Mission Hospital, Inc. d/b/a
Mission Regional Medical Center

Auditor's Report and Consolidated Financial Statements

September 30, 2014 and 2013

BKD LLP
CPAs & Advisors

Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
September 30, 2014 and 2013

Contents

BKD LLP
CPAs & Advisors

2800 Post Oak Boulevard, Suite 3200 // Houston, TX 77056-6167
713.499.4600 // fax 713.499.4699 // bkd.com

Independent Auditor's Report

Board of Directors
Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
Mission, Texas

We have audited the accompanying consolidated financial statements of Mission Hospital, Inc. d/b/a Mission Regional Medical Center and its subsidiaries, which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 Mission Hospital, Inc. d/b/a Mission Regional Medical Center and its subsidiaries as of September 30, 2014 and 2013, and the results of their operations, 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.

BKD, LLP

Houston, Texas
January 29, 2015

Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
Consolidated Balance Sheets
September 30, 2014 and 2013

Assets

	2014	2013
Current Assets		
Cash and cash equivalents	$ 7,702,813	$ 6,654,927
Short-term investments	5,816,889	6,025,161
Assets limited as to use, current	418,448	433,349
Patient accounts receivable, net of allowance; 2014 - $20,107,000 2013 - $23,190,000	13,131,460	13,889,806
Supplies	1,658,525	1,636,114
Prepaid expenses and other	2,599,619	4,162,411
Estimated amounts due from third-party payers	18,979,267	8,492,293
Total current assets	50,307,021	41,294,061
Assets Limited As To Use		
Held by trustees	5,033,015	5,047,665
Internally designated	1,399,967	1,190,359
	6,432,982	6,238,024
Less amount required to meet current obligations	418,448	433,349
	6,014,534	5,804,675
Investments	4,599,472	12,224,552
Property and Equipment, At Cost		
Land and land improvements	5,080,834	5,070,454
Buildings and leasehold improvements	26,762,526	26,679,271
Equipment	83,257,106	78,900,842
Construction in progress	337,735	1,013,088
	115,438,201	111,663,655
Less accumulated depreciation	77,729,544	71,357,513
	37,708,657	40,306,142
Other Assets		
Deferred financing costs	742,631	827,525
Other	1,182,374	1,148,625
	1,925,005	1,976,150
Total assets	$ 100,554,689	$ 101,605,580

Liabilities and Net Assets

	2014	2013
Current Liabilities		
Current maturities of long-term debt	$ 2,830,000	$ 2,700,000
Accounts payable	3,511,822	3,638,999
Accrued expenses	4,828,733	4,569,254
Estimated self-insurance costs, current	131,000	143,000
Total current liabilities	11,301,555	11,051,253
Estimated Self-insurance Costs	2,226,345	2,092,485
Deferred Compensation	1,399,967	1,190,359
Long-term Debt	26,735,438	29,605,174
Total liabilities	41,663,305	43,939,271
Unrestricted Net Assets	58,891,384	57,666,309
Total liabilities and net assets	$ 100,554,689	$ 101,605,580

Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
Consolidated Statements of Operations
Years Ended September 30, 2014 and 2013

	2014	2013
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual allowances and discounts)	$ 134,787,272	$ 127,308,285
Provision for uncollectible accounts	18,766,936	19,512,370
Net patient service revenue less provision for uncollectible accounts	116,020,336	107,795,915
Other	3,432,572	4,767,335
Total unrestricted revenues, gains and other support	119,452,908	112,563,250
Expenses and Losses		
Salaries and wages	54,028,733	53,288,399
Employee benefits	13,154,697	10,144,339
Supplies and other	27,203,757	25,287,202
Purchased services and professional fees	15,718,292	14,909,265
Depreciation and amortization	6,959,891	6,601,907
Interest	1,579,897	1,676,178
Loss on disposal of property and equipment	1,281	4,847
Total expenses and losses	118,646,548	111,912,137
Operating Income	806,360	651,113
Other Income		
Investment return	377,868	368,297
Gain on investment in equity investee	40,847	74,695
Total other income	418,715	442,992
Excess of Revenues Over Expenses	$ 1,225,075	$ 1,094,105

Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2014 and 2013

	2014	2013
Net Assets, Beginning of Year	$ 57,666,309	56,572,204
Excess of Revenues Over Expenses	1,225,075	1,094,105
Net Assets, End of Year	$ 58,891,384	$ 57,666,309

Mission Hospital, Inc. d/b/a
Mission Regional Medical Center
Consolidated Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Operating Activities		
Change in net assets	$ 1,225,075	$ 1,094,105
Items not requiring (providing) cash:		
Depreciation and amortization	6,959,891	6,601,907
Provision for uncollectible accounts	18,766,936	19,512,370
Loss on disposal of property and equipment	1,281	4,847
Gain on investment in equity investee	(40,847)	(74,695)
Net loss on investments	489,853	159,803
Changes in:		
Patient accounts receivable, net	(18,008,590)	(20,348,333)
Other current assets	1,540,381	(2,947,218)
Estimated third-party payer settlements	(10,486,974)	(6,731,259)
Accounts payable and accrued expenses	463,770	1,595,736
Net cash provided by (used in) operating activities	910,776	(1,132,737)
Investing Activities		
Purchase of investments	(4,495,896)	(12,384,771)
Sales of investments	11,644,437	18,808,688
Purchases of property and equipment	(4,321,929)	(4,766,516)
Proceeds from disposal of property and equipment	3,400	18,129
Other investing activities	7,098	65,499
Net cash provided by investing activities	2,837,110	1,741,029
Financing Activities		
Borrowings under line of credit	2,000,000	-
Repayments under line of credit	(2,000,000)	-
Principal payments on long-term debt	(2,700,000)	(2,575,000)
Net cash used in financing activities	(2,700,000)	(2,575,000)
Increase (Decrease) in Cash and Cash Equivalents	1,047,886	(1,966,708)
Cash and Cash Equivalents, Beginning of Year	6,654,927	8,621,635
Cash and Cash Equivalents, End of Year	$ 7,702,813	$ 6,654,927
Supplemental Cash Flows Information		
Interest paid	$ 1,597,690	$ 1,691,688

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Mission Hospital, Inc. d/b/a Mission Regional Medical Center (the Hospital) primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Mission, Texas, and surrounding areas of the Rio Grande Valley. The Hospital's consolidated financial statements include the Hospital, Mission Doctors Group (MDG), a wholly owned subsidiary, and Mission Foundation (the Foundation). MDG primarily provides physician services to patients in Mission, Texas, and surrounding areas. The Foundation is a not-for-profit organization whose purpose is to further the work of the Hospital by establishing an ongoing program to seek, receive and manage charitable contributions. The Hospital is the Foundation's sole member.

Principles of Consolidation

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

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 the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Hospital considers all liquid investments, other than those limited as to use, with original maturities of three months or less, to be cash equivalents. Cash equivalents consist primarily of money market accounts with brokers and certificates of deposit.

At September 30, 2014 and 2013, the Hospital's cash accounts exceeded federally insured limits by approximately $1,928,000 and $3,146,000, respectively.

Investments and Investment Return

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices. Guaranteed investment contracts are valued at cost. The investments in equity investee included in other assets are accounted for under the equity method of accounting. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

Assets Limited As To Use

Assets limited as to use consists of (1) assets held by trustees under bond indenture agreements and (2) assets internally designated under the supplemental executive retirement plan agreements. Amounts required to meet current liabilities of the Hospital are included in current assets.

