



ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements and Schedules

September 30, 2014 and 2013

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
Asante Health System and subsidiaries:

We have audited the accompanying consolidated financial statements of Asante Health System and its subsidiaries, which comprise the consolidated balance sheets as of September 30, 2014 and 2013, 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 U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free 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 Asante Health System and its subsidiaries as of September 30, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included on pages 36 to 38 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

January 2, 2015

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 2014 and 2013

(In thousands)

Assets	2014	2013
Current assets:		
Cash and cash equivalents	\$ 45,158	13,835
Assets whose use is limited, current portion	10,173	9,942
Patient accounts receivable (less allowance for doubtful accounts of \$8,183 and \$8,547 in 2014 and 2013, respectively)	86,716	100,473
Accrued interest and other receivables	1,961	3,962
Inventories	6,003	6,898
Prepaid expenses	5,869	4,230
Total current assets	155,880	139,340
Assets whose use is limited:		
Restricted by donors	7,552	5,867
Held by ACH Foundation	1,431	1,074
Board-designated assets	26,249	24,636
	35,232	31,577
Less amount required to meet current obligations	10,173	9,942
	25,059	21,635
Marketable securities	488,492	496,182
Property, plant, and equipment, net	322,317	315,834
Land held for future use	12,960	12,960
Other assets, net	25,589	28,104
Total assets	\$ 1,030,297	1,014,055

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 2014 and 2013

(In thousands)

Liabilities and Net Assets	2014	2013
Current liabilities:		
Accounts payable	\$ 17,248	17,220
Payroll, payroll taxes, and related benefits	27,054	24,369
Self-insurance liability, current portion	10,379	8,186
Estimated reimbursement due to governmental agencies, net	1,466	4,786
Current portion of pension benefit obligation	3,491	1,772
Other current liabilities	19,892	18,443
Current portion of long-term debt and capital lease obligations	10,173	9,942
Total current liabilities	89,703	84,718
Long-term debt and capital lease obligations, net of current portion	278,282	339,788
Pension benefit obligation	19,204	16,740
Other long-term liabilities	26,941	25,466
Total liabilities	414,130	466,712
Net assets:		
Unrestricted	607,183	540,402
Temporarily restricted	4,379	2,729
Permanently restricted	4,605	4,212
Total net assets	616,167	547,343
Commitments and contingencies (note 14)		
Total liabilities and net assets	\$ 1,030,297	1,014,055

See accompanying notes to consolidated financial statements.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2014 and 2013

(In thousands)

	<u>2014</u>	<u>2013</u>
Unrestricted revenues, gains, and other support:		
Net patient service revenue (net of provision for bad debts of \$15,725 and \$13,433 in 2014 and 2013, respectively)	\$ 629,364	525,506
Contribution from AHS affiliation	—	1,826
Other operating revenue	<u>11,813</u>	<u>13,899</u>
Total revenues, gains, and other support	<u>641,177</u>	<u>541,231</u>
Operating expenses:		
Salaries and benefits	335,829	288,950
Supplies	117,923	96,650
Purchased services	32,501	30,531
Professional fees	10,111	8,624
Repairs and maintenance	16,079	13,012
Insurance	7,664	4,273
Rent and utilities	10,342	9,182
Interest	12,799	13,019
Depreciation	37,537	32,538
Provider tax expense	28,160	23,190
Other	<u>8,835</u>	<u>5,978</u>
Total operating expenses	<u>617,780</u>	<u>525,947</u>
Operating income	<u>23,397</u>	<u>15,284</u>
Nonoperating income:		
Investment income, net of fees	49,062	29,901
Change in unrealized gains and losses on trading investments	(4,580)	25,232
Other, net	<u>(1,716)</u>	<u>(3,157)</u>
Total nonoperating income	<u>42,766</u>	<u>51,976</u>
Excess of revenues over expenses, carried forward	<u>\$ 66,163</u>	<u>67,260</u>

See accompanying notes to consolidated financial statements.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2014 and 2013

(In thousands)

	<u>2014</u>	<u>2013</u>
Unrestricted net assets:		
Excess of revenues over expenses, brought forward	\$ 66,163	67,260
Net assets released from restrictions used for purchases of property, plant, and equipment	618	598
Other	<u>—</u>	<u>(21)</u>
Increase in unrestricted net assets	<u>66,781</u>	<u>67,837</u>
Temporarily restricted net assets:		
Contributions and investment income	2,721	2,121
Restricted assets from AHS affiliation	—	709
Net assets released from restrictions	(1,071)	(1,238)
Other	<u>—</u>	<u>28</u>
Increase in temporarily restricted net assets	<u>1,650</u>	<u>1,620</u>
Permanently restricted net assets:		
Contributions and investment income	393	242
Restricted assets from AHS affiliation	<u>—</u>	<u>727</u>
Increase in permanently restricted net assets	<u>393</u>	<u>969</u>
Increase in net assets	68,824	70,426
Net assets, beginning of year	<u>547,343</u>	<u>476,917</u>
Net assets, end of year	<u>\$ 616,167</u>	<u>547,343</u>

See accompanying notes to consolidated financial statements.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended September 30, 2014 and 2013

(In thousands)

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Increase in net assets	\$ 68,824	70,426
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Contribution from AHS affiliation	—	(3,262)
Depreciation and amortization	40,688	34,277
Provision for bad debts	15,725	13,433
Realized and net change in unrealized gains and losses on marketable securities	(32,591)	(41,020)
Equity in earnings on investments in healthcare ventures	(1,570)	(698)
Restricted donations and investment income	(3,114)	(1,098)
Loss (gain) on sale of assets	(60)	2,214
Change in operating assets and liabilities:		
Patient accounts receivable, accrued interest, other receivables, and other assets	19	(27,978)
Inventories and prepaid expenses	(744)	272
Accounts payable, accrued payroll, payroll taxes and related benefits, self-insurance liability, estimated reimbursement due to governmental agencies, other current liabilities, and other long-term liabilities	8,693	2,957
Net cash provided by operating activities	<u>95,870</u>	<u>49,523</u>
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(44,433)	(62,918)
Sales of marketable securities and assets whose use is limited	276,868	261,219
Purchases of marketable securities and assets whose use is limited	(239,885)	(240,245)
Notes receivable repayments	175	172
Cash from AHS affiliation	—	205
Distributions from investments in healthcare ventures	1,253	1,344
Investment in healthcare ventures	(442)	(372)
Proceeds on sale of assets	38	426
Net cash used in investing activities	<u>(6,426)</u>	<u>(40,169)</u>
Cash flows from financing activities:		
Principal payments on long-term debt and capital lease obligations	(61,235)	(15,992)
Proceeds from restricted donations and investment income	3,114	1,098
Net cash used in financing activities	<u>(58,121)</u>	<u>(14,894)</u>
Net (decrease) increase in cash and cash equivalents	31,323	(5,540)
Cash and cash equivalents, beginning of year	13,835	19,375
Cash and cash equivalents, end of year	<u>\$ 45,158</u>	<u>13,835</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 12,301	12,368
Capital purchases in accounts payable	1,035	1,418

See accompanying notes to consolidated financial statements.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(1) Organization

Asante Health System (Asante) is a private, not-for-profit, community-based healthcare organization providing health-related services to the residents of Southern Oregon and Northern California. Asante includes the operations of the following private, not-for-profit operating units and affiliates:

Asante (Parent Company)

Asante provides various support services to its operating units and other affiliates.

