

Muhlenberg Regional Medical Center, Inc.

Consolidated Financial Statements

December 31, 2012 and 2011



Muhlenberg Regional Medical Center, Inc.

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Independent Auditors' Report

Board of Directors
Muhlenberg Regional Medical Center, Inc.

We have audited the accompanying consolidated financial statements of Muhlenberg Regional Medical Center, Inc. ("MRMC"), which comprise the consolidated balance sheet as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net deficit, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 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 Muhlenberg Regional Medical Center, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

ParenteBeard LLC

Clark, New Jersey
April 29, 2013

Muhlenberg Regional Medical Center, Inc.Consolidated Balance Sheet
December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> | | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|--|----------------------|----------------------|
| Assets | | | Liabilities and Net Deficit | | |
| Current Assets | | | Current Liabilities | | |
| Cash and cash equivalents | \$ 338,684 | \$ 1,651,563 | Current installment of long-term debt | \$ 271,678 | \$ - |
| Accounts receivable, patients (net of estimated allowance for doubtful collections of \$128,000 in 2012 and \$166,000 in 2011) | - | - | Accounts payable | 360,681 | 312,868 |
| Prepaid expenses and other current assets | 372,828 | 428,523 | Accrued expenses | 102,742 | 116,101 |
| Due from affiliates | 205,093 | 244,474 | Estimated third-party payor settlements | 3,539,889 | 4,431,325 |
| | | | Accrued postretirement benefits | 96,425 | 116,472 |
| Total current assets | 916,605 | 2,324,560 | Total current liabilities | 4,371,415 | 4,976,766 |
| Assets Whose Use is Limited | 1,949,144 | 1,826,564 | Long-Term Debt | 17,003,322 | 17,275,000 |
| Interest in Net Assets of Muhlenberg Foundation, Inc. | 9,677,814 | 9,446,030 | Estimated Third-Party Payor Settlements | 4,423,336 | 2,937,494 |
| Property and Equipment, Net | 13,417,795 | 14,167,434 | Accrued Pension Cost | 12,463,613 | 15,000,469 |
| Deferred Financing Costs, Net | 359,952 | 391,957 | Accrued Postretirement Benefits | 140,701 | 231,095 |
| Due from Affiliates | 34,713 | 32,762 | Deferred Compensation | 36,996 | 36,334 |
| Other Assets | 811,189 | 355,971 | Due to Affiliates | 41,938,173 | 41,938,173 |
| Beneficial Interest in Perpetual Trusts | 2,441,020 | 2,261,137 | Total liabilities | 80,377,556 | 82,395,331 |
| | | | Net Deficit | | |
| | | | Unrestricted | (64,438,538) | (64,883,131) |
| | | | Temporarily restricted | 5,914,620 | 5,864,831 |
| | | | Permanently restricted | 7,754,594 | 7,429,384 |
| | | | Total net deficit | (50,769,324) | (51,588,916) |
| Total assets | <u>\$ 29,608,232</u> | <u>\$ 30,806,415</u> | Total liabilities and net deficit | <u>\$ 29,608,232</u> | <u>\$ 30,806,415</u> |

See notes to consolidated financial statements

Muhlenberg Regional Medical Center, Inc.Consolidated Statement of Operations
Years Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|------------------|
| Unrestricted Revenues, Gains, and Other Support | | |
| Other revenues | \$ 2,799,247 | \$ 2,980,457 |
| Net assets released from restrictions for use in operations | <u>95,414</u> | <u>97,062</u> |
| Total unrestricted revenues, gains, and other support | <u>2,894,661</u> | <u>3,077,519</u> |
| Expenses | | |
| Salaries and wages | 952,412 | 1,189,578 |
| Employee benefits | 38,274 | 131,509 |
| Supplies and expenses | 2,505,212 | 2,543,735 |
| Provision for doubtful collections | - | 107,719 |
| Depreciation and amortization | 499,183 | 532,144 |
| Interest | <u>933,006</u> | <u>933,006</u> |
| Total expenses | <u>4,928,087</u> | <u>5,437,691</u> |
| Operating loss | (2,033,426) | (2,360,172) |
| Gain (Loss) on Sale of Property | 44,152 | (30,909) |
| Investment Income | 91,571 | 257,159 |
| Change in Net Unrealized Gains on Trading Securities | <u>99,609</u> | <u>(170,037)</u> |
| Revenues less than expenses | (1,798,094) | (2,303,959) |
| Pension/Postretirement Liability Adjustment | 309,718 | (417,918) |
| Transfer from Affiliate | 2,454,441 | 3,006,689 |
| Net Assets Released from Restrictions for Capital Purchases | <u>-</u> | <u>28,275</u> |
| Decrease in Unrestricted Net Deficit from Continuing Operations | 966,065 | 313,087 |
| Loss from Discontinued Operations | <u>(521,472)</u> | <u>(287,218)</u> |
| Decrease in unrestricted net deficit | <u>\$ 444,593</u> | <u>\$ 25,869</u> |

