Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

Consolidated Financial Statements

Years Ended September 30, 2013 and 2012

With Independent Auditors' Report

Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

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Years Ended September 30, 2013 and 2012

Contents

ParenteBeard

Independent Auditors' Report

Board of Directors
Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

We have audited the accompanying consolidated financial statements of Ashland Hospital Corporation and Subsidiaries d/b/a King's Daughters Medical Center (collectively, the "Medical Center"), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in 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.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ashland Hospital Corporation and Subsidiaries d/b/a King's Daughters Medical Center as of September 30, 2013 and 2012, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

ParenteBeard LLC

Pittsburgh, Pennsylvania
March 14, 2014

Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

Consolidated Balance Sheets

	September 30 2013	September 30 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 19,454,469	$ 63,366,719
Short-term investments	10,412,330	20,930,165
Patient accounts receivable, less allowance for doubtful accounts of $50,905,000 in 2013 and $55,729,000 in 2012	80,104,010	77,087,916
Inventories	11,325,501	10,164,903
Current portion of assets limited as to use	3,794,526	2,437,924
Other current assets	27,762,923	18,337,031
Total current assets	152,853,759	192,324,658
Assets limited as to use:		
By board of directors	225,961,540	210,416,254
By donors	1,460,093	1,204,542
By self-insurance trust agreements	11,618,465	12,082,909
By bond indenture agreements	10,373,519	23,391,837
Total assets limited as to use	249,413,617	247,095,542
Less assets limited as to use that are required for current liabilities	(3,794,526)	(2,437,924)
	245,619,091	244,657,618
Property, plant and equipment, net of accumulated depreciation	337,883,981	336,449,198
Other assets:		
Deferred financing costs, net of accumulated amortization of $551,588 in 2013 and $433,858 in 2012	2,556,017	2,673,747
Other	10,116,766	9,347,701
Total other assets	12,672,783	12,021,448
Total assets	$ 749,029,614	$ 785,452,922

See notes to consolidated financial statements.

	September 30	
	2013	2012
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	$ 31,439,939	$ 33,343,143
Accrued salaries, wages and related liabilities	26,357,863	31,943,800
Accrued governmental settlement (Note 16)	48,900,000	-
Accrued interest payable	1,698,185	1,714,375
Estimated third-party payor settlements	17,086,624	22,633,678
Current portion of long-term debt	8,268,661	7,989,823
Total current liabilities	133,751,272	97,624,819
Estimated malpractice liabilities, net of current portion	17,843,823	13,831,934
Long-term debt, net of current portion	235,202,766	240,590,975
Interest rate swap agreements	12,804,081	22,063,563
Accrued pension obligation	10,444,000	23,436,000
Other long-term liabilities	2,139,429	2,087,609
Total liabilities	412,185,371	399,634,900
Net assets:		
Unrestricted net assets	335,286,078	384,410,043
Temporarily restricted net assets	1,421,387	1,292,490
Permanently restricted net assets	136,778	115,489
Total net assets	336,844,243	385,818,022
Total liabilities and net assets	$ 749,029,614	$ 785,452,922

See notes to consolidated financial statements.

Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

Consolidated Statements of Operations and Changes in Net Assets

	Years Ended September 30	
	2013	**2012**
Unrestricted revenues, gains, and other support:		
Patient service revenues (net of contractual allowances and discounts)	$ 521,577,708	$ 591,728,130
Provision for bad debts	(54,191,252)	(57,279,724)
Net patient service revenues less provision for bad debts	467,386,456	534,448,406
Other revenues	18,500,594	18,311,717
Total unrestricted revenues, gains, and other support	485,887,050	552,760,123
Expenses:		
Salaries and wages	228,386,251	240,670,768
Employee benefits	49,358,884	59,128,427
Supplies and other expenses	149,798,401	151,368,663
Purchased services	35,509,088	35,933,355
Depreciation and amortization	41,303,107	38,049,346
Interest expense	10,523,218	9,960,197
Provider tax expense	7,600,688	7,612,068
Total expenses	522,479,637	542,722,824
Operating (loss) income	(36,592,587)	10,037,299
Investment income, net	15,953,385	22,138,245
Change in fair value of interest rate swap agreements	9,259,482	(1,951,438)
Other loss, net	(974,461)	(182,527)
Excess of (expenses over revenues) revenues over expenses before government settlement	(12,354,181)	30,041,579
Government settlement	(48,900,000)	-
Excess of (expenses over revenues) revenues over expenses after government settlement	(61,254,181)	30,041,579
Pension liability adjustment	12,094,731	(4,128,466)
Other	185,671	750,075
Change in net assets	(48,973,779)	26,663,188
Net assets, beginning of year	385,818,022	359,154,834
Net assets, end of year	$ 336,844,243	$ 385,818,022

See notes to consolidated financial statements.

Ashland Hospital Corporation and Subsidiaries
d/b/a King's Daughters Medical Center

Consolidated Statements of Cash Flows

	Years Ended September 30	
	2013	**2012**
Operating activities and other income		
Change in net assets	$ (48,973,779)	$ 26,663,188
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities and other income:		
Depreciation and amortization	41,303,107	38,049,346
Provision for bad debts	54,191,252	57,279,724
Net realized and unrealized gains on investments	(9,154,266)	(16,869,136)
Change in fair value of interest rate swap agreements	(9,259,482)	1,951,438
Pension liability adjustment	(12,094,731)	4,128,466
Other changes in assets and liabilities:		
Patient accounts receivable	(57,207,346)	(53,550,059)
Other current and noncurrent assets	(11,355,555)	(5,073,516)
Estimated third-party payor settlements	(5,547,054)	4,999,174
Governmental settlement	48,900,000	-
Other current and noncurrent liabilities	(8,350,779)	(4,874,272)
Estimated malpractice liabilities	4,011,889	1,747,025
Net cash (used in) provided by operating activities and other income	(13,536,744)	54,451,378
Investing activities		
Purchases of property, plant, and equipment, net	(38,744,920)	(36,230,745)
Short-term investments	10,517,835	157,400
Change in assets limited as to use	6,836,191	(2,124,067)
Net cash used in investing activities	(21,390,894)	(38,197,412)
Financing activities		
Repayment of long-term debt	(8,984,612)	(12,487,262)
Net cash used in financing activities	(8,984,612)	(12,487,262)
(Decrease) increase in cash and cash equivalents	(43,912,250)	3,766,704
Cash and cash equivalents, beginning of year	63,366,719	59,600,015
Cash and cash equivalents, end of year	$ 19,454,469	$ 63,366,719
Supplemental Disclosures		
Cash paid for interest	$ 10,539,408	$ 10,019,022
Property acquired through capital lease	$ 3,875,240	$ 3,821,476

See notes to consolidated financial statements.

1. Organization

The accompanying consolidated financial statements of Ashland Hospital Corporation and Subsidiaries d/b/a King's Daughters Medical Center (the Medical Center) include the transactions and accounts of Ashland Hospital Corporation (the Controlling Company), Ashland Medical Properties, Inc. (AMP), Kentucky Heart Foundation (KHF), Child Development Center (CDC), Kingsbrook Lifecare Center (KBNH), Kentucky Heart Institute (KHI), King's Daughters Medical Transport (KDMT), King's Daughters Medical Specialties (KDMS), King's Daughters Medical Center-Ohio (KDOH), Integrated Health Insurance Limited (IHIL), and KDMC Health Foundation (the Foundation). The Medical Center's primary mission is to provide health care services to the citizens of the communities it serves through its acute and specialty care operations. All significant intercompany transactions and balances have been eliminated in consolidation.

2. Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of its financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Adjustments to estimates are recorded, as appropriate, in periods in which they are determined.

Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents include highly liquid investments with a maturity at the time of acquisition of three months or less. Short-term investments represent investments that management has identified as available to meet current operating needs.

The Medical Center maintains its cash balances with various financial institutions. From time to time throughout the year, the Medical Center's on deposit cash balances may exceed amounts that are fully insured under federal deposit insurance coverage. The Medical Center also has repurchase agreements that are not covered under FDIC insurance that are included in cash and cash equivalents. The repurchase agreements are secured by U.S. Treasury Obligations held by a financial institution.

2. Accounting Policies (continued)

Patient Accounts Receivable and Net Patient Service Revenues

Patient accounts receivable and net patient service revenues are derived primarily from patients who reside in Kentucky and surrounding states. Patient accounts receivable consist of amounts due from third-party payers, including federal and state indemnity and managed care programs, managed care health plans and commercial insurance companies, and individual patients for health care services rendered.

The Medical Center does not require collateral or other security on its patient accounts receivable. Management maintains an allowance for doubtful accounts to reserve for estimated losses based on the length of time the account has been past due, third party payer classification, and historical experience.

Patient accounts receivable are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. In evaluating the collectability of patient accounts receivable, the Medical Center 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. For receivables associated with services provided to patients who have third-party coverage (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 Medical Center analyzes contractual amounts due and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients (which includes both patients without insurance and insured patients with deductible and copayment balances), the Medical Center 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 billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

2. Accounting Policies (continued)

Patient Accounts Receivable and Net Patient Service Revenues (continued)

The Medical Center's allowance for doubtful accounts for self-pay patients was 48% and 49%, respectively, of self-pay accounts receivable at September 30, 2013 and 2012. In addition, the Medical Center's self-pay account write-offs (net of recoveries) decreased to $35,178,081 in 2013 from $39,115,058 in 2012. The Medical Center does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, per diem payments, and contracted amounts. The Medical Center recognizes patient service revenues associated with services provided to patients who have third-party payor coverage on the basis of these established rates for the services rendered. For uninsured patients that do not qualify for charity care, the Medical Center recognizes revenues on the basis of its standard rates, discounted in accordance with the Medical Center's policy. On the basis of historical experience, a significant portion of the Medical Center's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Medical Center records a significant provision of bad debts related to uninsured patients in the period the services are provided. Patient service revenues, net of contractual allowances and discounts (but before the provisions for bad debts), recognized in 2013 and 2012 from these major payor sources, are as follows:

2. Accounting Policies (continued)

Patient Accounts Receivable and Net Patient Service Revenues (continued)

	September 30, 2013			
	Third-Party Government Payors	**Third-Party Commercial Payors**	**Self-Pay**	**Total All Payors**
Patient service revenues (net of contractual allowances and discounts)	$ 246,511,993	$ 242,696,076	$ 32,369,639	$ 521,577,708

	September 30, 2012			
	Third-Party Government Payors	**Third-Party Commercial Payors**	**Self-Pay**	**Total All Payors**
Patient service revenues (net of contractual allowances and discounts)	$ 281,364,123	$ 272,041,790	$ 38,322,217	$ 591,728,130

Patient service revenues reported above include the provision for bad debts for all entities within the Medical Center, which recognize significant amounts of patient service revenues at the time the services are rendered without assessing the patient's ability to pay.

2. Accounting Policies (continued)

Charity Care

The Medical Center provides medically necessary services without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy.

Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Medical Center utilizes the generally recognized Federal Poverty Guidelines, but also includes certain cases where incurred charges are significant when compared to income. Charity care provided in 2013 and 2012, measured at established rates, was approximately $42,782,000 and $65,015,000, respectively. These charges are not included in net patient service revenues. The estimated cost of charity care provided in 2013 and 2012 was $13,700,000 and $20,532,000, respectively.

Inventories

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

Assets Limited as to Use and Investments

Assets limited as to use include assets set aside by the Board of Directors for plant replacement, over which the Board of Directors retains control and may at its discretion subsequently use for other purposes, and assets held by trustees under bond indenture agreements and self-insurance trust arrangements. Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Investment income or loss (including realized and unrealized gains and losses on investments and interest and dividends) is included in the excess of (expenses over revenues) revenues over expenses unless the income or loss is restricted by donor or law. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on assets deposited in the malpractice trust is reported as other revenue. Investment income from all other investments is reported as investment income.

2. Accounting Policies (continued)

Interest Rate Swap Agreements

The Medical Center has entered into certain interest rate swap agreements, considered to be derivative instruments, in connection with its debt management program. The Medical Center records its derivative instruments as either assets or liabilities in the accompanying consolidated balance sheets at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship, and further, on the type of hedging relationship. The Medical Center's derivatives are not designated as hedges. Accordingly, the derivative gain or loss related to the change in fair value is included in excess of revenues over expenses. During the years ended September 30, 2013 and 2012, the Medical Center amortized approximately $80,000 of the accumulated derivative obligation included as a component of net assets, which is included in interest expense in the accompanying consolidated financial statements. The accumulated derivative obligation on previously designated hedges excluded from the excess of (expenses over revenues) revenues over expenses was approximately $1,500,000 and $1,580,000 at September 30, 2013 and 2012, respectively.

Property, Plant, and Equipment

Property, plant, and equipment amounts are recorded at cost or at fair market value if acquired by gift. The Medical Center provides for depreciation of property, plant, and equipment and amortization of capital lease obligations on a straight-line basis over the expected useful lives of the assets. Upon retirement or disposal, the asset and accumulated depreciation accounts are adjusted, and any gain or loss is recorded in the consolidated statement of operations. Maintenance costs and repairs are expensed as incurred.

The Medical Center reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of the assets. Any write-downs due to impairment are charged to operations at the time impairment is identified. Management determined that no impairment write-downs were necessary in 2013 and 2012.

2. Accounting Policies (continued)

Property, Plant, and Equipment (continued)

Management has considered its legal obligation to perform asset retirement activities, such as asbestos removal, on its existing properties. Management believes that there is an indeterminate settlement date for the asset retirement obligations because the range of time over which the Medical Center may settle the obligations is unknown and cannot be estimated.

The Medical Center capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowings.

Deferred Financing Costs

Deferred financing costs consist of the costs incurred in conjunction with the issuance of bonds. The Medical Center's policy is to amortize deferred financing costs over the term of the bonds using the bonds outstanding method. Amortization expense was $117,730 for the years ended September 30, 2013 and 2012.

Unamortized Bond Discount and Premium

Unamortized bond discount and premium are being amortized over the period the bonds are outstanding using the bonds outstanding method.