(a) Operating Units (which comprise the Obligated Group)

Asante has established an Obligated Group to access capital markets. Obligated Group members are jointly and severally liable for the long-term debt outstanding under the Obligated Group's master trust indenture. Asante's operating units, which comprise the Obligated Group, are as follows:

Asante Rogue Regional Medical Center (ARRMC)

A regional tertiary healthcare facility providing for the healthcare needs of Southern Oregon and Northern California.

Asante Three Rivers Medical Center (ATRMC)

A community hospital in Josephine County providing inpatient and outpatient healthcare services to the Grants Pass community and surrounding area.

Siskiyou Imaging

An Oregon LLC providing magnetic resonance imaging services in Ashland. The venture is jointly owned by Asante (33.3%), Asante Ashland Community Hospital (ACH) (33.3%) and a physician group (33.3%). Although Siskiyou Imaging is not an Obligated Group member, it is consolidated into the Obligated Group financial results.

(b) Other Affiliates

The following are consolidated affiliates of Asante and are not part of the Asante obligated group.

Asante Physician Partners (APP)

Wholly owned subsidiary that employs and manages physician providers, including primary care, specialists, and mid-level providers.

Asante Ashland Community Hospital (AACH)

Separate 501(c)(3) corporation of which Asante is the sole corporate member as part of a member substitution transaction finalized August 1, 2013. AACH serves Ashland and the surrounding communities. See detail of the transaction in (c) below.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Asante Foundation (the Foundation)

The Foundation is a public benefit corporation of Asante, responsible for fund-raising and development.

Southern Oregon Insurance, Inc. (SOII)

SOII is a single parent direct issue captive, incorporated in the state of Hawaii, providing healthcare professional and commercial general liability insurance and claims management services for Asante.

Southern Oregon Trauma and Emergency Services, LLC (SOTES)

SOTES is an Oregon LLC that coordinates trauma and emergency medical services provided at ARPMC and ATRMC.

(c) *Ashland Healthcare Service Affiliation*

On August 1, 2013, Asante and Ashland Healthcare Services (AHS) effected an Affiliation Agreement (AA), which financially, clinically and operationally integrated the two organizations. Asante became the sole corporate member of AHS. As of that date the members of the Asante Board of Directors became the Board members of AHS. The Affiliation Agreement provides for reversion options for both parties if certain circumstances are met within a given timeframe. Among the requirements of the AA are for Asante to operate AACH as an acute care hospital for a period of time, to spend at least \$10 million on capital expenditures over three years, and to provide funding to the AHS retirement plan. Unidentified liabilities in excess of certain limits create an opportunity for Asante to trigger reversion during that same three-year period ending July 31, 2016.

Ashland Healthcare Services, formerly operated as Ashland Community Hospital (ACH) is doing business as Asante Ashland Community Hospital (AACH) and is operating under that name subsequent to the affiliation. The hospital provides surgical, emergency and diagnostic services to the communities in the Southern Rogue Valley and Northern California. The results of the operations of AACH from August 1, 2013 to September 30, 2014 have been included in the consolidated statements herein presented.

This transaction was accounted for as an acquisition under Accounting Standards Codification (ASC 958-805) *Not-for-Profit Entities Business Combinations*. No consideration was paid by Asante to acquire the net assets of AHS. The affiliation resulted in an excess of assets acquired over liabilities assumed of approximately \$3,262,000 with approximately \$1,826,000 reported in other operating revenue.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The following table summarizes the fair value estimates of the AHS assets acquired and liabilities assumed as of August 1, 2013 (in thousands):

Cash and investments	\$ 3,005
Accounts receivable	6,168
Property, plant and equipment	24,438
Other assets	1,176
Interest in assets of ACH Foundation	1,046
Accounts payable	(849)
Payroll and related benefits liability	(1,541)
Defined benefit pension obligation	(18,512)
Other liabilities	(3,308)
Long-term debt, including current portion	(8,361)
	<hr/>
Total contribution	\$ 3,262
	<hr/>
Unrestricted contribution	\$ 1,826
Temporarily restricted contribution	709
Permanently restricted contribution	727
	<hr/>
	\$ 3,262
	<hr/>

The following are the financial results of AACH for the two months ended September 30, 2013 and are included in the Asante consolidated statement of operations (in thousands).

Total operating revenue	\$ 7,821
Excess of revenues over expenses	346

The following pro forma combined financials information presents Asante results as if the affiliation had been reported as of the beginning of the Asante fiscal year Oct 1, 2013.

	2013	
	<u>Actual</u>	<u>Pro forma</u>
Total operating revenues	\$ 541,231	576,772
Excess of revenues over expenses from operations	15,284	11,512
Excess of revenues over expenses	67,260	63,685

(2) Summary of Significant Accounting Policies

(a) Basis of Consolidation

The accompanying consolidated financial statements include the accounts of Asante and other affiliates. All significant intercompany account balances and transactions have been eliminated.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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. The significant estimates in Asante's consolidated financial statements include accounts receivable allowances, third-party payor settlement liabilities, valuation of investments, and liabilities related to self-insurance programs and pension obligation.

(c) Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid financial instruments with original maturities of three months or less when purchased. Cash equivalent balances included in cash and cash equivalents in the consolidated balance sheets at September 30, 2014 and 2013 are \$1,574,000 and \$2,235,000, respectively.

Asante maintains cash and cash equivalents on deposit at various institutions, which at times exceed the insured limits by the Federal Deposit Insurance Corporation. This exposes Asante to potential risk of loss in the event the institution becomes insolvent.