See notes to consolidated financial statements

Muhlenberg Regional Medical Center, Inc.Consolidated Statement of Changes in Net Deficit
Years Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|------------------------|------------------------|
| Unrestricted Net Deficits | | |
| Revenues less than expenses | \$ (1,798,094) | \$ (2,303,959) |
| Pension/postretirement liability adjustment | 309,718 | (417,918) |
| Transfer from affiliate | 2,454,441 | 3,006,689 |
| Net assets released from restrictions for capital purchases | <u>-</u> | <u>28,275</u> |
| Decrease in unrestricted net deficit from continuing operations | 966,065 | 313,087 |
| Loss from discontinued operations | <u>(521,472)</u> | <u>(287,218)</u> |
| Decrease in unrestricted net deficit | <u>444,593</u> | <u>25,869</u> |
| Temporarily Restricted Net Assets | | |
| Change in interest in net assets of Muhlenberg Foundation, Inc. | 86,457 | (196,539) |
| Transfers from affiliates | 95,414 | 125,337 |
| Investment (loss) income | (36,668) | 15,474 |
| Net assets released from restrictions for use in operations | (95,414) | (97,062) |
| Net assets released from restrictions for capital purchases | <u>-</u> | <u>(28,275)</u> |
| Increase (decrease) in temporarily restricted net assets | <u>49,789</u> | <u>(181,065)</u> |
| Permanently Restricted Net Assets | | |
| Change in interest in net assets of Muhlenberg Foundation, Inc. | 145,327 | (23,233) |
| Change in valuation of beneficial interest in perpetual trusts | <u>179,883</u> | <u>(90,638)</u> |
| Increase (decrease) in permanently restricted net assets | <u>325,210</u> | <u>(113,871)</u> |
| Decrease (increase) in net deficit | 819,592 | (269,067) |
| Net Deficit | | |
| Beginning of year | <u>(51,588,916)</u> | <u>(51,319,849)</u> |
| End of year | <u>\$ (50,769,324)</u> | <u>\$ (51,588,916)</u> |

See notes to consolidated financial statements

Muhlenberg Regional Medical Center, Inc.