Patients Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Hospital's allowance for doubtful accounts for self-pay patients increased from 89 percent of self-pay accounts receivable at September 30, 2013, to 91 percent of self-pay accounts receivable at September 30, 2014. In addition, the Hospital's write-offs increased approximately $8,587,000 from approximately $12,949,000 for the year ended September 30, 2013, to approximately $21,536,000 for the year ended September 30, 2014. The Hospital increased the allowance as a percent of self-pay accounts as experience indicates more patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Buildings and improvements	10-40 years
Leasehold improvements	10 years
Equipment	3-20 years

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Long-lived Asset Impairment

The Hospital evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended September 30, 2014 and 2013.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Operating Income

The Hospital uses operating income as an intermediate reporting measure on the consolidated statements of operations. Amounts excluded from operating income include investment return and gains and losses from investments in equity investee.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Professional Liability Claims

The Hospital recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in Note 6.

Self Insurance

The Hospital has elected to self-insure certain costs related to employee health programs. Costs resulting from noninsured losses are charged to income when incurred. The Hospital has purchased insurance that limits its exposure to claims exceeding $300,000 per covered person with a maximum insurance reimbursement of $2,000,000 per covered person.

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period ending date.

Income Taxes

The Hospital, Foundation and MDG are exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, these companies are subject to federal income tax on any unrelated business taxable income.

The Hospital, Foundation and MDG file tax returns in the U.S. Federal jurisdiction. With a few exceptions, the Hospital, Foundation and MDG are no longer subject to U.S. Federal examinations by tax authorities for years before 2011.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to three years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services (CMS). Payment under both programs are contingent on a hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognizes revenue under the grant accounting model using the cliff recognition approach. Under this approach, revenue is recognized once meaningful use status has been met for the full reporting period.

The Hospital has recorded revenue from these programs of approximately $1,633,000 and $3,225,000 for 2014 and 2013, respectively, which is included in other revenue within operating revenues in the consolidated statements of operations.

Note 2: Net Patient Service Revenue

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the consolidated statements of operations as a component of net patient service revenue.

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include those shown on the following page.

Medicare. Substantially all inpatient acute care, inpatient rehabilitation and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare administrative contractor.

Medicaid. Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge based on the patient's acuity. Outpatient services rendered to Medicaid program beneficiaries are paid using a mixture of cost-based and fee-schedule methodologies. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid administrative contractor.

During 2013, the CMS issued the new supplemental security income ratio used for calculating Medicare disproportionate share hospital reimbursement for the federal fiscal year ended September 30, 2011. The impact of this updated Medicare reimbursement estimate was a decrease in revenues of approximately $526,000 for the year ended September 30, 2013.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. Settlements under reimbursement agreements with Medicare and Medicaid programs are estimated and recorded in the period the related services are rendered and are adjusted in future periods as adjustments become known or as the service years are no longer subject to audit, review or investigation. Annual cost reports required under the Medicare and Medicaid programs are subject to routine audits, which may result in adjustments to the amounts ultimately determined to be due to the Hospital under the reimbursement programs. These audits often require several years to reach their final determination of amounts earned under the programs. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers and managed care providers. The basis for payment to the Hospital under these agreements includes discounts from established charges and prospectively determined daily rates.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized for the years ended September 30, 2014 and 2013, is as shown on the following page.

	2014	2013
Medicare	$ 54,173,055	$ 56,515,149
Medicaid	38,278,782	29,875,146
Other third-party payers	23,979,738	20,098,923
Self-pay	18,355,697	20,819,067
	$ 134,787,272	$ 127,308,285

During the federal fiscal year 2012, the State of Texas implemented a Section 1115(a) Medicaid Waiver program, which substantially replaced the previous upper payment limit program. Under this waiver, hospitals are paid supplemental funds for uncompensated care costs and delivery system improvement projects. Payments are based on approved uncompensated costs and delivery system improvement projects, with Hidalgo County, Texas (the County), providing inter-governmental transfer (IGT) payments that are eligible for federal match. The IGT funds provided by the County for these programs originate, in part, from the County's general tax revenues and, in part, from Local Provider Participation Fund (LPPF) assessments paid by all acute care hospitals in the County. The Hospital recognized as a component of supplies and other expense LPPF assessment expense of approximately $1,880,000 and $1,750,000 for the years ended September 30, 2014 and 2013, respectively.