(d) Patient Accounts Receivable

Accounts receivable are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Credit is granted without collateral to Asante's patients, most of whom are local residents and are insured under third-party payor agreements. Asante manages the receivables by regularly reviewing its accounts and contracts and by providing appropriate allowances for contractual discounts and uncollectible amounts. Asante estimates these allowances based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. The mix of receivables based on significant third-party payor classifications is as follows:

	September 30	
	2014	2013
Medicare	45%	40%
Medicaid	18	16
Private pay	3	14
Others	34	30
	100%	100%

(e) Inventories

Inventories are stated at the lower of average cost, as determined by the first-in, first-out method, or market.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(f) *Assets Whose Use is Limited*

Assets whose use is limited are carried at fair value and are accounted for as trading securities and primarily include assets subject to donor restrictions, assets held by trustees under indenture agreements, and designated assets set aside by the Board of Trustees (the Board) for certain purposes, over which the Board retains control and may, at its discretion, subsequently use for other purposes. Amounts that will be used to satisfy current liabilities are classified as current assets in the accompanying consolidated balance sheets. Gains and losses on sales of assets whose use is limited are computed on the specific-identification method. Interest income or loss (including realized gains and losses on investments, interest, and dividends) is included in nonoperating income unless the income or loss is restricted by donor or law. Unrealized gains and losses on trading securities are included in nonoperating income in the accompanying consolidated statements of operations.

(g) *Marketable Securities*

Marketable securities are accounted for as trading securities and consist principally of U.S. government agency obligations, corporate obligations, and equity securities that are stated at fair value. Amounts are classified as noncurrent assets in the accompanying consolidated balance sheets as Asante does not intend that they be used to satisfy current obligations. Gains and losses on sales of marketable securities are computed on the specific-identification method. Interest income or loss (including realized gains and losses on investments, interest, and dividends) is included in nonoperating income. Unrealized gains and losses on trading securities are included in nonoperating income in the accompanying consolidated statements of operations.

(h) *Property, Plant, and Equipment*

Property, plant, and equipment acquisitions are recorded at cost. Depreciation expense is computed using the straight line method over the following estimated useful lives of the assets:

Buildings	15–50 years
Land improvements	8– 20 years
Equipment	3–25 years
	The shorter of
	lease term or
Leasehold improvements	useful life

Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included within depreciation in the accompanying consolidated financial statements.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from 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.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Asante assesses potential impairment to its long-lived assets, including land held for future use, when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is recognized when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset. No impairment losses have been identified.

(i) *Financing Costs*

Financing costs incurred in connection with debt agreements are deferred and amortized over the life of the respective debt and are included in other assets in the accompanying consolidated balance sheets.

(j) *Investments in Healthcare Ventures*

Investments in healthcare-related joint ventures, where Asante does not have a controlling interest, have been accounted for using the equity method and are included in other assets in the accompanying consolidated balance sheets.

(k) *Self-Insurance*

Workers' Compensation

The annual self-insured retention under Asante's workers' compensation program is \$400,000 per claim per year. Asante carries an excess coverage policy for its worker's compensation program. The accrued liability for the self-insured components of the plan includes the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. The actuarially determined total estimated gross liability at September 30, 2014 is \$9,264,000 with \$1,674,000 of this amount insured by excess carriers. The actuarially determined total estimated gross liability at September 30, 2013 is \$9,930,000 with \$2,084,000 of this amount insured by excess carriers. The current portion of the accrued liability for workers' compensation is included in self-insurance liability. The long-term portion of the accrued liability is included in other long-term liabilities.

Medical

Asante maintains a self-insured medical plan for its employees. The accrued liability for the self-insured components of the plan includes estimates of the costs for the incurred but not paid claims as well as related claims administration expense.

The actuarially determined estimated liability for Asante is \$3,835,000 and \$2,901,000 at September 30, 2014 and 2013, respectively, and is included in self-insurance liability.

Professional Liability

Asante is self-insured for professional liability exposures through SOII. SOII provides coverage for Asante's claims up to \$1 million per claim with a \$5 million annual aggregate for the years ended September 30, 2014 and 2013. Asante has purchased insurance with third-party carriers for claims in excess of the \$1 million amount per claim or \$5 million aggregate. The coverage provided by SOII and the third-party carriers is in the form of claims-made insurance policies. Should the claims-made

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

policies not be renewed or replaced, claims related to occurrences during the terms of the policies but reported subsequent to their termination may be uninsured. Asante, including SOII, records actuarially estimated liabilities for reported claims as well as an estimated tail liability for claims that have been incurred but not reported.

The total expected value, undiscounted estimated gross liability for Asante, excluding AACH, at September 30, 2014 is \$20,552,000 with \$4,316,000 of this amount insured by excess carriers. The total expected value, undiscounted estimated gross liability for Asante, excluding AACH, at September 30, 2013 is \$17,552,000 with \$5,450,000 of this amount insured by excess carriers. The current portion of the liability is \$3,318,000 and is recorded in self-insurance liability. The long-term portion is \$17,234,000 and is included in other long-term liabilities. The receivable for insurance recoveries is included in other assets.

AACH has purchased claims-made professional liability insurance coverage for claims up to \$1 million per occurrence with a \$3 million aggregate, with a \$25,000 per claim deductible. AACH is responsible for estimated obligations up to the deductible amount and a tail liability for claims that have been incurred but not yet reported. The AACH net estimated self insurance obligation for professional liability at the expected value, undiscounted, is \$212,000 at September 30, 2014, which is included in self insurance liability.

Management is not aware of any potential professional liability claims whose settlement would be in excess of amounts provided or would otherwise have a material adverse effect on Asante's consolidated financial position.

(I) Oregon State Provider Tax

The State of Oregon operates a provider tax program related to certain patient service revenues at certain qualifying hospitals. Asante recorded provider tax expenses of approximately \$28,160,000 and \$23,190,000 for the years ended September 30, 2014 and 2013, respectively. Asante recorded provider tax liabilities of \$7,076,000 and \$6,356,000 at September 30, 2014 and 2013, respectively, which are included in other current liabilities in the accompanying consolidated balance sheets. In addition, Asante has entered into an agreement with the Oregon Association of Hospitals and Health Systems (OAHHS), which provides that all payments to Asante related to beneficiaries of the Oregon Medical Assistance Program are to be remitted directly to OAHHS. OAHHS aggregates these payments, returning a portion to Asante. The remaining funds are pooled by OAHHS with like amounts received on behalf of other hospitals subject to the provider tax, and OAHHS redistributes such funds to the qualifying hospitals. Asante estimates the amounts from OAHHS for the years ended September 30, 2014 and 2013 are \$28,160,000 and \$23,190,000, respectively, which are reflected as a component of net patient service revenue in the accompanying consolidated statements of operations. Asante recorded receivables of \$7,053,000 and \$6,335,000 at September 30, 2014 and 2013, respectively, which are included in patient accounts receivable in the accompanying consolidated balance sheets.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(m) Net Assets

Unrestricted

All net assets that are not restricted by donors are included in unrestricted net assets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Asante has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Asante in perpetuity. Based on Asante's policy, income earned on permanently restricted funds is transferred to temporarily restricted net assets and used to support specific programs with either a restricted or unrestricted purpose. Spending, for entities other than AACH, may not exceed 5% of the corpus in any fiscal year, based on Asante's endowment spending policy. AACH allows 100% of earnings on investments to be spent for the restricted purpose of the permanent fund.