Consolidated Statement of Cash Flows

Years Ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Cash Flows from Operating Activities | | |
| Decrease (increase) in net deficit | \$ 819,592 | \$ (269,067) |
| Adjustments to reconcile decrease (increase) in net deficit to net cash used in operating activities: | | |
| Depreciation | 467,178 | 500,139 |
| Amortization | 32,005 | 32,005 |
| (Gain) loss on sale of property and equipment | (44,152) | 30,909 |
| Loss on impairment | 295,055 | 607,570 |
| Transfers from affiliates | (2,549,855) | (3,132,026) |
| Change in valuation of beneficial interest in perpetual trusts | (179,883) | 90,638 |
| Net realized and unrealized (gains) and losses | (103,290) | 38,687 |
| Recoveries of doubtful collections | (147,881) | (223,270) |
| Pension/postretirement liability adjustment | (309,718) | 417,918 |
| Change in net deficit: | | |
| Accounts receivable, patients | 147,881 | 950,854 |
| Prepaid expenses and other current assets | 55,695 | (345,603) |
| Other assets | (455,218) | (97,953) |
| Due from/to affiliates | 2,491,871 | 402,744 |
| Accounts payable | 47,813 | (341,431) |
| Accrued expenses | (13,359) | (734,996) |
| Estimated third-party payor settlements | 594,406 | (25,533) |
| Accrued pension cost | (2,227,138) | (986,519) |
| Accrued postretirement benefits | (110,441) | (1,164,669) |
| Deferred compensation | 662 | (73,917) |
| Net cash used in operating activities | <u>(1,188,777)</u> | <u>(4,323,520)</u> |
| Cash Flows from Investing Activities | | |
| Purchase of property and equipment | (12,594) | (13,333) |
| Decrease (increase) in investments and assets whose use is limited | (19,290) | 304,454 |
| Net proceeds from sale of property and equipment | 44,152 | 3,896,882 |
| Change in interest in net assets of Mulenberg Foundation, Inc. | <u>(231,784)</u> | <u>219,772</u> |
| Net cash (used in) provided by investing activities | <u>(219,516)</u> | <u>4,407,775</u> |
| Cash Flows from Financing Activities | | |
| Transfers from affiliates | <u>95,414</u> | <u>125,337</u> |
| Net cash provided by financing activities | <u>95,414</u> | <u>125,337</u> |
| (Decrease) increase in cash and cash equivalents | (1,312,879) | 209,592 |
| Cash and Cash Equivalents, Beginning | <u>1,651,563</u> | <u>1,441,971</u> |
| Cash and Cash Equivalents, Ending | <u>\$ 338,684</u> | <u>\$ 1,651,563</u> |
| Supplemental Disclosure of Cash Flow Information | | |
| Interest paid | <u>\$ 933,006</u> | <u>\$ 933,006</u> |
| Transfer from affiliates in the form of forgiveness of related liabilities | <u>\$ 2,454,441</u> | <u>\$ 3,006,689</u> |

See notes to consolidated financial statements

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
December 31, 2012 and 2011

1. Organizational Structure and Nature of Operations

Muhlenberg Regional Medical Center, Inc. ("MRMC") is a not-for-profit, controlled entity of JFK Health System, Inc. ("JFK Health System"). MRMC was a 355-bed acute care medical center located in Plainfield, New Jersey. MRMC was established and is operated for the promotion of health. On February 21, 2008, the JFK Health System Board of Directors voted to immediately authorize the filing of a certificate of need ("CON") application to close MRMC. The CON application was approved on July 29, 2008 and MRMC was closed on August 13, 2008. See Note 19. In August 2008, the acute hospital at MRMC was closed and only the School of Nursing and School of Radiology and a few small outpatient services remained opened under MRMC through December 31, 2008. The Emergency Room operation was transferred to The Community Hospital Group, Inc. d/b/a JFK Medical Center during 2008, and then the School of Nursing and School of Radiology were transferred to The Community Hospital Group, Inc. d/b/a JFK Medical Center during 2009.

On December 31, 2010 MRMC formed a joint venture with Meridian Healthcare to establish the new organization, JFK Meridian Home Care Services LLC dba JFK at Home. JFK at Home is a Home Health Care provider. MRMC has 50% ownership in the joint venture which is accounted for on the equity method of accounting. As of December 31, 2012 and 2011, the investment was \$811,189 and \$355,971, respectively, and included in other assets on the consolidated balance sheet.

During 2007, the Muhlenberg Foundation, Inc. (the "Foundation") transferred to MRMC a pledge which included the Midtown Shops property ("the property"). Once MRMC closed on the property, Midtown Shops became a wholly-owned MRMC subsidiary. On June 30, 2011, the property, which had a carrying value of approximately \$3,928,000, was sold for \$4,010,000, and a loss on sale of \$30,909, net of closing costs, was recorded in the consolidated statement of operations as of December 31, 2011.

Other controlled entities of JFK Health System include: The Community Hospital Group, Inc. d/b/a JFK Medical Center ("JFK Medical Center"); John F. Kennedy Medical Center Foundation, Inc.; Muhlenberg Foundation, Inc. (the "Foundation"); Lifestyle Institute, Inc.; JFK Healthshare, Inc.; Hartwyck at JFK, Inc.; Hartwyck West Nursing Home, Inc. and affiliates; Hartwyck at Oak Tree, Inc. ("Oak Tree"); and Atlantic Insurance Exchange, Ltd., a wholly-owned insurance company.