Estimated Malpractice Liabilities

The provision for estimated self-insured medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Excess of (Expenses Over Revenues) Revenues Over Expenses

The statement of operations includes excess of (expenses over revenues) revenues over expenses. Changes in unrestricted net assets that are excluded from excess of (expenses over revenues) revenues over expenses, consistent with industry practice, include contributions received for the acquisition of property and equipment, pension liability adjustment, and the effects of changes in accounting methods.

2. Accounting Policies (continued)

Operating Income and Nonoperating Gains and Losses

Only those activities directly associated with the furtherance of the Medical Center's primary mission are considered to be operating activities. Other activities that result in gains or losses are considered to be nonoperating. Nonoperating gains and losses include investment income, changes in the fair value of interest rate swap agreements, and other miscellaneous nonoperating revenues and expenses.

Federal Income Taxes

The Medical Center, KHF, KBNH, CDC, KHI, KDMT, KDMS, KDOH, and the Foundation have been recognized by the IRS as Section 501(c)(3) charitable organizations. Section 501(c)(3) organizations are exempt from federal and state income taxes on related income. These organizations do not engage in significant unrelated activities and therefore no tax is recorded. AMP is a small taxable entity subject to federal and state income taxation.

Meaningful Use of Electronic Health Records

The American Recovery and Reinvestment Act of 2009 established one-time incentive payments under the Medicare and Medicaid programs for hospitals that meaningfully use certified electronic health records ("EHR") technology. In general, a hospital may receive an incentive payment for up to four years, provided it successfully demonstrates meaningful use of certified EHR technology for the EHR reporting period. The key component of receiving the EHR incentive payments is "demonstrating meaningful use," which means meeting a series of objectives that make use of an EHR's potential related to the improvement of quality, efficiency, and patient safety. Meaningful use will be assessed on a year-by-year basis.

2. Accounting Policies (continued)

Meaningful Use of Electronic Health Records (continued)

Once the Medical Center meets the requirements for an incentive payment, a preliminary payment is made by The Centers for Medicare & Medicaid Services based on discharge data from the Medical Center's most recently filed cost report. The final amount of the payment is determined at the time the cost report for the period beginning in the payment year is settled, based on discharge data from that cost report. The Medical Center attested as a meaningful user for the years ended September 30, 2013 and 2012. As such, the Medical Center recognized approximately $1,163,000 and $2,934,000 at September 30, 2013 and 2012, respectively, as grant income under the Medicare program. The Medical Center recognized $1,328,000 and $1,263,000 at September 20, 2103 and 2012, respectively, as grant income under the Medicaid program. This grant income is included in other operating revenues in the accompanying consolidated statements of operations.

Grant income recognized is based on management's estimate and it is reasonably possible that the estimates used could change materially in the near term. Any such changes would affect operations in the period in which they occur. The Medical Center's attestation as a meaningful user is subject to audit by the Federal Government or its designee.

Reclassification

Certain reclassifications were made to the 2012 statement of cash flows to conform with the 2013 presentation.

Advertising Costs

Advertising costs are expensed as incurred. Such costs amounted to approximately $2,330,000 and $2,713,000 in 2013 and 2012, respectively.

New Accounting Standards

Fair Value Measurements and Disclosures:

The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, *Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU No. 2011-04 includes new and clarified guidance on fair value measurements (highest and best use, equity instruments, managed net portfolio positions, and application of premiums and discounts) and requires additional disclosures (quantitative information, valuation processes and sensitivity of unobservable inputs, assets not in highest and best use, and assets not measured at fair value). The adoption of the amended guidance required certain additional disclosures in the notes to the Medical Center's financial statements on a prospective basis.

3. Medicare and Medicaid Programs

The Medical Center is a provider of services under contractual arrangements with the Medicare and Medicaid Programs (Programs). Approximately 49% and 13%, respectively, of the Medical Center's 2013 net patient service revenues were derived from services to patients covered by these Programs. Comparable percentages for 2012 were 51% and 17%, respectively.

Payments from Medicare for inpatient services are based upon the patient's diagnosis, irrespective of cost. The diagnosis upon which payment is based is subject to review by Medicare Program representatives. The Medicare Program reimburses the Medical Center for outpatient services on a prospective payment system with services classified into clinically similar ambulatory payment classes.

The Kentucky Medicaid Program reimburses the Medical Center on a prospectively determined rate per discharge using diagnosis related groups for inpatient services. Outpatient services are reimbursed on a fee-for-service reimbursement rate.

In the health care industry, laws and regulations governing the Programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Certain reimbursement from the Programs is determined from annual cost reports, which are subject to audit by the Programs. Management believes that adequate provisions have been made for reasonable adjustments that may result from final settlements. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines and penalties, and exclusions from the Programs. The Medical Center believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing, except as disclosed at Note 16.

The Commonwealth of Kentucky legislation imposes a tax on health care providers. The legislation also provides a system for limited reimbursement for services provided to indigent patients. The Medical Center incurred provider tax expense of approximately $7,601,000 and $7,612,000 in 2013 and 2012, respectively, and received a reimbursement benefit of approximately $3,372,000 and $2,731,000 in 2013 and 2012, respectively.

4. Property, Plant, and Equipment

Property, plant, and equipment consist of the following at September 30:

	2013	2012
Land	$ 30,399,116	$ 29,458,916
Land improvements	9,676,723	7,815,272
Buildings	191,539,299	182,238,330
Building improvements	211,034,742	200,681,748
Equipment	299,006,815	269,898,836
Construction in process	2,305,933	14,437,104
	743,962,628	704,530,206
Less accumulated depreciation	406,078,647	368,081,008
	$ 337,883,981	$ 336,449,198

Depreciation expense, including amortization of capital leases, was $41,182,797 and $37,929,036 for the years ended September 30, 2013 and 2012, respectively.

5. Assets Limited as to Use

The composition of assets limited as to use at September 30 are as follows:

	2013	2012
By Board of Directors:		
Cash and cash equivalents	$ 3,526,250	$ 8,934,133
Common stock and equity mutual funds	129,184,876	93,335,387
Corporate bonds and notes	23,740,685	25,888,511
Bond mutual funds	32,188,812	42,851,175
U.S. Treasury obligations	14,639,198	26,825,710
U.S. Government agency obligations	2,702,185	2,149,806
Real estate fund	19,979,534	10,431,532
	$ 225,961,540	$ 210,416,254
By donors:		
Cash and cash equivalents	$ 1,460,093	$ 1,204,542
By self-insurance trust agreements:		
Cash and cash equivalents	$ 184,061	$ 708,725
Common stock and equity mutual funds	1,917,039	-
Corporate bonds and notes	9,513,500	7,728,671
U.S. Government agency obligations	3,865	5,425
Mutual funds	-	3,640,088
	$ 11,618,465	$ 12,082,909
By bond indenture agreements:		
Cash and cash equivalents	$ 10,373,519	$ 23,391,837

5. Assets Limited as to Use (continued)

The composition of short-term investments at September 30 is as follows:

	2013	2012
Corporate bonds and notes	$ 10,412,330	$ 20,930,165

Investment income from assets limited as to use, short-term investments and cash equivalents is included in other revenue and investment income, net in the accompanying financial statements as follows for the years ended September 30:

	2013	2012
Interest and dividend income	$ 6,835,086	$ 6,994,263
Realized gains on investments	4,027,353	1,127,801
Unrealized gains on investments	5,126,913	15,741,335
	$ 15,989,352	$ 23,863,399
Amounts included in other revenues	$ 35,967	$ 1,725,154
Amounts included in investment income, net	15,953,385	22,138,245
	$ 15,989,352	$ 23,863,399

The Medical Center's investments are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in these risks in the near term could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets. While the Medical Center does not directly invest in derivative securities, it may indirectly hold these securities through investment holdings with a manager of hedge funds.