Unconditional promises to give cash and other assets to Asante are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When restricted funds to be used for operations are expended for their restricted purposes, these amounts are reflected in unrestricted net assets as net assets released from restrictions for operations and are included in other income. When restricted funds are expended for the acquisition of property, plant, and equipment, these amounts are reported as released from restriction for capital in the consolidated statements of changes in net assets.

Temporarily restricted and permanently restricted net assets are maintained for the following purposes as stipulated by donors at September 30 (in thousands):

	<u>2014</u>	<u>2013</u>
Temporarily restricted:		
Capital	\$ —	90
Child and infant health (capital)	1,868	760
Restricted for specific purpose at AACH	750	737
Others	1,761	1,142
	<u>\$ 4,379</u>	<u>2,729</u>
Permanently restricted:		
Education	\$ 618	580
Francis Cheney Family Place/TRCH Family House	2,292	2,094
Restricted for specific purpose at AACH	830	727
Others	865	811
	<u>\$ 4,605</u>	<u>4,212</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(n) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated settlements under third-party reimbursement agreements are accrued in the period the related services are rendered and adjusted in future periods, primarily as a result of final settlements.

(o) Charity Care

Asante provides care to patients who meet poverty guidelines under its charity care policy. Asante does not pursue collection of amounts determined to qualify as charity care; therefore, they are not reported as revenue.

(p) Nonoperating Income

Nonoperating income includes certain items that management deems to be outside the scope of its primary business. Items consist primarily of investment income, net results of the Foundation, and other income. Investment income consists of investment income from marketable securities and assets whose use is limited, offset by investment management fees, and unrealized gains (losses).

(q) Net Contributions from the Foundation

Asante reports the net results of the Foundation activities as part of nonoperating income under the “other, net” classification. Net results from the Foundation for the years ended September 30 (in thousands) are as follows:

	2014	2013
Other operating revenue	\$ 1,977	1,003
Total operating revenue	1,977	1,003
Salaries and benefits	814	716
Supplies	224	88
Purchased services	279	170
Rent and utilities	19	36
Other	152	116
Total operating expenses	1,488	1,126
Operating gain (loss)	489	(123)
Net unrealized gains on trading investments	458	1,149
Excess of revenues over expenses	\$ 947	1,026

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(r) *Excess of Revenues over Expenses*

The consolidated statements of operations report the excess of revenues over expenses and other changes in unrestricted net assets. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include transfers of assets to and from unconsolidated affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets).

(s) *Federal and State Income Taxes*

Asante has received a determination letter from the Internal Revenue Service stating that it is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, except for unrelated business income. Management believes Asante is operated in a manner that qualifies it for tax-exempt status. Income taxes are provided for the tax effects of transactions unrelated to Asante's tax-exempt purpose reported in the consolidated financial statements; however, such activities are not significant to the consolidated financial statements. Asante does not believe that it has adopted any uncertain tax positions as defined by Financial Accounting Standards Board (FASB) ASC Subtopic 740-10, *Income Taxes – Overall*.

AACH has received a Determination Letter from the District Director of the IRS stating it is exempt from federal income taxes under 501(c)(3) of the Internal Revenue Code. AACH has not undertaken any transactions that are unrelated to its exempt purpose, thus has no unrelated business income. Management also believes that AACH has not undertaken or adopted any uncertain tax positions.

(t) *Reclassifications*

Certain 2013 amounts have been reclassified to conform to the 2014 presentation.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(3) Marketable Securities and Assets Whose Use is Limited

The composition of marketable securities and assets whose use is limited at fair value at September 30 is as follows (in thousands):

	2014	2013
Corporate equity securities	\$ 208,127	224,946
Mutual funds	75,663	80,174
Corporate bonds	61,856	56,575
Exchange traded international index funds	96,640	70,381
U.S. government agency obligations	52,198	24,049
U.S. government obligations	7,149	11,435
Cash and cash equivalents	3,807	44,744
Collateralized mortgage obligations	13,655	6,874
Municipal bonds	—	672
Convertible preferred securities	1,727	4,060
Certificates of deposit	529	505
Convertible bonds	942	2,270
	<u>522,293</u>	<u>526,685</u>
Add:		
Assets held by ACH Foundation	1,431	1,074
Less:		
Assets whose use is limited, current portion	10,173	9,942
Assets whose use is limited, net of current portion	<u>25,059</u>	<u>21,635</u>
Marketable securities	<u>\$ 488,492</u>	<u>496,182</u>

Investment income for the years ended September 30 comprised the following elements (in thousands):

	2014	2013
Interest and dividends	\$ 14,369	15,915
Realized gains, net	<u>37,157</u>	<u>15,794</u>
	51,526	31,709
Less:		
Investment fees	<u>(2,464)</u>	<u>(1,808)</u>
	<u>\$ 49,062</u>	<u>29,901</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

In accordance with ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. These levels are:

- Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Level 2 valuations are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The following table presents the balances of assets measured at fair value on a recurring basis at September 30, 2014 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair value</u>
Assets:				
Corporate equity securities:				
Large cap value	\$ 66,195	—	—	66,195
Small/mid cap growth	77,593	—	—	77,593
Large cap growth	64,339	—	—	64,339
Total	<u>208,127</u>	<u>—</u>	<u>—</u>	<u>208,127</u>
Mutual funds:				
Money market	59,641	—	—	59,641
Small cap equity fund	16,022	—	—	16,022
Total	<u>75,663</u>	<u>—</u>	<u>—</u>	<u>75,663</u>
Corporate bonds	—	61,856	—	61,856
Exchange traded international index funds	96,640	—	—	96,640
U.S. government agency obligations	—	52,198	—	52,198
U.S. government obligations	—	7,149	—	7,149
Cash and cash equivalents	3,807	—	—	3,807
Collateralized mortgage obligations	—	13,655	—	13,655
Municipal bonds	—	—	—	—
Convertible preferred securities	—	1,727	—	1,727
Certificates of deposit	—	529	—	529
Convertible bonds	—	942	—	942
Total	<u>\$ 384,237</u>	<u>138,056</u>	<u>—</u>	<u>522,293</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The following table presents the balances of assets measured at fair value on a recurring basis at September 30, 2013 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair value</u>
Assets:				
Corporate equity securities:				
Large cap value	\$ 70,142	—	—	70,142
Small/mid cap growth	89,749	—	—	89,749
Large cap growth	65,055	—	—	65,055
Total	<u>224,946</u>	<u>—</u>	<u>—</u>	<u>224,946</u>
Mutual funds:				
Money market	63,548	—	—	63,548
Small cap equity fund	16,626	—	—	16,626
Total	<u>80,174</u>	<u>—</u>	<u>—</u>	<u>80,174</u>
Corporate bonds	—	56,575	—	56,575
Exchange traded international index funds	70,381	—	—	70,381
U.S. government agency obligations	—	24,049	—	24,049
U.S. government obligations	—	11,435	—	11,435
Cash and cash equivalents	44,744	—	—	44,744
Collateralized mortgage obligations	—	6,874	—	6,874
Municipal bonds	—	672	—	672
Convertible preferred securities	—	4,060	—	4,060
Certificates of deposit	—	505	—	505
Convertible bonds	—	2,270	—	2,270
Total	<u>\$ 420,245</u>	<u>106,440</u>	<u>—</u>	<u>526,685</u>

All investments held at September 30, 2014 and 2013 are able to be redeemed or liquidated on a daily basis with one or two days' notice.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(4) Property, Plant, and Equipment

Property, plant, and equipment, net as of September 30 consist of the following (in thousands):

	2014	2013
Land and land improvements	\$ 20,526	20,192
Buildings	343,601	306,417
Equipment and furniture	369,807	341,181
Leasehold improvements	1,596	1,596
Buildings under capital leases	4,602	4,602
	<u>740,132</u>	<u>673,988</u>
Less allowance for depreciation	<u>(433,418)</u>	<u>(394,878)</u>
	306,714	279,110
Construction in progress	<u>15,603</u>	<u>36,724</u>
	<u>\$ 322,317</u>	<u>315,834</u>

Depreciation expense, including depreciation expense on rental properties classified as nonoperating, for the years ended September 30, 2014 and 2013 was \$38,579,000 and \$33,608,000, respectively. Accumulated amortization for assets under capital lease obligations was \$3,685,000 and \$3,352,000 at September 30, 2014 and 2013, respectively.

(5) Other Assets

Other assets at September 30 consist of the following (in thousands):

	2014	2013
Unamortized bond issue costs	\$ 8,626	10,744
Investments in healthcare ventures	3,751	3,114
Insurance recoverable	5,990	7,534
Other	7,222	6,712
	<u>\$ 25,589</u>	<u>28,104</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(6) Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations at September 30 consist of the following (in thousands):

	<u>2014</u>	<u>2013</u>
The Hospital Facilities Authority of the City of Medford, Oregon Revenue Bonds Series 2002-B maturing in varying annual amounts, due 2034	\$ 33,200	84,525
The Hospital Facilities Authority of the City of Medford, Oregon Revenue Bonds Series 2005-A, (net of unamortized discount of \$1,366 and \$1,419, respectively) maturing in varying annual amounts, due 2040	68,334	68,281
The Hospital Facilities Authority of the City of Medford, Oregon Revenue Bonds Series 2010, (net of unamortized premium of \$2,419 and \$2,513, respectively) maturing in varying annual amounts, due 2040	155,990	159,888
Oregon Hospital Authority Direct Placement, maturing in varying annual amounts, due 2019 (2011 loan)	18,694	22,874
AACH bank loan maturing in varying annual amounts, due in 2016	7,730	8,031
Capital lease obligations	<u>4,507</u>	<u>6,131</u>
Total long-term debt and capital lease obligations	288,455	349,730
Less current portion	<u>(10,173)</u>	<u>(9,942)</u>
Total long-term debt and capital lease obligations, net of current portion	<u>\$ 278,282</u>	<u>339,788</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Annual maturities of long-term debt and the future minimum capital lease obligations, excluding net bond premium of \$1,053, are as follows as of September 30, 2014 (in thousands):

	Long-term debt	Capital lease obligations
2015	\$ 8,508	1,835
2016	16,354	1,517
2017	9,199	537
2018	9,515	466
2019	6,783	64
Thereafter	232,536	904
	<u>282,895</u>	<u>5,323</u>
Less amounts representing interest – 4% and 8%	<u>—</u>	<u>816</u>
Net present value	282,895	4,507
Less current portion	<u>(8,508)</u>	<u>(1,665)</u>
Total long-term debt and capital lease obligations	<u>\$ 274,387</u>	<u>2,842</u>

A summary of interest cost is as follows (in thousands):

	2014	2013
Bond interest and amortization cost	\$ 11,768	12,033
Other interest	<u>1,031</u>	<u>986</u>
	<u>\$ 12,799</u>	<u>13,019</u>

(a) 2002 Series B Bonds

The Series B Bonds were issued in February 2002. The bonds are currently issued as seven-day auction rate bonds. Conversion to a different maturity period or to a fixed rate is available at Asante's option.

The interest on these bonds is reset every seven days by the auction process. Should current bondholders desire to sell more bonds than bids are received to purchase them, this would result in a failed auction. Failed auctions result in a reset of the interest rate for that issue at the failed auction rate (a calculated rate not to exceed 15.0% for 2002 Series B Bonds). A failed auction on these bonds does not result in a default or failure, but could result in higher interest costs.

The 2002 Series B Bond auctions failed in 2008, and for each weekly auction thereafter through September 30, 2014. The average rate paid by Asante for the failed auction interest rate during the year ended September 30, 2014 was 0.084%. The rates for those failed auctions ranged between 0.180% and 0.015%.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

In May 2014, Asante repurchased \$51,325,000 of these bonds at a discount of 6.5% resulting in a gross gain of \$3,340,000. After adjusting for write-off of unamortized issue costs and transaction expenses, the net gain on repurchase was \$1,588,000. These bonds have not been retired and are being held for possible future reissue. These bonds can be retired at Asante's discretion.

(b) 2005 Series A Bonds

The Series A Bonds were issued in November 2005. The bonds were converted from seven-day auction rate bonds to fixed-rate bonds in February 2010. The bonds bear interest at a rate of 5.0%.