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Basis of Reporting

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of MRMC as a going concern. In August 2008, the acute hospital at MRMC was closed and through December 31, 2009 all operations were transferred to JFK Medical Center except for the Home Health Department which was sold in 2010. As shown in the accompanying consolidated financial statements, during 2012 MRMC's revenues less than expenses were approximately (\$1,798,000). Its working capital deficiency was approximately \$3,455,000 at December 31, 2012. As of December 31, 2012, MRMC had over \$17 million owed in long-term debt and \$42 million owed to affiliates with only \$2.3 million in cash, investments, and assets whose use is limited. JFK Health System has committed to funding all obligations and cash flow requirements of MRMC. JFK Health System has also retained a consultant to assess the organization and operations and develop a strategic plan for JFK Health System.

In July 2009, JFK Health System issued \$152,925,000 to the obligated group including JFK Medical Center, MRMC and Oak Tree, Series 2009 A-1 Bonds ("Series of 2009 A-1 Bonds") under the State of New Jersey Hospital Asset Transformation Program ("HATP") which refinanced the MRMC bonds. The Series 2009 A-1 Bonds were issued in connection to the termination of then acute care services at MRMC and to provide funds for various capacity expansion and capital improvement projects for JFK Health System in connection with the MRMC acute hospital closing. Principal payment of \$271,678 is due October 1, 2013 and is included in current installment of long-term debt.

On April 1, 2009, JFK Health System Board of Directors approved an amendment to freeze the JFK Health System Cash Balance Retirement Plan effective May 3, 2009. No additional employees will be eligible to become a participant of the Plan after that date. Service credits of participants were also frozen as of May 3, 2009, but participants of the Plan will continue to earn interest credits.

During 2011, MRMC approved phasing out the medical post-retirement benefits.

JFK Health System will provide the opportunity for MRMC to continue its remaining operations as a going concern. The consolidated financial statements do not include any adjustments that might be necessary if MRMC is unable to continue as a going concern.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of MRMC and its wholly-owned subsidiary Midtown Shops through the date of sale on June 30, 2011 (see Note 1). All significant intercompany balances and transactions have been eliminated.

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
December 31, 2012 and 2011

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.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt investments purchased with an original maturity of three months or less, excluding investments and assets whose use is limited.

Assets Whose Use is Limited

Assets whose use is limited include assets set aside under deferred compensation plans and assets restricted by donor and consists of cash and cash equivalents, mutual funds, marketable equity securities and corporate bonds and are carried at fair value.

Interest in Net Assets of Muhlenberg Foundation, Inc.

MRMC and the Foundation are financially interrelated organizations. MRMC recognizes its rights to the assets held by the Foundation as interest in net assets of Muhlenberg Foundation, Inc. in the accompanying consolidated balance sheet unless the Foundation has been granted variance power. MRMC adjusts that interest for its share of the change in the net assets of the Foundation as a change in temporarily or permanently restricted net assets, depending upon type of donor restriction, in the accompanying consolidated statement of changes in net assets. Amounts will be distributed to MRMC when donor restrictions are met.

Beneficial Interest in Perpetual Trusts

Under perpetual trust arrangements, MRMC has recorded the asset and has recognized permanently restricted contribution revenue at the fair value of MRMC's beneficial interest in the trust assets. Income earned on the trust assets and distributed to MRMC is recorded as investment income in the accompanying statement of operations, unless otherwise restricted by the donor. Subsequent changes in fair values are recorded as change in valuation of beneficial interest in perpetual trusts in permanently restricted net assets.

Pursuant to the terms of the instruments creating such perpetual trusts, MRMC and Muhlenberg Foundation have no legal right to direct the application of the assets and even though these assets are reported in the accompanying consolidated balance sheet, they are subject to the jurisdiction of the court. With the closure of MRMC's hospital the perpetual trusts are all being reviewed, however, the possible future financial effects, if any, are not presently determinable.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated property and equipment are recorded at fair market value at the date of receipt. Depreciation is computed using the straight-line method based on estimated useful lives ranging from 3 to 40 years.

