plan year. In general, participants are entitled to receive the deferred funds upon their death, attainment of the specified vesting date, or involuntary termination of their employment without cause, whichever occurs first. The related expense was approximately \$2,836 and \$2,861 for the years ended June 30, 2014 and 2013, respectively, and is included in salaries and employee benefits in the accompanying consolidated statements of operations.

(11) Regulation and Reimbursement

The Corporation provides healthcare services primarily through two general acute-care hospitals, one specialty hospital, two skilled nursing facilities, and various physician practices. The Corporation and other healthcare providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and State Medicaid programs;
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission (HSCRC);
- Government regulation, government budgetary constraints, and proposed legislative and regulatory changes; and

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- Lawsuits alleging malpractice and related claims.

Such inherent risks require the use of certain management estimates in the preparation of the Corporation's consolidated financial statements, and it is reasonably possible that a change in such estimates may occur.

The Medicare and Medicaid state reimbursement programs represent a substantial portion of the Corporation's revenues, and the Corporation's operations are subject to a variety of other federal, state, and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the Corporation. Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Corporation.

The current rate of reimbursement for hospital services to patients under the Medicare and Medicaid programs is based on an agreement between the Center for Medicaid and Medicare Services (CMS) and the HSCRC. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted to the State of Maryland under Section 1814(b) of the Social Security Act.

In January 2014, CMS approved Maryland's new waiver for a five-year period beginning January 1, 2014 for inpatient and outpatient hospital services. The new waiver ties hospital per capita revenue growth to the state's historic economic growth rate of 3.58% per annum and requires that Medicare spending per capita in Maryland not exceed the national average by more than 1%. It also requires Maryland to generate Medicare savings of \$330 million over five years. The new waiver also imposes quality measures and encourages population health management.

(12) Related-Party Transactions

Land Leases

Sinai and Levindale are constituent agencies of AJCF, a charitable corporation.

The legal title to substantially all land, land improvements, buildings, and fixed equipment included in Sinai's and Levindale's operating property is held by an affiliate of AJCF. Sinai and Levindale have entered into leases with the AJCF affiliate with respect to these assets. The leases allow Sinai and Levindale to conduct their business on the property as currently conducted. Rent under each lease is \$1.00 per year. The leases may not be terminated before December 31, 2050.

Other

In addition to its arrangement with AJCF, Sinai receives services from certain other constituent agencies of AJCF.

(13) Income Taxes

At June 30, 2014, LB Investments has approximately \$61,512 in net operating loss carryforwards for income tax purposes. The net operating loss carryforwards for tax purposes are available to reduce future taxable income and expire in varying periods through 2034.

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The net operating loss carryforwards created a net deferred tax asset of approximately \$24,264 and \$21,362 as of June 30, 2014 and 2013, respectively. Management has determined that it is more likely than not that Investments will not be able to utilize the deferred tax assets; therefore, a full valuation allowance was recorded against the net deferred assets as of June 30, 2014 and 2013.

(14) Other Long-Term Liabilities

Other long-term liabilities at June 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Professional/general liability (note 15(a))	\$ 51,959	69,891
Pension liability	17,719	28,886
Asset retirement obligation	3,260	3,260
Deferred compensation	4,959	5,468
Other	22,250	22,829
	<u>\$ 100,147</u>	<u>130,334</u>

At June 30, 2014, there was \$7,779 included in other current liabilities related to professional liability.

(15) Self-Insurance Programs

(a) *Professional/General Liability*

The Corporation is self-insured, through LifeBridge Insurance, for most medical malpractice and general liability claims arising out of the operations of LifeBridge and its subsidiaries. Estimated liabilities have been recorded for both reported and incurred but not reported claims. LifeBridge Insurance purchases reinsurance from other carriers to cover its liabilities in excess of various retentions. The amounts that LifeBridge subsidiaries must transfer to LifeBridge Insurance to fund medical malpractice and general liability claims are actuarially determined and are sufficient to cover expected liabilities. Management's estimate of the liability for its medical malpractice and general liability claims, including incurred but not reported claims, is principally based on actuarial estimates performed by an independent third-party actuary. Professional liability coverage for certain employed physicians is provided by commercial insurance carriers.