(c) 2010 Series Bonds

The 2010 Bonds were issued in February 2010. The bonds were issued as fixed-rate securities, with maturities beginning in 2012 and final maturity in 2040. The bonds bear interest ranging from 3.0% to 5.5%.

(d) 2011 Loan

The 2011 loan was issued during the year ending September 30, 2012 as a direct placement to fund a portion of information system installation and implementation costs. The loan has a fixed-rate with an effective interest rate of 1.92%. The loan is repaid monthly and matures in 2019.

(e) AACH Bank Loan

The loan originated in 2004 with a regional bank was used to remodel the surgical section of AACH. The loan has a fixed rate of 4.0% and the maturity date is September 2016. Currently Asante guarantees the payments.

(f) Line of Credit and Guarantees

Asante has a \$5,000,000 revolving line-of-credit arrangement with a commercial bank. The line of credit has as an interest rate of the daily LIBOR plus 0.90% (1.05% at September 30, 2014). No amounts were drawn on this line of credit as of September 30, 2014. The line of credit expires on August 15, 2015.

Asante guarantees a loan for CVI Real Property, LLC, which owns a building on the ARRCM campus. The amount of this loan was \$3,586,000 and \$3,718,000 at September 30, 2014 and 2013, respectively.

Asante has a 25% guarantee of indebtedness for CVISO Management Company, LLC. This guarantee is for an operating line of credit in an amount up to \$500,000. There was no balance outstanding on the line of credit at September 30, 2014.

Asante guarantees a loan for The Women's Center, LLC which owns a building adjacent to the ATRMC campus. The amount of this loan was \$5,584,000 at September 30, 2014.

(g) Debt Covenants

The bond indentures and other loan agreements contain, among other things, provisions placing restrictions on additional borrowings and leases and requiring the maintenance of debt service

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

coverage and other ratios. Management believes that Asante is in compliance with these covenants as of September 30, 2014.

(7) Retirement Plan

Asante sponsors the Asante Retirement Plan and Trust, a defined-contribution plan, which has two components, the Matching Plan and the Basic Plan. In the Matching Plan, Asante matches the employee's pretax contributions with \$0.50 for each dollar, capped at 3% of salary. Under the Basic Plan, Asante contributes 3% of the employee's salary to a tax deferred account. All eligible employees receive this contribution, whether or not they contribute to a tax deferred account. To be eligible for both the Basic and Matching Plans, employees must work at least one year and maintain a work level of at least 1,000 hours per year. Contributions are funded every two weeks and are fully and immediately vested. Costs related to these defined-contribution plans by Asante totaled approximately \$11,864,000 and \$10,653,714 for the years ended September 30, 2014 and 2013, respectively.

(8) Defined Benefit Pension Plan

As of August 1, 2013 Asante sponsors a noncontributory defined benefit pension plan (the Plan), covering certain AACH employees and retirees who meet requirements as specified in the Plan. The assets of the Plan are available to pay the benefits of all eligible employees of the Plan. The Plan was frozen effective December 31, 2006. No new participants have been admitted to the Plan after this date. That event did not terminate the Plan. Benefits earned before the plan was frozen will continue to be paid as participants qualify to receive the benefits.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The following table sets forth disclosures related to the Plan in accordance with FASB ASC 715-20-65, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of September 30, 2014 (in thousands):

	<u>2014</u>	<u>2013</u>
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of the year	\$ 35,860	36,128
Interest cost	1,635	274
Prior service cost	725	—
Actuarial loss (gain) on PBO, net	1,597	(542)
Projected benefit obligation at year-end	<u>\$ 39,817</u>	<u>35,860</u>
Change in fair value of plan assets:		
Fair value of assets at beginning of the year	\$ 17,348	17,312
Actual return on plan assets	1,111	179
Actuarial loss on assets	(206)	—
Benefits paid	(1,131)	(143)
Fair value of assets at end of the year	<u>\$ 17,122</u>	<u>17,348</u>
Reconciliation of funded status:		
Funded status	<u>\$ 22,695</u>	<u>18,512</u>
Net amount recognized	<u>\$ 22,695</u>	<u>18,512</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued current portion of pension benefit obligation	\$ 3,491	1,772
Accrued noncurrent portion of pension benefit obligation	19,204	16,740
Accumulated change in net assets	22,695	18,512

The accumulated benefit obligation for the Plan is the same as the projected benefit obligation at September 30, 2014 and 2013, respectively.

Net periodic benefit cost includes the following components and is included in salaries and benefits in the accompanying consolidated statements of operations and changes in net assets:

	<u>2014</u>	<u>2013</u>
Interest cost	\$ 1,635	274
Expected return on plan assets	(1,111)	(179)
Prior service cost	725	—
Recognized actuarial loss	2,934	—
Net periodic pension cost	<u>\$ 4,183</u>	<u>95</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(a) Assumptions

The Company used the following actuarial assumptions to determine its benefit obligations at September 30, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Discount rate	4.16%	4.70%

The Company used the following actuarial assumptions to determine its net periodic benefit cost for the years ended September 30, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Discount rate	4.16%	4.70%
Expected long-term rate of return on plan assets	6.25	6.25

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns of individual assets categories.

Pension plan assets are managed according to an investment policy adopted by the plan's trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plan's trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities and cash/other investments. The target allocations are:

<u>Asset class</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Target</u>
U.S. equities-large cap	—%	40%	26%
U.S. equities-mid cap	—	15	3
U.S. equities small cap	—	10	3
International developed countries	—	25	17
Emerging markets	—	10	3
U.S. core bonds	15	35	18
High yield bonds	—	6	4
International bonds	—	15	2
Alternative investments	—	25	16
Cash and cash equivalents	5	20	8

Assets are rebalanced annually when balances fall outside of the approved range for each asset class unless unusual circumstances warrant more immediate action.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

Following is a description of the valuation methodologies used for plan assets measured at fair value.

- Mutual Funds: valued based on published values
- Insurance Contract: valued by trustee based on published values or valuations of similar assets with comparable inputs, maturities and rates of return

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan 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. In accordance with FASB ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. See note 3 for the definitions of the three levels within the fair value hierarchy.

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of September 30, 2014 (in thousands).