Muhlenberg Regional Medical Center, Inc.

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

Impairment of Long-Lived Assets

MRMC reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

Deferred Financing Costs

Deferred financing costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the term of the debt using an effective interest method. Amortization amounted to \$32,005 in 2012 and 2011. Accumulated amortization of deferred financing costs at December 31, 2012 and 2011 totaled \$128,021 and \$96,016, respectively.

Revenues Less Than Expenses

The consolidated statement of operations includes the determination of revenues less than expenses. Changes in unrestricted net assets which are excluded from the determination of revenues less than expenses, consistent with industry practice, include, pension liability adjustment, permanent transfers of assets to and from subsidiaries for other than goods and services, loss from discontinued operations and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Other Revenues

Other revenues consists of rental income from JFK Medical Center (see Note 18) and gains on investment in joint venture recorded under the equity method of accounting.

Functional Expenses

MRMC expenses are related to maintenance of the campus and continued operations. During 2012 and 2011, the functional classification of expenses are general and administrative.

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
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Income Taxes

MRMC is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its exempt income under Section 501(a) of the Code.

MRMC accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold in 2012 or 2011.

MRMC's federal Tax Exempt Organization Business Income Tax Returns are no longer subject to examination by the Internal Revenue Service for years before 2009.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents approximate fair value at December 31, 2012 and 2011.

Investments and assets whose use is limited are stated at fair value, which are the amounts reported in the consolidated balance sheet, based on quoted market prices, if available, or estimated using quoted market prices of similar securities.

Beneficial interest in perpetual trust are valued using discounted cash flow methodologies.

Long-term debt fair value is calculated based on quoted market prices, if available, or estimated using quoted market prices of similar securities.

Postretirement Benefits

MRMC accounts for postretirement benefits on an accrual basis. Postretirement benefits include reimbursement to qualified retirees for a portion of their health and life insurance costs.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by MRMC 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 MRMC in perpetuity.

Subsequent Events

MRMC evaluated subsequent events for recognition or disclosure through April 29, 2013, the date the financial statements were issued.

New Accounting Pronouncement

Fair Value Measurement and Disclosure

In May 2011, the FASB issued updated guidance related to fair value measurements and disclosures. The updated guidance includes new and clarified guidance on fair value measurements (highest and best use, equity instruments, managed net portfolio positions, and application of premiums and discounts) and disclosure (quantitative information, valuation processes and sensitivity of unobservable inputs, assets not in highest and best use, and assets not measured at fair value). The adoption of the amended guidance required certain additional disclosures in the notes to MRMC's financial statements.

3. Net Patient Service Revenue Audits

MRMC had agreements with third-party payors that provided for payments to MRMC at amounts different from its established rates. A significant portion of MRMC's net patient service revenues were derived from these third-party payor programs. A summary of the principal payment arrangements with major third-party payors follows:

- Medicare: Prior to August 2008, inpatient acute care services and outpatient services rendered to Medicare program beneficiaries were paid at prospectively determined rates. These rates varied according to patient classification systems that were based on clinical, diagnostic, and other factors. In addition, MRMC was reimbursed for certain cost reimbursable items at tentative interim rates, with final settlement determined after submission of annual cost reports by MRMC and audits thereof by the Medicare fiscal intermediary. MRMC's Medicare cost reports have been settled by the Medicare fiscal intermediary through December 31, 2004.
- Medicaid: Prior to August 2008, inpatient acute care services rendered to Medicaid program beneficiaries were paid at prospectively determined rates per discharge. These rates varied according to a patient classification system that was based on clinical, diagnostic, and other factors. Inpatient nonacute services were paid at prospectively determined per diem rates. Outpatient services were paid based on a published fee schedule, with final settlement determined after submission of annual cost reports. The Medicaid cost reports have been settled through December 31, 2008.

Revenue received under third-party arrangements continues to be subject to audit and retroactive adjustment. During 2012 and 2011, there were net favorable adjustments of \$1,164,475 and \$212,754, respectively. These adjustments are related to final settlements of prior year cost reports and other settlements and are recorded within net patient service revenues of discontinued operations.