(b) *Workers' Compensation*

Sinai, Northwest, Levindale, and LAA are insured for workers' compensation liability through a combination of self-insurance and excess insurance. Losses for asserted and unasserted claims are accrued based on estimates derived from past experiences, as well as other considerations including the nature of each claim or incident, relevant trend factors, and estimates of incurred but not reported amounts. The Corporation has accrued a liability for known and incurred but not reported claims of \$6,439 and \$6,170 at June 30, 2014 and 2013, respectively, which is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

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June 30, 2014 and 2013

(Dollars in thousands)

Management believes this accrual is adequate to provide for all workers' compensation claims that have been incurred through June 30, 2014. All other entities have occurrence-based commercial insurance coverage. Additionally, there are no material insurance recoveries related to workers' compensation as of June 30, 2014.

The Corporation maintains a stop-loss policy on workers' compensation claims. The Corporation is insured for individual claims exceeding \$450.

(c) *Health Insurance*

The Corporation is self-insured for employee health claims. Under the self-insurance plan, the Corporation accrued a liability of \$2,178 and \$2,172 at June 30, 2014 and 2013, respectively, for known claims and incurred but not reported claims, which is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

(16) **Concentration of Credit Risk**

The Corporation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Medicare	29%	30%
Medicaid	10	7
BlueCross	12	13
Commercial and other	40	36
Self-pay	9	14
	<u>100%</u>	<u>100%</u>

(17) **Commitments and Contingencies**

(a) *Litigation*

The Corporation is subject to numerous laws and regulations of federal, state, and local governments. The Corporation's compliance with these laws and regulations can be subject to periodic governmental review and interpretation, which can result in regulatory action unknown or unasserted at this time. Management is aware of certain asserted and unasserted legal claims and regulatory matters arising in the ordinary course of business. After consultation with legal counsel, it is management's opinion that the ultimate resolution of these claims will not have a material adverse effect on the Corporation's financial position.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(b) Letters of Credit

M&T Bank has established an open letter of credit for Sinai of \$211 (which has not been drawn upon) to guarantee Sinai's obligation for liabilities assumed as a member of a risk retention group during the period 1988 to 1994. Additionally, M&T Bank has established a standby letter of credit of \$2,384 to serve as collateral as required by the Maryland Office of Unemployment Insurance. M&T Bank has established a standby letter of credit for Levindale of \$441 as required by the State of Maryland Department of Labor, Licensing, and Regulation. M&T Bank has established a standby letter of credit for LifeBridge Health & Fitness of \$200 as required by the State of Maryland Office of the Attorney General. M&T Bank has established a standby letter of credit of \$52 to serve as collateral as required by the City of Baltimore for the Children's Hospital project.

(c) Contract Commitments

There are no material contract commitments outstanding at June 30, 2014.

(d) Operating Leases

The Corporation has entered into operating lease agreements for hospital equipment and office space, which expire on various dates through year 2020. Total rental expense for the years ended June 30, 2014 and 2013 for all operating leases was approximately \$14,761 and \$11,559, respectively. Future minimum lease payments under all noncancelable operating leases are as follows:

Years ending June 30:		
2015	\$	13,106
2016		13,086
2017		12,152
2018		11,535
2019		11,325
Thereafter		11,248
	\$	<u>72,452</u>

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(18) Noncontrolling Interest

The reconciliation of a noncontrolling interest reported in unrestricted net assets is as follows:

	<u>LifeBridge Health, Inc.</u>	<u>Noncontrolling interest</u>	<u>Unrestricted net assets</u>
Balance at June 30, 2012	\$ 480,953	(393)	480,560
Operating income	20,090	83	20,173
Nonoperating income	<u>33,503</u>	<u>—</u>	<u>33,503</u>
Excess of revenues over expenses	53,593	83	53,676
Change in funded status of pension plan	17,594	—	17,594
Net assets released for purchase of property and equipment	10,816	—	10,816
Other	<u>172</u>	<u>—</u>	<u>172</u>
Change in net assets	<u>82,175</u>	<u>83</u>	<u>82,258</u>
Balance at June 30, 2013	563,128	(310)	562,818
Operating income	31,135	118	31,253
Nonoperating income	<u>53,701</u>	<u>—</u>	<u>53,701</u>
Excess of revenues over expenses	84,836	118	84,954
Change in funded status of pension plan	7,623	—	7,623
Net assets released for purchase of property and equipment	5,202	—	5,202
Other	<u>181</u>	<u>—</u>	<u>181</u>
Change in net assets	<u>97,842</u>	<u>118</u>	<u>97,960</u>
Balance at June 30, 2014	<u>\$ 660,970</u>	<u>(192)</u>	<u>660,778</u>

(19) Functional Expenses

The Corporation provides general healthcare services to patients. Expenses for the years ended June 30, 2014 and 2013 related to providing these services are as follows:

	<u>2014</u>	<u>2013</u>
Healthcare services	\$ 793,874	775,612
General and administrative	<u>252,658</u>	<u>238,173</u>
	<u>\$ 1,046,532</u>	<u>1,013,785</u>

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(20) Fair Value of Financial Instruments

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

(a) *Assets and Liabilities*

Cash and cash equivalents, patient service receivables, other receivables, inventory, prepaid expenses, pledges receivable, accounts payable and accrued liabilities, advances to third-party payors, and other current liabilities – The carrying amounts reported in the consolidated balance sheet approximate the related fair values.