Assets	Level 1	Level 2	Level 3	Total fair value
Cash and equivalents	\$ 357	—	—	357
Mutual funds:				
Large cap	3,741	—	—	3,741
Mid cap	402	—	—	402
Small cap	406	—	—	406
International	2,803	—	—	2,803
Fixed income	3,214	—	—	3,214
Alternative	1,818	—	—	1,818
Real estate	388	—	—	388
Insurance contract	—	3,993	—	3,993
Total plan assets at fair value	\$ 13,129	3,993	—	17,122

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of September 30, 2013 (in thousands)

Assets	Level 1	Level 2	Level 3	Total fair value
Cash and equivalents	\$ 1,786	—	—	1,786
Mutual funds:				
Large cap	1,854	—	—	1,854
Mid cap	1,920	—	—	1,920
Small cap	1,401	—	—	1,401
International	3,564	—	—	3,564
Alternative	1,721	—	—	1,721
Real estate	418	—	—	418
Commodities	117	—	—	117
Precious metals	103	—	—	103
Insurance contract	—	4,464	—	4,464
Total plan assets at fair value	\$ 12,884	4,464	—	17,348

(b) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts deemed appropriate. In fiscal 2015, Asante expects to contribute approximately \$3,600 to the Plan.

Benefit payments are expected to be paid as follows in future years (in thousands):

	Pension benefits
2015	\$ 1,327
2016	1,423
2017	1,583
2018	1,674
2019	1,765
2020	1,851
2021–2025	10,370

Expected benefit payments presented above are based on actuarial estimates. Actual benefit payments may vary significantly from these estimates. Management is not aware of any settlements or curtailments that would require additional recognition during 2014.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(9) Net Patient Service Revenue

Asante has agreements with Medicare and Medicaid programs and various other payors, which provide for payments to Asante at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare/Medicaid – Inpatient acute care services rendered to these program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The majority of Medicare outpatient services are reimbursed based on the prospective payment system known as Ambulatory Payment Classification. Asante is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by Asante and audits thereof by the third-party payors.

Adjustments from finalization and adjustment of prior years' cost reports and other third-party settlement estimates resulted in an increase (decrease) in net patient service revenues of approximately \$1,661,000 and \$(1,334,000) for the years ended September 30, 2014 and 2013, respectively.

The composition of significant third-party payors for the years ended September 30, as a percentage of gross patient service revenues, is as follows:

	2014	2013
Medicare	54%	55%
Commercial and other insurance	24	22
Medicaid	20	17
Self-pay	2	6
	<u>100%</u>	<u>100%</u>

Accounts receivable are reduced by allowances for contractually obligated deductions and for doubtful accounts. Allowances are calculated based on recent historical trends for every payor-source category. Management reviews and updates these calculations monthly. The difference between the standard rates and the amounts actually collected on patient accounts is charged off against these contractual allowances and allowances for doubtful accounts.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(10) Charity and Community Benefit

Asante provides services without charge, or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. Asante also provides services to patients covered under government programs that pay less than established costs. The estimated cost of charges foregone is determined by multiplying forgone charges by the ratio of gross operating expenses divided by gross operating revenue. The estimated cost of charges foregone for these programs, plus other educational and community programs provided at no cost at September 30, are summarized in the chart below (in thousands):

	<u>2014</u>	<u>2013</u>
Cost of charges foregone:		
Charity care services	\$ 12,372	21,432
Medicaid services, net of reimbursement	41,678	34,324
Other public services	<u>3,497</u>	<u>3,337</u>
Total charity and government programs	<u>57,547</u>	<u>59,093</u>
Cost of other programs:		
Sponsorships and donations	235	98
Community education and other	<u>15,960</u>	<u>15,303</u>
Total direct community programs	<u>16,195</u>	<u>15,401</u>
Total community benefit	<u>\$ 73,742</u>	<u>74,494</u>

In addition to the community benefit summarized above, Asante provides services to Medicare patients for which reimbursement is estimated by management to be less than cost by approximately \$54,179,000 and \$60,128,000 for the years ended September 30, 2014 and 2013, respectively.

Asante prides itself on providing high quality, accessible, and cost-effective care in all areas, thus allowing it to achieve its mission, which includes offering a broad range of health programs and services to the community. In some cases, the revenues from these needed programs do not cover the costs of the program. These programs are offered due to community need, and so reflect additional support provided by Asante to the community. Among these services are Behavioral Health programs, Obstetrics, Maternal Fetal Medicine, and Lab Outreach programs.

Sponsorships and donations include funds donated to social service and community agencies for healthcare and community related activities.

Community education includes programs offered by Asante to support and improve the quality of healthcare programs and services available to the residents of Southern Oregon and Northern California. The programs are low cost or free to participants. Examples include health programs for women and children, senior wellness services, health screenings, and immunizations.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(11) Functional Classification of Operating Expenses

The following is a summary of management's functional classification of operating expenses for the years ended September 30 (in thousands):

		<u>2014</u>	<u>2013</u>
Patient care services	\$	475,463	403,402
Support services and administrative costs		142,317	122,545
	\$	<u>617,780</u>	<u>525,947</u>

(12) Fair Value Measurements

The estimated fair value of certain assets and liabilities is reflected in the accompanying consolidated balance sheets in the following manner: the carrying amount of cash and cash equivalents, accounts receivable, inventory, accounts payable, accrued payroll, payroll taxes and related benefits, other current liabilities, and estimated reimbursement due to governmental agencies approximates fair value of these instruments due to short-term maturities. Fair values of marketable securities and assets whose use is limited are based on quoted market prices, if available, or estimated using quoted market prices for similar securities, as described in note 3.

The estimated fair value of long-term debt is shown below (in thousands):

	<u>2014</u>		<u>2013</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
Long-term debt and capital lease obligations	\$ 288,455	299,311	349,730	339,879

(13) Investments in Healthcare Ventures

Asante has the following investments in healthcare ventures at September 30 (in thousands):

	<u>Ownership</u>		<u>2014</u>	<u>2013</u>
CVI Real Property, LLC	25%	\$	416	450
CVISO Management Company, LLC	25		207	213
Grants Pass Surgery Center, LLC	35		—	87
Population Health Alliance of Oregon	14		666	—
Southern Oregon Linen Services	39		770	667
Surgery Center of Southern Oregon, LLC	20		1,090	880
The Women's Center LLC	50		406	471
Others	varies		196	346
		\$	<u>3,751</u>	<u>3,114</u>

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

The investments in these ventures are accounted for on the equity method and are included in other assets, net, in the accompanying consolidated balance sheets. Income (net) from the equity investments in joint ventures, which was \$1,570,000 and \$698,000 for the years ended September 30, 2014 and 2013, respectively, is included in other operating revenue in the accompanying consolidated statements of operations.