6. Retirement Plans

Through January 1, 2011, the Medical Center sponsored a defined benefit plan covering eligible employees who qualify as to age and length of service. Pension benefits are generally based upon years of service and an employee's average monthly compensation during their years of service. The Medical Center's funding policy is to contribute amounts to the plan sufficient to meet all minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as the Medical Center may determine appropriate from time to time. Pension plan assets are primarily invested in listed and readily marketable stocks and bonds. A measurement date of September 30 was used for the plan at September 30, 2013 and 2012.

At January 1, 2011, the Medical Center approved a plan amendment to freeze the benefit accruals in the plan. New employees since the amendment date have not been eligible to participate.

Previously, the Medical Center amended the plan to allow participants as of December 31, 1992, eligible to participate in the King's Daughters Medical Center's Base Contribution Plan and King's Daughters Medical Center's Matching Contribution Plan to make a one-time irrevocable election to cease being a member of the defined benefit plan as of January 1, 1993 or any subsequent January 1, and become a limited participant in the defined benefit plan. Upon becoming a limited participant, the participant will cease to accrue any additional benefits under the defined benefit plan. Additionally, all new employees hired after December 31, 1992, are not eligible to participate in the defined benefit plan. However, all employees who are part of a group subject to collective bargaining continue to participate and earn benefits in the defined benefit plan.

On January 1, 1993, the Medical Center established two defined contribution plans for those participants of the defined benefit plan as of December 31, 1992, who elect to participate in the defined contribution plans in lieu of accruing additional benefits in the defined benefit plan and for all new non-collectively bargained employees of the Medical Center. The plans established are the King's Daughters Medical Center's Base Contribution Plan (Base Plan), a non-contributory plan, and King's Daughters Medical Center's Matching Contribution Plan (Matching Plan), a contributory plan.

6. Retirement Plans (continued)

The Medical Center established the Base and Matching Plans to cover substantially all employees employed subsequent to December 31, 1992, (except for collectively bargained employees) who qualify as to age and length of service and those employees who were participants in the defined benefit plan and qualify as to length of service, but as of January 1, elected to become a limited participant in the defined benefit plan and an active participant in the defined contribution plans. Effective January 1, 2011, employees subject to collective bargaining may participate in the Base and Matching Plans. The Medical Center contributes 3% of the participants' compensation for the Base Plan and 50% of eligible participant contributions for the Matching Plan, unless such contributions are suspended or terminated.

A summary of the components of net periodic costs for the years ended September 30 follows:

	2013	2012
Defined benefit plan:		
Service cost	$ 431,000	$ 353,000
Interest cost	3,104,638	3,349,667
Expected return on plan assets	(4,264,715)	(3,733,168)
Net amortization	831,808	691,065
Net periodic pension cost	102,731	660,564
Defined contribution plans	5,308,346	7,172,824
Total retirement benefit costs	$ 5,411,077	$ 7,833,388

Included in unrestricted net assets at September 30, 2013 and 2012, are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized actuarial loss of $20,438,746 and $32,533,199, respectively. There was no unrecognized net prior service cost for the years ended September 30, 2013 or 2012. No prior service cost is expected to be recognized during the year ended September 30, 2014. The actuarial loss expected to be recognized during the year ended September 30, 2014 is $473,643.

6. Retirement Plans (continued)

The following table sets forth the defined benefit plan's funded status and amounts recognized in the Medical Center's consolidated balance sheets, as measured at September 30, 2013 and 2012:

	2013	2012
Change in projected benefit obligation:		
Benefit obligation, beginning of year	$ 76,455,140	$ 67,087,225
Service cost	431,000	353,000
Interest cost	3,104,638	3,349,667
Actuarial (gain) loss	(9,472,005)	8,638,218
Benefits paid	(3,061,512)	(2,972,970)
Projected benefit obligation, end of year	67,457,261	76,455,140
Change in plan assets:		
Fair value of plan assets, beginning of year	53,019,140	45,840,225
Actual return on plan assets	6,055,633	7,551,885
Employer contributions	1,000,000	2,600,000
Benefits paid	(3,061,512)	(2,972,970)
Fair value of plan assets, end of year	57,013,261	53,019,140
Underfunded status	$ (10,444,000)	$ (23,436,000)

The underfunded status is included in long-term liabilities as accrued pension obligation at September 30, 2013 and 2012.

The net increase (decrease) recognized as a pension liability adjustment included in changes in unrestricted net assets was $12,094,731 and $(4,128,466) for the years ended September 30, 2013 and 2012, respectively. There was no net prior service cost recognized in the minimum pension liability included in changes in unrestricted net assets for the years ended September 30, 2013 and 2012, respectively.

No plan assets are expected to be returned to the Medical Center during the fiscal year-ended September 30, 2013. The accumulated benefit obligation was $67,457,261 and $76,455,140 at September 30, 2013 and 2012, respectively.

6. Retirement Plans (continued)

Assumptions:

Weighted average assumptions used to determine net periodic benefit obligations as of September 30 were as follows:

	2013	**2012**
Discount rate	5.13%	4.15%
Rate of compensation increase	N/A	N/A

Weighted average assumptions used to determine net periodic benefit cost for the years ending September 30 were as follows:

	2013	**2012**
Discount rate	4.15%	5.11%
Rate of compensation increase	N/A	N/A
Expected return on plan assets	8.25%	8.25%

The Medical Center has estimated the long-term rate of return on plan assets based primarily on historical returns on plan assets, adjusted for changes in target portfolio allocations and recent changes in long-term interest rates based on publicly available information.

6. Retirement Plans (continued)

Plan Assets:

The Medical Center's defined benefit plan weighted-average allocations at September 30 by asset category are as follows:

	Target	2013	2012
Asset Class			
Equity	60.0%	60.9%	59.0%
Fixed income	40.0	38.5	40.0
Cash and cash equivalents	–	0.6	1.0
	100.0%	60.9%	100.0%

The defined benefit plan's assets are invested in a portfolio that provides for asset allocation strategies across equity and debt markets. The portfolio's objective is to maximize the plan's surplus, minimize annual contributions, and fund the annual interest credit. Management and its investment advisor have prepared asset allocation recommendations based on detailed analyses of the plan's current and expected future financial needs.

The following table sets forth by level, within the fair value hierarchy (Note 10), the plan assets at fair value as of September 30, 2013:

	Fair Value	Quoted Prices in Active Markets (Level 1)
Money market mutual funds	$ 397,514	$ 397,514
Mutual funds (A)	54,276,999	54,276,999
Exchange traded funds	2,338,748	2,338,748
	$ 57,013,261	$ 57,013,261

(A) Forty-two percent of mutual funds invest in common stock of large-cap and mid-cap U.S. companies. Three percent of mutual funds invest in common stock of small-cap U.S. companies. Fourteen percent of the mutual fund investments focus on emerging markets. Forty-one percent of mutual funds invest in fixed income investments.