The Hospital recognized as a component of net patient service revenue approximately $20,533,000 and $17,468,000 under the waiver and Medicaid disproportionate share for the years ended September 30, 2014 and 2013, respectively.

Note 3: Concentrations of Credit Risk

Accounts Receivable

The Hospital grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at September 30, 2014 and 2013, is as follows:

	2014	2013
Medicare	47%	45%
Medicaid	13%	20%
Other third-party payers	15%	15%
Patients	25%	20%
	100%	100%

Note 4: Investments and Investment Return

Assets Limited As To Use

Assets limited as to use, at September 30, include:

	2014	2013
Held by trustees under indenture agreements:		
Guaranteed investment contracts	$ 2,357,253	$ 2,357,253
Money market accounts	2,675,762	2,690,412
	5,033,015	5,047,665
Internally designated:		
Mutual funds	1,399,967	1,190,359
	$ 6,432,982	$ 6,238,024

Other Investments

Other investments include the items shown below:

	2014	2013
Mutual funds	$ 413,420	$ 368,589
Certificates of deposit	143,632	148,450
Corporate bonds	6,488,827	12,533,156
Government obligations	3,294,106	5,029,898
Interest receivable	76,376	169,620
	10,416,361	18,249,713
Less long-term investments	4,599,472	12,224,552
Short-term investments	$ 5,816,889	$ 6,025,161

Total investment return is comprised of the following:

	2014	2013
Interest and dividend income	$ 867,721	$ 528,100
Realized gains (loss)	(93,695)	260,280
Unrealized loss	(396,158)	(420,083)
	$ 377,868	$ 368,297

Note 5: Investments in Joint Ventures

The Hospital has entered into joint venture agreements known as Mission Specialty Center Joint Venture d/b/a East Mission Medical Office Venture (Venture I), East Mission Doctors Plaza Condominium Owners Association (Venture II) and West Mission Medical Office, LLC (Venture III) (collectively, the Ventures). The Hospital owns a one-third interest in Ventures I and II and a 25 percent interest in Venture III. Venture I constructed a medical office building. Venture II was established for real estate and facility development for medical and doctor services. Venture III was created for construction and operation of a medical office building. The Hospital leases space in the office buildings from the Ventures under leases accounted for as operating leases. Rent expense paid by the Hospital to the Ventures was approximately $589,000 and $594,000 for the years ended September 30, 2014 and 2013, respectively. The Hospital also owns a 10 percent interest in Assisted Living Partnership, II d/b/a The Bridges at Mission, which owns and operates a facility near the Hospital's campus. The Hospital's investments in these entities are accounted for under the equity method.

Note 6: Professional Liability Claims

The Hospital is self-insured for the first $2,000,000 of each medical malpractice claim. The Hospital purchases commercial insurance coverage above the self-insurance limits. Losses from asserted and unasserted claims identified under the Hospital's incident reporting system are accrued based on estimates that incorporate the Hospital's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. It is reasonably possible that the Hospital's estimate of losses will change by a material amount in the near term.

Activity in the Hospital's accrued medical malpractice claims liability during 2014 and 2013 is summarized below:

	2014	2013
Balance, beginning of year	$ 2,235,485	$ 2,401,042
Current year claims incurred and changes in estimates for prior years	121,860	(165,557)
Balance, end of year	$ 2,357,345	$ 2,235,485

Note 7: Long-term Debt

	2014	2013
Revenue bonds (A)	$ 8,405,000	$ 9,855,000
Revenue bonds (B)	9,465,000	10,035,000
Revenue bonds (C)	11,360,000	12,040,000
	29,230,000	31,930,000
Add unamortized bond premium	335,438	375,174
	29,565,438	32,305,174
Less current maturities	2,830,000	2,700,000
	$ 26,735,438	$ 29,605,174

(A) Series 2005 Hidalgo County Health Services Corporation Hospital Revenue Bonds (the 2005 Bonds) in the original amount of $19,585,000 with a net premium of $294,284, dated February 1, 2005, bearing interest at rates ranging from 3.50 percent to 5.00 percent. The 2005 Bonds are due in annual installments of principal through August 15, 2019, including mandatory sinking fund payments. Interest is paid semi-annually. All of the 2005 Bonds still outstanding may be redeemed at the Hospital's option on or after February 15, 2014, at face value.