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
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4. Assets Whose Use Is Limited

The composition of investments and assets whose use is limited at December 31, 2012 and 2011 is set forth in the following table:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Assets Whose Use is Limited | | |
| Under deferred compensation plans: | | |
| Cash and cash equivalents | \$ 30,214 | \$ 30,432 |
| Mutual funds – equities | 6,782 | 5,902 |
| Total under deferred compensation plans | <u>36,996</u> | <u>36,334</u> |
| Donor restricted: | | |
| Cash and cash equivalents | 282,225 | 240,401 |
| Mutual funds – fixed income | 840,023 | 748,223 |
| Mutual funds – equities | 444,203 | 351,462 |
| Marketable equity securities | 161,528 | 135,309 |
| Corporate bonds | 184,169 | 314,835 |
| Total donor restricted | <u>1,912,148</u> | <u>1,790,230</u> |
| Noncurrent portion of assets whose use is limited | <u>\$ 1,949,144</u> | <u>\$ 1,826,564</u> |

Unrestricted investment income, gains and losses for assets whose use is limited, and cash and cash equivalents are comprised of the following in 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|---|------------------|---------------------|
| Investment income: | | |
| Interest and dividend income | \$ 87,890 | \$ 125,809 |
| Realized gains, net | 3,681 | 131,350 |
| Total | <u>\$ 91,571</u> | <u>\$ 257,159</u> |
| Change in net unrealized gains (losses) on trading securities | <u>\$ 99,609</u> | <u>\$ (170,037)</u> |

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements
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5. Fair Value Measurements

MRMC measured its assets whose use is limited on a recurring basis in accordance with accounting principles generally accepted in the United States of America.

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 – Fair value is based on unadjusted quoted prices in active markets that are accessible to MRMC for identical assets. These generally provide the most reliable evidence.

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

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

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

| | Fair Value as of December 31, 2012 | | | | |
|---|------------------------------------|---------------------|---------------------|-------------------|---------------------|
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Reported at Fair Value | | | | | |
| Assets whose use is limited: | | | | | |
| Cash and cash equivalents | \$ 312,439 | \$ 312,439 | \$ 312,439 | \$ - | \$ - |
| Mutual funds – equities | 450,985 | 450,985 | 450,985 | - | - |
| Mutual funds – fixed income | 840,023 | 840,023 | 840,023 | - | - |
| Marketable equity securities | 161,528 | 161,528 | 161,528 | - | - |
| Corporate bonds | 184,169 | 184,169 | - | 184,169 | - |
| Beneficial interest in perpetual trusts | 2,441,020 | 2,441,020 | - | - | 2,441,020 |
| Total | <u>\$ 4,390,164</u> | <u>\$ 4,390,164</u> | <u>\$ 1,764,975</u> | <u>\$ 184,169</u> | <u>\$ 2,441,020</u> |

| | | | | | |
|--------------------------------|----------------------|----------------------|-------------------|----------------------|-------------|
| Disclosed at Fair Value | | | | | |
| Cash and cash equivalents | <u>\$ 338,684</u> | <u>\$ 338,684</u> | <u>\$ 338,684</u> | <u>\$ -</u> | <u>\$ -</u> |
| Long-term debt | <u>\$ 17,275,000</u> | <u>\$ 19,730,241</u> | <u>\$ -</u> | <u>\$ 19,730,241</u> | <u>\$ -</u> |

| | Fair Value as of December 31, 2011 | | | | |
|---|------------------------------------|---------------------|---------------------|-------------------|---------------------|
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Reported at Fair Value | | | | | |
| Assets whose use is limited: | | | | | |
| Cash and cash equivalents | \$ 270,833 | 270,833 | 270,833 | - | - |
| Mutual funds – equities | 357,364 | 357,364 | 357,364 | - | - |
| Mutual funds – fixed income | 748,223 | 748,223 | 748,223 | - | - |
| Marketable equity securities | 135,309 | 135,309 | 135,309 | - | - |
| Corporate bonds | 314,835 | 314,835 | - | 314,835 | - |
| Beneficial interest in perpetual trusts | 2,261,137 | 2,261,137 | - | - | 2,261,137 |
| Total | <u>\$ 4,087,701</u> | <u>\$ 4,087,701</u> | <u>\$ 1,511,729</u> | <u>\$ 314,835</u> | <u>\$ 2,261,137</u> |