Investments (donor-restricted, assets limited as to use, and long-term), and beneficial interest in split interest agreements – Fair values are based on quoted market prices of individual securities or investments if available, or are estimated using quoted market prices for similar securities or investment managers' best estimate of underlying fair value.

Investment in unconsolidated affiliates – Investments in unconsolidated affiliates are not readily marketable. Therefore, it is not practicable to estimate their fair value and such investments are recorded in accordance with the equity method or at cost.

(b) *Long-Term Debt*

The Series 2008 MHHEFA Bonds bear interest at fixed rates and had a fair value of \$276,718 and \$278,305 at June 30, 2014 and 2013, respectively. The fair market value of the fixed rate Series 2011 MHHEFA Bonds was \$55,387 and \$55,007 as of June 30, 2014 and 2013, respectively. The fair value of the Corporation's long-term debt is measured using quoted offered-side prices when quoted market prices are available. If quoted market prices are not available, the fair value is determined by discounting the future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Corporation's credit standing. In determining an appropriate spread to reflect its credit standing, the Corporation considers credit default swap spreads, bond yields of other long-term debt, and interest rates currently offered for similar debt instruments of comparable maturities by the Corporation's bankers as well as other banks that regularly compete to provide financing to the Corporation.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

(c) ***Fair Value Hierarchy***

The following table presents assets that are measured at fair value on a recurring basis as of June 30, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 18,087	—	—	18,087
Equity securities and mutual funds	259,371	—	—	259,371
Treasury securities	12,330	—	—	12,330
Government securities	—	8,037	—	8,037
Fixed Income	—	23,053	—	23,053
Beneficial interest in split interest agreement	—	4,633	—	4,633
Total assets	<u>\$ 289,788</u>	<u>35,723</u>	<u>—</u>	<u>325,511</u>

The following table presents assets that are measured at fair value on a recurring basis as of June 30, 2013:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 11,197	—	—	11,197
Equity securities and mutual funds	235,809	—	—	235,809
Treasury securities	14,492	—	—	14,492
Government securities	—	12,921	—	12,921
Fixed Income	—	22,512	—	22,512
Beneficial interest in split interest agreement	—	4,088	—	4,088
Total assets	<u>\$ 261,498</u>	<u>39,521</u>	<u>—</u>	<u>301,019</u>

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2014 and 2013

(Dollars in thousands)

See note 2(e) for information on investments of the Corporation that are treated under the equity method and are not reported above.

For the years ended June 30, 2014 and 2013, there were no significant transfers into or out of Levels 1, 2, or 3.

(21) Subsequent Events

Management evaluated all events and transactions that occurred after June 30, 2014 and through October 17, 2014. The Corporation did not have any subsequent events during this period that were required to be recognized or disclosed.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2014

(Dollars in thousands)

Assets	Sinai Hospital Consolidated	Northwest Hospital	Levindale Hebrew Geriatric Ctr & Hospital	Courtland Gardens	Other LifeBridge Entities	Eliminations	LifeBridge Health Consolidated
Current assets:							
Cash and cash equivalents	\$ 115,635	68,279	12,196	1,032	22,569	—	219,711
Investments	9,058	3,341	276	—	—	—	12,675
Assets limited as to use, current portion	8,602	2,855	416	—	—	—	11,873
Patient service receivables, net of allowance for doubtful accounts of \$35,085	72,601	27,082	8,694	1,572	11,375	—	121,324
Other receivables	29,360	1,691	1,912	384	12,062	(38,850)	6,559
Inventory	19,240	3,211	135	14	65	—	22,665
Prepaid expenses	3,519	695	125	12	6,368	—	10,719
Pledges receivable, current portion	3,482	663	153	—	—	—	4,298
Total current assets	261,497	107,817	23,907	3,014	52,439	(38,850)	409,824
Long-term investments	150,498	86,271	26,831	—	111,095	—	374,695
Donor-restricted investments	9,059	3,341	276	—	—	—	12,676
Reinsurance recovery receivable	—	—	—	—	13,365	—	13,365
Assets limited as to use, net of current portion	—	—	—	—	34,157	—	34,157
Pledges receivable, net of current portion	2,810	501	123	—	—	—	3,434
Property and equipment, net	260,051	114,814	42,629	4,770	37,374	—	459,638
Deferred financing costs, net of accumulated amortization of \$633	1,652	532	135	—	—	—	2,319
Beneficial interest in split interest agreement	4,633	—	—	—	—	—	4,633
Investment in unconsolidated affiliates	—	—	—	—	82,969	(64,249)	18,720
Other assets, net of accumulated amortization of \$229	8,699	900	316	—	7,024	—	16,939
Total assets	\$ 698,899	314,176	94,217	7,784	338,423	(103,099)	1,350,400