The Hidalgo County Health Services Corporation issued the 2005 Bonds on behalf of the Hospital. The 2005 Bonds are secured by a pledge of the Hospital's revenues, the reserve funds established with the bond trustee pursuant to the loan agreement and bond indenture, and a mortgage lien on the land and buildings constituting the main campus of the Hospital.

(B) Series 2007 Hidalgo County Health Services Corporation Hospital Revenue Bonds (the 2007 Bonds) in the original amount of $12,645,000 with a net premium of $254,056, dated March 1, 2007, bearing interest at rates ranging from 4.00 percent to 5.00 percent. The 2007 Bonds are due in annual installments of principal through August 15, 2026. Interest is paid semi-annually. All of the 2007 Bonds still outstanding may be redeemed at the Hospital's option on or after August 15, 2017, at face value.

The Hidalgo County Health Services Corporation issued the 2007 Bonds on behalf of the Hospital. The 2007 Bonds are secured by a pledge of the Hospital's revenues, the reserve funds established with the bond trustee pursuant to the loan agreement and bond indenture, and a mortgage lien on the land and buildings constituting the main campus of the Hospital. The purpose of the 2007 Bonds was to advance refund a portion of the 1996 Series Hospital Revenue Bonds (1996 Bonds).

(C) Series 2008 Hidalgo County Health Services Corporation Hospital Revenue Bonds (the 2008 Bonds) in the original amount of $15,155,000 with a net premium of $121,437, dated May 12, 2008, bearing interest at 5.00 percent. The 2008 Bonds are due in annual installments of principal through August 15, 2026. Interest is paid semi-annually. All of the 2008 Bonds still outstanding may be redeemed at the Hospital's option on or after August 15, 2017, at face value.

The Hidalgo County Health Services Corporation issued the 2008 Bonds on behalf of the Hospital. The 2008 Bonds are secured by a pledge of the Hospital's revenues, the reserve funds established with the bond trustee pursuant to the loan agreement and bond indenture, and a mortgage lien on the land and buildings constituting the main campus of the Hospital. The purpose of the 2008 Bonds was to refund a portion of the 1996 Bonds.

The bond indenture and loan agreements require that certain funds be established with a trustee. Accordingly, these funds are included as assets limited as to use held by trustees in the consolidated financial statements. The agreements also require the Hospital to comply with certain restrictive covenants, including minimum insurance coverage, maintaining a maximum annual debt-service coverage ratio of at least 1.10, and restrictions on the incurrence of additional debt and disposition of assets.

Aggregate annual maturities of long-term debt at September 30, 2014, are:

2015	$	2,830,000
2016		2,975,000
2017		3,120,000
2018		3,275,000
2019		3,430,000
Thereafter		13,600,000
	$	29,230,000

Note 8: Charity Care

The Hospital's direct and indirect costs for services furnished under its charity care policy aggregated approximately $8,310,000 and $8,110,000 in 2014 and 2013, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

Note 9: Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	2014	2013
Health care services	$ 95,061,906	$ 91,463,102
General and administrative	23,584,642	20,449,035
	$ 118,646,548	$ 111,912,137

Note 10: Pension Plan

The Hospital has a defined contribution 403(b) pension plan covering substantially all employees. The Hospital provides matching contributions for a participant's elective deferrals, Roth 403(b) contributions and each participant's contribution equal to 33.3 percent of up to 3.0 percent of a participant's compensation.

The Hospital also sponsors a defined contribution supplemental executive retirement plan (the plan) covering certain members of senior management. Contributions to the plan are determined annually by the Board of Directors in accordance with the plan's documents.

Pension expense for both plans was approximately $559,000 and $402,000 for 2014 and 2013, respectively.