6. Retirement Plans (continued)

The following table sets forth by level, within the fair value hierarchy, the plan assets at fair value as of September 30, 2012:

	Fair Value	Quoted Prices in Active Markets (Level 1)
Money market mutual funds	$ 522,542	$ 522,542
Mutual funds (A)	52,496,598	52,496,598
	$ 53,019,140	$ 53,019,140

(A) Forty-six percent of mutual funds invest in common stock of large-cap and mid-cap U.S. companies. Three percent of mutual funds invest in common stock of small-cap U.S. companies. Ten percent of the mutual fund investments focus on emerging markets. Forty-one percent of mutual funds invest in fixed income investments.

At September 30, 2013 and 2012, the Plan did not have any assets or liabilities whose fair value were measured using Level 2 and Level 3 inputs.

The following is a description of the valuation methodologies used for the plan's assets measured at fair value:

Money market mutual funds: The carrying amounts approximate fair value because of the short maturity of these financial instruments.

Mutual funds and exchange traded funds: Valued at the net asset value ("NAV") of shares (basis for trade) held by the Medical Center at year end.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Medical Center believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

6. Retirement Plans (continued)

Plan assets are held by a bank-administered trust fund, which invests the plan assets in accordance with the provisions of the plan agreement. The plan agreement permits investment in common stocks, corporate bonds and debentures, U.S. Government securities, certain insurance contracts, real estate and other specified investments, based on certain target allocation percentages.

Cash Flows:

The Medical Center currently expects to make a contribution of $1,550,000 to the defined benefit plan during the fiscal year ending September 30, 2014 in order to satisfy minimum funding requirements. Management will evaluate funding status during the year and may elect to make additional voluntary contributions.

Benefits expected to be paid to beneficiaries of the defined benefit plan are approximately as follows:

Years Ending September 30:		
2014	$	3,197,000
2015		3,349,000
2016		3,498,000
2017		3,707,000
2018		3,895,000
2019 through 2023		21,602,000

7. Line of Credit

The Medical Center has an unused line of credit with a bank in the amount of $15,000,000 at September 30, 2013 and 2012. The line of credit expires September 19, 2014. The note has a variable interest rate equal to LIBOR plus 1.25% with a floor of 3.0% at September 30, 2013 and 2012.

8. Long-Term Debt

The following is a summary of long-term debt of the Medical Center at September 30:

	2013	2012
Variable Rate Medical Center Revenue Bonds, Series 2008A [A]	$ 49,500,000	$ 50,000,000
Variable Rate Medical Center Revenue Bonds, Series 2008B [A]	49,500,000	50,000,000
Medical Center Revenue Bonds, Series 2008C [B]	44,800,000	46,255,000
Medical Center Revenue Bonds, Series 2010A [C]	68,070,000	70,445,000
Medical Center Revenue Bonds, Series 2010B [C]	28,175,000	28,175,000
Capital Lease Payable - Software [D]	1,560,566	1,433,680
Capital Lease Payable - Other [E]	2,704,528	3,092,222
	244,310,094	249,400,902
Less unaccreted bond discount	(1,886,601)	(1,960,502)
Plus unamortized bond premium	1,047,934	1,140,398
	243,471,427	248,580,798
Current portion	(8,268,661)	(7,989,823)
Total long-term debt	$ 235,202,766	$ 240,590,975

8. Long-Term Debt (continued)

[A] In September 2008, the Kentucky Economic Development Finance Authority (KEDFA) issued $50 million of Variable Rate Medical Center Revenue Bonds, Series 2008A (the Series 2008A Bonds) and $50 million of Variable Rate Medical Center Revenue Bonds, Series 2008B (the Series 2008B Bonds) dated September 1, 2008 on behalf of the Medical Center. The proceeds of the Series 2008A Bonds and Series 2008B Bonds were used for the purpose of refunding Series 2006 Bonds and Series 2004 Bonds and to pay costs of acquiring, constructing, improving and equipping the Medical Center's healthcare facilities and to pay related costs of issuance.

The Series 2008A Bonds and Series 2008B Bonds are variable rate demand bonds in which the interest rate is determined every 7 days by a remarketing agent (0.08% at September 30, 2013). The Series 2008A Bonds and Series 2008B Bonds, which are subject to retirement in varying principal payments through 2038, are subject to optional redemption, in whole or in part, on any interest rate adjustment rate date at the redemption price of 100% of the principal amount redeemed plus accrued interest thereon to the redemption date. The Medical Center is required to maintain letters of credit on the Series 2008A Bonds and the Series 2008B Bonds through maturity.

The Series 2008A Bonds and Series 2008B Bonds are secured through irrevocable letters of credit provided by a bank that expires on September 24, 2015 after which they are renewable for one year thereafter. The letters of credit have repayment terms in 48 equal monthly installments commencing on the 367th day after a failed remarketing. Interest rates as determined by these auctions are subject to various risks including changes in the credit markets, remarketing mechanisms, and the potential for failed auctions. The default interest rate for the Series 2008B Bonds is based upon a formulaic maximum rate which is the greater of the prime rate plus 2% or 12%.

[B] In September 2008, KEDFA issued $46.58 million of Medical Center Revenue Bonds, Series 2008C (the Series 2008C Bonds) dated September 1, 2008 on behalf of the Medical Center. The proceeds of the Series 2008C Bonds were used for the purpose of refunding Series 1993B Bonds, Series 2001 Bonds and Series 2003B Bonds and to pay related costs of issuance.

8. Long-Term Debt (continued)

The Series 2008C Bonds are fixed rate bonds with serial and term maturities at interest rates ranging from 4% to 6.5%. Interest is payable semi-annually on February 1 and August 1. The Series 2008C Bonds are subject to retirement in varying principal payments through 2038. The Series 2008C Bonds maturing after February 1, 2018 are subject to an optional redemption prior to maturity on or after February 1, 2018, in whole at any time or in part on any interest payment date, at a redemption price equal to the principal amount thereof, plus interest accrued to the date fixed for redemption.

[C] In April 2010, KEDFA issued $75 million of Medical Center Revenue Bonds, Series 2010A (the Series 2010A Bonds) and $32.615 million of Medical Center Revenue Bonds, Series 2010B (the Series 2010B Bonds) dated March 1, 2010 on behalf of the Medical Center. The proceeds of the Series 2010A and 2010B Bonds were used for the purpose of refunding Series 1998 Bonds and to pay costs of acquiring, constructing, improving and equipping the Medical Center's healthcare facilities and to pay related costs of issuance.

The Series 2010A Bonds are fixed rate bonds with serial and term maturities at interest rates ranging from 3% to 5%. Interest is payable semi-annually on February 1 and August 1. The Series 2010A Bonds are subject to retirement in varying principal payments through 2040. The Series 2010A Bonds maturing after February 1, 2020 are subject to an optional redemption prior to maturity on or after February 1, 2020, in whole at any time or in part on any interest payment date, at a redemption price equal to the principal amount thereof, plus interest accrued to the date fixed for redemption.