(14) Commitments and Contingencies

(a) *Operating Leases*

Asante leases various buildings, office space, and equipment under noncancelable operating leases. These leases expire at various times and have various renewal options. Rent expense related to these leases was \$4,242,000 and \$3,950,000 for the years ended September 30, 2014 and 2013, respectively. Future minimum lease commitments at September 30, 2014 under noncancelable operating leases with initial terms of one year or more are as follows (in thousands):

2015	\$	3,716
2016		2,577
2017		2,239
2018		2,058
2019		1,569
Thereafter		6,999

(b) *Litigation*

Asante is involved in litigation and other routine regulatory investigations arising in the ordinary course of business. In management's opinion, after consultation with legal counsel, these matters will be resolved without material adverse effect on Asante's consolidated financial position or results from operations.

(c) *Regulatory Environment*

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs, along with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that Asante is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2014 and 2013

(d) *Collective Bargaining Agreements*

Approximately 17% of Asante's employees are covered by a collective bargaining agreement. All are bedside nurses with the Oregon Nurses Association. One contract covers all of the employees in this bargaining unit, and the current contract expires June 30, 2017.

(e) *Purchase Commitments*

Asante has committed to various construction and information technology purchases, including a new electronic medical records system. As of September 30, 2014, the future commitments for these projects total approximately \$9,053,000.

(15) Subsequent Events

Asante has evaluated the impact of subsequent events through January 2, 2015, the date on which the consolidated financial statements were issued, and has determined that all subsequent events have been appropriately reflected in the accompanying consolidated financial statements.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidating Schedule – Balance Sheet Information

September 30, 2014

(In thousands)

Assets	Asante obligated group	Other affiliates	Eliminations	Consolidated total
Current assets:				
Cash and cash equivalents	\$ 43,506	1,652	—	45,158
Assets whose use is limited, current portion	10,173	—	—	10,173
Patient accounts receivable, net	77,201	9,515	—	86,716
Accrued interest and other receivables	1,246	715	—	1,961
Inventories	5,677	326	—	6,003
Prepaid expenses	5,513	356	—	5,869
Total current assets	143,316	12,564	—	155,880
Intercompany receivable (payable)	(2,297)	2,297	—	—
Assets whose use is limited:				
Restricted by donors	—	7,552	—	7,552
Held by ACH Foundation	—	1,431	—	1,431
Board-designated assets	10,173	16,076	—	26,249
Less amount required to meet current obligations	10,173	—	—	10,173
	—	25,059	—	25,059
Marketable securities	469,130	19,362	—	488,492
Property, plant, and equipment, net	292,546	29,771	—	322,317
Land held for future use	12,960	—	—	12,960
Beneficial interest in Foundation	23,498	—	(23,498)	—
Other assets, net	25,056	533	—	25,589
Total assets	\$ 964,209	89,586	(23,498)	1,030,297

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidating Schedule – Balance Sheet Information

September 30, 2014

(In thousands)

Liabilities and Net Assets	Asante obligated group	Other affiliates	Eliminations	Consolidated total
Current liabilities:				
Accounts payable	\$ 13,160	4,088	—	17,248
Payroll, payroll taxes, and related benefits	25,518	1,536	—	27,054
Self-insurance liability, current portion	7,620	2,759	—	10,379
Estimated reimbursement due to governmental agencies, net	526	940	—	1,466
Current portion of pension benefit obligation	—	3,491	—	3,491
Other current liabilities	18,282	1,610	—	19,892
Current portion of long-term and capital lease obligations	9,781	392	—	10,173
Total current liabilities	74,887	14,816	—	89,703
Long-term debt and capital lease obligations, net of current portion	270,778	7,504	—	278,282
Pension benefit obligation	—	19,204	—	19,204
Other long-term liabilities	19,891	7,050	—	26,941
Total liabilities	365,556	48,574	—	414,130
Net assets:				
Unrestricted	591,250	32,028	(16,095)	607,183
Temporarily restricted	3,628	4,379	(3,628)	4,379
Permanently restricted	3,775	4,605	(3,775)	4,605
Total net assets	598,653	41,012	(23,498)	616,167
Total liabilities and net assets	\$ 964,209	89,586	(23,498)	1,030,297

See accompanying independent auditors' report.

ASANTE HEALTH SYSTEM AND SUBSIDIARIES

Consolidating Schedule – Operations and Changes in Net Assets Information

Year ended September 30, 2014

(In thousands)

	Asante obligated group	Other affiliates	Eliminations	Consolidated total
Unrestricted revenues, gains, and other support:				
Net patient service revenue	\$ 558,219	71,145	—	629,364
Other operating revenue	11,698	2,430	(2,315)	11,813
Total revenues, gains, and other support	569,917	73,575	(2,315)	641,177
Operating expenses:				
Salaries and benefits	268,311	67,518	—	335,829
Supplies	108,108	9,815	—	117,923
Purchased services	24,070	8,431	—	32,501
Professional fees	6,496	3,615	—	10,111
Repairs and maintenance	15,036	1,043	—	16,079
Insurance	3,769	5,373	(1,478)	7,664
Rent and utilities	7,860	2,482	—	10,342
Interest	12,341	458	—	12,799
Depreciation	35,668	1,869	—	37,537
Provider tax expense	28,160	—	—	28,160
Other	7,097	1,738	—	8,835
Total operating expenses	516,916	102,342	(1,478)	617,780
Operating income (loss)	53,001	(28,767)	(837)	23,397
Nonoperating income	40,652	2,224	(110)	42,766
Excess (deficit) of revenues over expenses	93,653	(26,543)	(947)	66,163
Net asset transfer	(19,079)	19,079	—	—
Net assets released from restrictions used for purchases of property, plant, and equipment, and other	377	241	—	618
Increase (decrease) in unrestricted net assets	74,951	(7,223)	(947)	66,781
Temporarily restricted net assets:				
Contributions and investment income	2,467	2,721	(2,467)	2,721
Net assets released from restrictions	(829)	(1,064)	822	(1,071)
Increase (decrease) in temporarily restricted net assets	1,638	1,657	(1,645)	1,650
Permanently restricted net assets:				
Contributions and investment income	290	392	(289)	393
Increase (decrease) in permanently restricted net assets	290	392	(289)	393
Increase (decrease) in net assets	76,879	(5,174)	(2,881)	68,824
Net assets, beginning of year:				
Unrestricted net assets	514,833	39,245	(13,676)	540,402
Temporarily and permanently restricted net assets	6,941	6,941	(6,941)	6,941
Net assets, end of year	\$ 598,653	41,012	(23,498)	616,167

See accompanying independent auditors' report.