Note 11: Related-party Transactions

The Hospital is party to a cooperative agreement (the Agreement) with the County and five local hospital systems in the County to fund the physician and pharmacy costs paid through an indigent care program of the County. As part of the County's indigent care program, certain uncompensated care payments under the Medicaid 1115 Waiver program (see Note 2) are contingent on the County making an IGT. The Hospital contributed approximately $522,000 and $411,000 to the County during the years ended September 30, 2014 and 2013, respectively, which are reflected as a component of purchased services in the consolidated statements of operations.

Note 12: Disclosures About Fair Value of Financial Instruments

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy where the fair value measurements fall at September 30, 2014 and 2013.

		Fair Value Measurement Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2014:				
Money market mutual funds	$ 5,278,011	$ 5,278,011	$ -	$ -
Mutual funds	1,813,387	1,813,387	-	-
Corporate bonds	6,488,827	4,280,731	2,157,471	50,625
U.S. Treasury obligations	2,070,350	2,070,350	-	-
U.S. agency obligations	1,223,756	-	1,223,756	-
September 30, 2013:				
Money market mutual funds	2,395,524	2,395,524	-	-
Mutual funds	1,558,948	1,558,948	-	-
Corporate bonds	12,533,156	9,990,931	2,477,225	65,000
U.S. Treasury obligations	3,630,597	-	3,630,597	-
U.S. agency obligations	1,399,301	205,704	1,193,597	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended September 30, 2014.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include mutual funds, corporate bonds and government obligations. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include corporate and government obligations. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Hospital did not hold any significant Level 3 securities at September 30, 2014 and 2013.

Quoted market prices were used to determine the fair value of Level 1 items listed previously. For Level 2 investments, inputs include maturity and coupon rates and/or closing prices of similar securities from comparable industry financial data.

Fair Value of Financial Instruments

The following table presents estimated fair values of the Hospital's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2014 and 2013:

		Fair Value Measurements Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2014:				
Financial assets:				
Cash and cash equivalents	$ 7,702,813	$ 7,702,813	$ -	$ -
Investments and assets limited as to use	16,849,343	11,060,238	3,381,227	2,407,878
Financial liabilities:				
Long-term debt	29,565,438	-	29,613,400	-

	Carrying Amount	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013:				
Financial assets:				
Cash and cash equivalents	$ 6,654,927	$ 6,654,927	$ -	$ -
Investments and assets limited as to use	24,487,737	14,764,065	7,301,419	2,422,253
Financial liabilities:				
Long-term debt	32,305,174	-	32,039,375	-

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents

The carrying amount approximates fair value.

Certificates of Deposit and Guaranteed Investment Contracts

Amortized cost approximates fair value.

Long-term Debt

Fair value is estimated based on the borrowing rates currently available to the Hospital for debt with similar terms and maturities.

Note 13: 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 revenue are described in Notes 1 and 2.

Professional Liability Claims

Estimates related to the accrual for professional liability claims are described in Notes 1 and 6.

Investments

The Hospital 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.

Employee Health Claims

Estimates related to the accrual for self-insured employee health claims are discussed in Note 1.

Note 14: Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (PPACA) is substantially reforming the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation required the establishment of health insurance exchanges, which provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, are being substantially decreased. Each state's participation in an expanded Medicaid program is optional.

The State of Texas has currently indicated it will not expand the Medicaid program, which may result in revenues from newly covered individuals not offsetting the Hospital's reduced revenue from other Medicare/Medicaid programs.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible it will have a negative impact on the Hospital's net patient service revenue. In addition, it is possible the Hospital will experience payment delays and other operational challenges during PPACA's implementation.

Note 15: Commitments and Contingencies

Guarantees

The Hospital and its joint venture partners have guaranteed debt related to medical office buildings owned by the joint ventures (Note 5). The total debt outstanding subject to those guarantees was approximately $1,466,000 at September 30, 2014.

Litigation

In the normal course of business, the Hospital 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 Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital 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.

Note 16: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were issued.