The Series 2010B Bonds are fixed rate bonds with serial and term maturities at interest rates ranging from 2% to 5%. Interest is payable semi-annually on February 1 and August 1. The Series 2010B Bonds are subject to retirement in varying principal payments through 2025. The Series 2010B Bonds maturing after February 1, 2020 are subject to an optional redemption prior to maturity on or after February 1, 2020, in whole at any time or in part on any interest payment date, at a redemption price equal to the principal amount thereof, plus interest accrued to the date fixed for redemption.

8. Long-Term Debt (continued)

[D] In January 2008, the Medical Center entered into a license fee agreement for a term of 68 months for software which was implemented in November 2008. The license fee agreement is recorded at the present value of minimum payments in the amount of approximately $8 million. Monthly principal and interest payments of $101,135 are being made. The interest rate was imputed at 5.25% which is considered the Medical Center's incremental borrowing rate at the inception of the lease. This agreement expired in July 2013.

In July 2012, the Medical Center entered into an additional license fee agreement for a term of 29 months for software which was implemented in November 2008. The license fee agreement is recorded at the present value of minimum payments in the amount of approximately $551,000. Monthly principal and interest payments of $36,106 are being made. The interest rate was imputed at 4.00% which is considered the Medical Center's incremental borrowing rate at the inception of the lease.

In August 2013, the Medical Center entered into a perpetual license conversion agreement for a term of 16 months for software which was implemented in November 2008. The license fee agreement is recorded at the present value of minimum payments in the amount of approximately $1,578,000. Monthly principal and interest payments of $101,135 are being made. The interest rate was imputed at 4.00% which is considered the Medical Center's incremental borrowing rate at the inception of the lease.

[E] At varying rates of imputed interest from 1.49% to 4% due through 2015, collateralized by certain property and equipment. Property and equipment include the following property under capital lease:

	2013	2012
Building	$ 339,350	$ 339,350
Equipment	7,822,832	5,613,032
Less accumulated depreciation	(1,579,051)	(1,805,405)
	$ 6,583,131	$ 4,146,977

In May 2012, the Medical Center entered into an agreement to lease telephone equipment for a term of 36 months. The agreement is recorded at the present value of minimum payments in the amount of approximately $3,270,000. Annual principal payments of $1,132,461 are being made. The interest rate was imputed at 4.00% which is considered the Medical Center's incremental borrowing rate at the inception of the lease.

8. Long-Term Debt (continued)

The Medical Center has a $9,255,628 letter of credit with a bank, none of which is outstanding at September 30, 2013 or 2012. Advances bear interest at prime, with a floor of 4.00% at September 30, 2013 and 2012. The interest rates were 4.00% at September 30, 2013 and 2012. This letter of credit expires May 17, 2014 and is renewable for an additional year. This letter of credit is a guarantee of payment for workers' compensation claims in lieu of a trusteed cash balance for the same amount.

The following is a schedule of future minimum payments on long-term debt:

	Bonds	Capital Leases
Years Ending September 30:		
2014	$ 5,020,000	$ 3,357,645
2015	5,195,000	1,028,895
2016	5,385,000	-
2017	5,615,000	-
2018	5,840,000	-
Thereafter	212,990,000	-
	$ 240,045,000	
		4,386,540
Less amount representing interest		(121,446)
Present value of future minimum lease payments		4,265,094
Less current maturities		(3,248,421)
Non-current portion		$ 1,016,673

The Corporation paid interest of approximately $10,539,000 and $10,019,000 during 2013 and 2012, respectively. The Medical Center capitalized interest costs of approximately $792,000 and $1,387,000 during 2013 and 2012, respectively.

The Corporation was in violation of its debt service coverage ratio as required by the Letter of Credit and Reimbursement Agreement due to the one time government settlement noted in Note 16. The Corporation received a waiver of this covenant violation from Branch Banking and Trust Company as of September 30, 2013. Also, this violation resulted in a violation of the Master Trust Indenture, which management cured by hiring an outside consultant.

9.Interest Rate Swap Agreements

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the Medical Center has entered into several interest rate swap agreements for a portion of its floating rate debt. The fair value of the agreements, $12,804,081 and $22,063,563 as of September 30, 2013 and 2012, respectively, were determined by a third-party valuation specialist and are recorded as long-term liabilities within the consolidated balance sheets. The agreements are as follows:

On May 23, 2001, the Medical Center entered into an interest rate swap agreement that provides for the Medical Center to receive interest from the counterparty of 68% of the one-month LIBOR rate and to pay interest to the counterparty at a fixed rate of 4.07% on notional amounts of $13,200,000 and $13,700,000 at September 30, 2013 and 2012, respectively. The agreement will expire on February 1, 2031. Under the agreement, the Medical Center pays interest amounts every six months commencing on August 1, 2001 and receives interest amounts every 35th calendar day, with the settlements included in interest expense.

On August 10, 2004, the Medical Center entered into an interest rate swap agreement that provides for the Medical Center to receive interest from the counterparty of the one-month LIBOR rate and to pay interest to the counterparty at a fixed rate of 5.618% on notional amounts of $21,000,000 at September 30, 2013 and 2012. The agreement will expire on February 1, 2034. Under the agreement, the Medical Center pays interest amounts every six months commencing on February 1, 2005 and receives interest amounts every 5th Monday commencing on September 27, 2004, with the settlements included in interest expense.

On October 26, 2005, the Medical Center entered into an interest rate swap agreement that provides for the Medical Center to receive interest from the counterparty of the one-month LIBOR rate and to pay interest to the counterparty at a fixed rate of 5.293% on notional amounts of $24,948,000 and $25,606,000 at September 30, 2013 and 2012, respectively. The agreement will expire on September 1, 2036. Under the agreement, the Medical Center pays interest amounts every six months commencing on March 1, 2007 and receives interest amounts monthly, with the settlements included in interest expense.

On June 20, 2006, the Medical Center entered into an interest rate swap agreement that provides for the Medical Center to receive interest from the counterparty of the ten-year LIBOR rate less 63 basis points and to pay interest to the counterparty at the one-month LIBOR rate on notional amounts of $24,948,000 and $25,606,000 at September 30, 2013 and 2012, respectively. The agreement will expire on September 1, 2036. Under the agreement, the Medical Center pays or receives the net interest amounts monthly, with the monthly settlements included in interest expense.

9. Interest Rate Swap Agreements (continued)

On August 3, 2010, the Medical Center entered into an interest rate swap agreement that provided for the Medical Center to receive interest from the counterparty of the one-month LIBOR plus 177 basis points and to pay interest to the counterparty at the ten-year ISDA swap rate less 63 basis points on notional amounts of $25,606,000 at September 30, 2012. The agreement expired on September 1, 2013.

As a result of these interest rate swap agreements, interest expense was increased by $2,496,996 and $2,525,294 for the years ended September 30, 2013 and 2012, respectively.