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2014

(Dollars in thousands)

Liabilities and Net Assets	Sinai Hospital Consolidated	Northwest Hospital	Levindale Hebrew Geriatric Ctr & Hospital	Courtland Gardens	Other LifeBridge Entities	Eliminations	LifeBridge Health Consolidated
Current liabilities:							
Accounts payable and accrued liabilities	\$ 56,296	18,063	8,038	1,494	41,343	(38,850)	86,384
Accrued salaries, wages, and benefits	31,307	10,845	3,097	466	18,066	—	63,781
Advances from third-party payors	25,945	6,516	3,373	132	—	—	35,966
Current portion of long-term debt and capital lease obligations	2,903	1,070	150	—	2,075	—	6,198
Other current liabilities	8,533	215	13	—	621	—	9,382
Total current liabilities	124,984	36,709	14,671	2,092	62,105	(38,850)	201,711
Other long-term liabilities	27,977	10,744	2,433	34	58,959	—	100,147
Long-term debt and capital lease obligations, net of current portion	230,216	77,172	9,607	—	6,419	—	323,414
Total liabilities	383,177	124,625	26,711	2,126	127,483	(38,850)	625,272
Net assets:							
Unrestricted net assets	266,891	182,474	66,862	5,658	203,334	(64,249)	660,970
Noncontrolling interest in consolidated subsidiaries	—	—	—	—	(192)	—	(192)
Total unrestricted net assets	266,891	182,474	66,862	5,658	203,142	(64,249)	660,778
Temporarily restricted	38,407	7,077	644	—	3,575	—	49,703
Permanently restricted	10,424	—	—	—	4,223	—	14,647
Total liabilities and net assets	\$ 698,899	314,176	94,217	7,784	338,423	(103,099)	1,350,400

See accompanying independent auditors' report.

LIFEBRIDGE HEALTH, INC. AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2014

(Dollars in thousands)

	Sinai Hospital Consolidated	Northwest Hospital	Levindale Hebrew Geriatric Ctr & Hospital	Courtland Gardens	Other LifeBridge Entities	Eliminations	LifeBridge Health Consolidated
Unrestricted revenues, gains, and other support:							
Patient service revenue (net of contractual allowances and discounts)	\$ 686,412	230,238	79,011	14,515	63,562	—	1,073,738
Provision for bad debts	36,760	15,043	2,647	479	1,316	—	56,245
Net patient service revenue	649,652	215,195	76,364	14,036	62,246	—	1,017,493
Net assets released from restrictions used for operations	3,465	—	102	—	368	—	3,935
Other operating revenue	44,403	6,425	1,593	50	55,188	(51,302)	56,357
Total operating revenues	697,520	221,620	78,059	14,086	117,802	(51,302)	1,077,785
Expenses:							
Salaries and employee benefits	361,279	120,304	46,796	8,910	60,667	727	598,683
Supplies	123,335	35,102	8,599	904	6,506	—	174,446
Purchased services	125,100	36,954	14,674	3,728	45,014	(52,029)	173,441
Depreciation, amortization, and gain/loss on sale of assets	34,201	11,332	3,216	468	12,836	—	62,053
Repairs and maintenance	13,368	3,966	1,013	165	400	—	18,912
Interest	12,296	4,506	535	—	1,660	—	18,997
Total expenses	669,579	212,164	74,833	14,175	127,083	(51,302)	1,046,532
Operating income (loss)	27,941	9,456	3,226	(89)	(9,281)	—	31,253
Other income, net:							
Investment income	10,234	7,069	1,521	—	3,636	—	22,460
Unrealized gains on trading investments	19,566	9,093	2,055	—	518	—	31,232
Other	—	—	—	—	9	—	9
Total other income, net	29,800	16,162	3,576	—	4,163	—	53,701
Excess (deficiency) of revenues over expenses	\$ 57,741	25,618	6,802	(89)	(5,118)	—	84,954

See accompanying independent auditors' report.