10. Disclosures About Fair Value of Assets and Liabilities

The Medical Center measures its assets and liabilities at fair value on a recurring basis in accordance with accounting principles generally accepted in the United States of America. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 Fair value is based on unadjusted quoted prices in active markets for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the same term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 Fair value is based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

10. Disclosures About Fair Value of Assets and Liabilities (continued)

The fair value of financial instruments listed below was determined using the following valuation hierarchy at September 30, 2013 and 2012:

	2013				
	Carrying Value	Fair Value	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets - Recurrring fair value measurements:					
Short term investments					
Corporate bonds and notes	$ 10,412,330	$ 10,412,330	$ -	$ 10,412,330	$ -
Assets limited as to use					
Money market mutual funds	14,280,569	14,280,569	14,280,569	-	-
Common stock	38,092,878	38,092,878	38,092,878	-	-
Mutual funds (A)	126,237,238	126,237,238	126,237,238	-	-
Corporate bonds and notes	33,366,790	33,366,790	-	33,366,790	-
U.S. Treasury obligations	14,639,198	14,639,198	-	14,639,198	-
U.S. Government agency obligations	2,817,410	2,817,410	-	2,817,410	-
Real estate investment fund	19,979,534	19,979,534	-	-	19,979,534
	249,413,617	249,413,617	178,610,685	50,823,398	19,979,534
Total assets	$ 259,825,947	$ 259,825,947	$ 178,610,685	$ 61,235,728	$ 19,979,534
Assets disclosed at fair value:					
Cash and cash equivalents	$ 19,454,469	$ 19,454,469	$ 19,454,469	$ -	$ -
Liabilities - Recurrring fair value measurements:					
Interest rate swap agreements	$ (12,804,081)	$ (12,804,081)	$ -	$ (12,804,081)	$ -
Liabilities disclosed at fair value:					
Long-term debt	$ (240,045,000)	$(247,627,406)	$ -	$(247,627,406)	$ -

10. Disclosures About Fair Value of Assets and Liabilities (continued)

	2012				
	Carrying Value	**Fair Value**	**Quoted Prices in Active Markets (Level 1)**	**Other Observable Inputs (Level 2)**	**Unobservable Inputs (Level 3)**
Assets - Recurrring fair value measurements:					
Short term investments					
Corporate bonds and notes	$ 20,930,165	$ 20,930,165	$ -	$ 20,930,165	$ -
Assets limited as to use					
Money market mutual funds	33,983,822	33,983,822	33,983,822	-	-
Common stock	31,397,455	31,397,455	31,397,455	-	-
Mutual funds (B)	116,413,154	116,413,154	116,413,154	-	-
Corporate bonds and notes	25,888,638	25,888,638	-	25,888,637	-
U.S. Treasury obligations	26,825,710	26,825,710	-	26,825,710	-
U.S. Government agency obligations	2,155,231	2,155,231	-	2,155,231	-
Real estate investment fund	10,431,532	10,431,532	-	-	10,431,532
	247,095,542	247,095,542	181,794,431	54,869,578	10,431,532
Total assets	$ 268,025,707	$ 268,025,707	$ 181,794,431	$ 75,799,743	$ 10,431,532
Assets disclosed at fair value:					
Cash and cash equivalents	$ 63,366,719	$ 63,366,719	$ 63,366,719	$ -	$ -
Liabilities - Recurrring fair value measurements:					
Interest rate swap agreements	$ (22,063,563)	$ (22,063,563)	$ -	$ (22,063,563)	$ -
Liabilities disclosed at fair value:					
Long-term debt	$ (244,875,000)	$(252,730,243)	$ -	$(252,730,243)	$ -

10. Disclosures About Fair Value of Assets and Liabilities (continued)

(A) Twenty-six percent of mutual funds invest in fixed income investments. Thirty-nine percent invest in international equities. Thirty-five percent of mutual funds invest in alternative investments.

(B) Three percent of mutual funds invest in common stock of large-cap U.S. companies. Less than one percent of the mutual fund investments focus on emerging markets. Forty-three percent of mutual funds invest in fixed income investments. Seventeen percent invest in international equities. Thirty-six percent of mutual funds invest in alternative investments..

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value and for financial instruments disclosed at fair value. There have been no changes in methodologies used at September 30, 2013 and 2012.

Cash and cash equivalents: The carrying amounts approximate fair value because of the short maturity of these financial instruments.

Common stock: Valued at closing price reported on the active market on which the individual securities are traded.

Money market and Mutual funds: Valued at the net asset value ("NAV") of shares (basis for trade) held by the Medical Center at year end.

Corporate bonds and notes, U.S. treasury obligations and U.S. government agency obligations: Valued based on spreads of published interest rate curves.

Interest rate swap agreements: Valued based on information supplied by the Counter Party to the swap. The fair value takes into consideration the prevailing interest rate environment, the specific terms and conditions of the agreements, and considers the credit risk of the Medical Center and the Counter Party. The value represents the estimated exit price the Medical Center would pay to terminate the agreements.

Long-term debt: Valued using quoted market prices and discounted cash flows of debt services, based on the current incremental borrowing rate for debt considering similar types of borrowing arrangements

10. Disclosures About Fair Value of Assets and Liabilities (continued)

The Medical Center measures its real estate investment fund (the Fund) at fair value based on the Fund's underlying investments using unobservable inputs (Level 3) in accordance with accounting principles generally accepted in the United States of America. Changes to the real estate investment fund in 2013 and 2012 were as follows:

	2013	2012
Beginning balance	$ 10,431,532	$ -
Realized and unrealized gains	1,695,041	443,287
Advisory fees	(147,039)	(11,755)
Purchases	8,000,000	10,000,000
Ending balance	$ 19,979,534	$ 10,431,532

The following table shows quantitative information about significant unobservable inputs utilized by independent appraisers in determining the fair values of the Fund's real estate investments at September 30, 2013. The cash flow models used in the valuations include estimated cash inflows and outflows over a specified holding period. Property cash flows may include contractual rental revenues, projected future rental revenues and expenses and forecasted capital costs, including tenant improvements and leasing commissions, based upon current market conditions and expectations for change. Property capitalization and discount rates are based on the location, type and nature of each property, as well as current and anticipated market conditions. Mortgage cash flow projections may include contractual interest payments and participation in projected property cash flows. Mortgage capitalization and discount rates are based on rates applied to the underlying property valuation, but also consider market interest rates, loan-to-value ratio, remaining mortgage term and specific terms of the mortgage.

10. Disclosures About Fair Value of Assets and Liabilities (continued)

As of September 30, 2013

Property / Investment Type	Fair Value at 9/30/2013 ($ in millions)	OAR (%)	Average Discount Rate (%)	Discount Rate Range (%)	Average Exit Cap Rate (%)	Exit Cap Rate Range (%)	Average Market Rental Growth Rate Forcast (%) Yr. 1	Yr. 2	Yr. 3	Long-term	Average Expense Growth Rate (%)
Apartments											
Equity	$ 2.3	5.3	7.2	6.75 - 7.75	6.1	5.75 - 7.00	3.9	3.9	3.0	3.0	3.0
Mortgage	11.5	N/A	6.9	3.00 - 8.75	5.3	4.75 - 6.00	3.4	3.6	3.6	3.1	3.0
Hotel											
Mortgage	1.3	N/A	8.2	5.75 - 9.25	7.8	7.50 - 8.25	5.7	5.4	3.0	3.0	3.0
Industrial											
Equity	0.7	5.9	8.8	7.50 - 11.00	7.2	7.00 - 8.00	2.4	2.7	3.3	3.0	3.0
Mortgage	1.1	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Office											
Mortgage	0.3	N/A	7.8	7.75	5.8	5.75	4.0	4.0	3.0	3.0	3.0
Retail											
Equity	0.7	6.1	9.3	9.00 - 11.00	8.3	8.00 - 9.50	0.8	1.7	3.0	3.0	3.0
Mortgage	2.1	N/A	7.6	7.25 - 8.25	6.8	6.00 - 7.50	3.0	3.0	3.0	3.0	3.0
Average											
Equity	3.7	5.6	7.9	6.75 - 11.00	6.7	5.75 - 9.50	3.1	3.3	3.1	3.0	3.0
Mortgage	16.3	N/A	7.1	3.00 - 9.25	5.7	4.75 - 8.25	3.6	3.7	3.4	3.1	3.0

11. Concentration of Credit Risk

The Medical Center grants credit (without requiring collateral) to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30 follows:

	2013	2012
Medicare	39 %	33 %
Medicaid	15	16
Anthem/Blue Cross	8	10
Patients	26	28
Other third-party payers	12	13
	100 %	100 %

12. Functional Expenses

The Medical Center provides general health care services to residents within the communities served by the Medical Center. Approximately 85% of the Medical Center's expenses related to health care services and 15% related to general and administrative costs for both of the years ended September 30, 2013 and 2012.

13. Commitments

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Total rent expense for the years ended September 30, 2013 and 2012 for all operating leases was approximately $3,674,000 and $3,504,000, respectively. Future rental commitments, as of September 30, 2013, for all noncancellable operating leases with terms in excess of one year are as follows: $3,685,000 – 2014, $3,258,000 – 2015, $2,968,000 – 2016, $1,900,000 – 2017, $1,774,000 – 2018 and $9,742,000 – thereafter.

14. Self-Insurance

The Medical Center is involved in litigation arising in the ordinary course of business. Claims have been asserted against the Medical Center and are currently in various stages of litigation. It is the opinion of management of the Medical Center, based on their experience, that the ultimate resolution of professional liability claims will not have a significant effect on the Medical Center's consolidated financial statements.

The Medical Center is self-insured for medical malpractice and professional and general liability claims arising on or after July 1, 1976. Currently, the Medical Center has excess insurance for claims over the self-insured limit. Losses from asserted claims and from unasserted claims identified under the Medical Center's incident reporting system and incidents incurred but not reported are accrued based on estimates that incorporate the Medical Center's past experience, as well as other considerations including the nature of each claim or incident and relevant trend factors.

14. Self-Insurance (continued)

IHIL was incorporated in the Cayman Islands on August 3, 2012 and insures the risks of the Medical Center and its subsidiaries. IHIL did not charge insurance premiums to the Medical Center during the year ended September 30, 2013. The fair value of assets in IHIL was approximately $11,430,000 at September 30, 2013. IHIL assets are controlled by the Medical Center and are reflected in the accompanying consolidated financial statements.

The Medical Center has recorded a reserve of approximately $21,638,000 and $16,269,000 in 2013 and 2012, respectively, for asserted and unasserted professional and general claims. The estimated current portion of the obligation of approximately $3,795,000 and $2,438,000 in 2013 and 2012, respectively, is included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. The estimated liability for such malpractice and professional and general liability claims is not discounted in the accompanying consolidated financial statements. The Medical Center is also self-insured for workers' compensation and employee health benefits.

While the ultimate amount of costs incurred under the Medical Center's self-insured programs is dependent on future developments, in management's opinion, recorded reserves are adequate to cover the future settlement of claims. However, it is reasonably possible that recorded reserves may not be adequate to cover the future settlement of claims. Adjustments, if any, to estimates recorded resulting from ultimate claim payments will be reflected in operations in the periods in which such adjustments are known.

The Medical Center has established an irrevocable trust fund for the payment of medical malpractice claim settlements. Professional insurance consultants have assisted the Medical Center in determining amounts to be deposited in the trust fund. The balance on deposit in the irrevocable trust was $11,618,465 and $12,082,909 at September 30, 2013 and 2012, respectively.

15. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose. Permanently restricted net assets are those which must be maintained in perpetuity, based on donor restrictions. When a donor restriction expires, temporarily restricted net assets used for operations are classified to unrestricted net assets and reported in the statements of operations as other revenues while temporarily restricted net assets restricted for property and equipment are excluded from the excess of revenues over expenses and reported as an increase in net assets.

15. Temporarily and Permanently Restricted Net Assets (continued)

At September 30, temporarily and permanently restricted net assets include the following:

	2013	2012
Temporarily restricted:		
Education Funds	$ 9,650	$ 12,161
Program Funds	1,411,737	1,280,329
	$ 1,421,387	$ 1,292,490
Permanently restricted:		
Boyd County Medical Society Scholarship Fund	$ 136,778	$ 115,489
	$ 136,778	$ 115,489

16. Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenues are described in Notes 2 and 3.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 2 and 14.

16. Significant Estimates and Concentrations (continued)

Litigation

In the normal course of business, the Medical Center is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Medical Center's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

In connection with its nationwide review, the U.S. Department of Justice (DOJ) is reviewing certain hospital charges relating to implantable cardio-defibrillators (ICDs) for compliance with the Centers for Medicare and Medicaid Services criteria. The review covers the period from October 2003 to present. As such, a potential exists that the Medical Center may be subject to claims for recoupment and penalties. The Medical Center has reserved an estimated amount to cover any and all claims and damages related to this review.

In February 2014, the Medical Center and the United States of America, acting through the DOJ and on behalf of the Office of Inspector General (OIG-HHS) of the Department of Health and Human Services (HHS) (collectively the "United States") and the Commonwealth of Kentucky, reached an agreement to settle the DOJ's review related to unnecessary diagnostic cardiac catheterizations and coronary stents. Under the terms of the agreement, the Medical Center will pay $40.9 million ("Settlement Amount") to the United States. Interest will accrue on the Settlement Amount at the simple rate of 2.5%. Accordingly, $40.9 million is included in the current accrued governmental settlement at September 30, 2013 for the Settlement Amount. An additional $8 million has been included in the current accrued government settlement at September 30, 2013 for legal fees associated with the investigation and settlement. In addition to the settlement, the Medical Center will enter into a Corporate Integrity Agreement with the OIG-HHS.

Pension and Other Postretirement Benefit Obligations

The Medical Center has a noncontributory defined benefit pension plan whereby it agrees to provide certain postretirement benefits to eligible employees. The benefit obligation is the actuarial present value of all benefits attributed to service rendered prior to the valuation date based on the projected unit credit cost method. It is reasonably possible that events could occur that would change the estimated amount of this liability materially in the near term.

16. Significant Estimates and Concentrations (continued)

Investments

The Medical Center invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated balance sheets.

Current Economic Conditions

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Medical Center's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated financial statements could change rapidly, resulting in material future adjustments in investment values (including defined benefit pension plan investments) and allowances for accounts receivable that could negatively impact the Medical Center's ability to meet debt covenants or maintain sufficient liquidity.

17. Subsequent Events

Subsequent events have been evaluated through March 14, 2014, which is the date the financial statements were available to be issued.