| | | | | | |
|--------------------------------|----------------------|----------------------|---------------------|----------------------|-------------|
| Disclosed at Fair Value | | | | | |
| Cash and cash equivalents | <u>\$ 1,651,563</u> | <u>\$ 1,651,563</u> | <u>\$ 1,651,563</u> | <u>\$ -</u> | <u>\$ -</u> |
| Long-term debt | <u>\$ 17,275,000</u> | <u>\$ 18,333,410</u> | <u>\$ -</u> | <u>\$ 18,333,410</u> | <u>\$ -</u> |

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The following table summarizes changes in Level 3 instruments measured at fair value on a recurring basis:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Balance, beginning of year | \$ 2,261,137 | \$ 2,351,775 |
| Investment income from beneficial interest in perpetual trusts | 89,992 | 71,069 |
| Distributions from beneficial interest in perpetual trusts | (89,992) | (71,069) |
| Valuation gain (loss) | <u>179,883</u> | <u>(90,638)</u> |
| Balance, end of year | <u>\$ 2,441,020</u> | <u>\$ 2,261,137</u> |

Level 1 and Level 2 assets whose use is limited are valued at fair value based on quoted market prices, or similar assets quoted market prices.

Level 3 instruments are valued using discounted cash flow methodologies based on the underlying securities. Beneficial interest in perpetual trusts are eleven trusts established in which MRMC receives between 2.5% and 100% of the annual income and gains and losses are discounted using an average interest rate of 2.9%.

6. Property and Equipment

Property and equipment and accumulated depreciation at December 31, 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|-------------------------------|----------------------|----------------------|
| Land and land improvements | \$ 1,366,989 | \$ 1,366,989 |
| Buildings and improvements | 61,874,777 | 62,169,832 |
| Fixed equipment | 66,694 | 66,694 |
| Equipment | <u>42,522,194</u> | <u>42,509,600</u> |
| Total | 105,830,654 | 106,113,115 |
| Less accumulated depreciation | <u>92,412,859</u> | <u>91,945,681</u> |
| Property and equipment, net | <u>\$ 13,417,795</u> | <u>\$ 14,167,434</u> |

Due to the closure of the acute care facility of MRMC, cumulative impairments of \$13,751,713 and \$13,456,658 were recorded against building and improvements and equipment assets as of December 31, 2012 and 2011, respectively, in the table above.

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7. Accrued Expenses

Accrued expenses at December 31, 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|-------------------------|-------------------|-------------------|
| Severance | \$ - | \$ 2,214 |
| Unemployment | 3,000 | 10,000 |
| Other | 68,690 | 65,950 |
| Employee benefits | 20,780 | 23,353 |
| Refunds of overpayments | 10,272 | 14,584 |
| Total | <u>\$ 102,742</u> | <u>\$ 116,101</u> |

8. Long-Term Debt

Series 2009 A-1 Bonds, Obligated Group

In June 2009, the New Jersey Health Care Facilities Financing Authority (the "Authority") issued \$152,925,000 to the obligated group consisting of JFK Medical Center, Oak Tree, and MRMC (the "Borrowers"), Series 2009 A-1 Bonds ("Series of 2009 A-1 Bonds") under the State of New Jersey Hospital Asset Transformation Program ("HATP"). The Series of 2009 A-1 Bonds include serial bonds of \$5,930,000, maturing through October 1, 2014 with interest at 4.0%, term bonds of \$30,540,000 with interest at 5% due through October 1, 2019, term bonds of \$40,735,000 with interest at 5.25% due through October 1, 2024, and term bonds of \$75,720,000 with interest of 5.75% due through October 1, 2031. Principal payments are not due until October 1, 2013. The Series of 2009 A-1 Bonds refinanced various series of bonds issued on behalf of, and other indebtedness of JFK Medical Center, Hartwyck at Oak Tree, and MRMC, all in connection with the termination of the provision of hospital acute-care services at MRMC and pursuant to the State's HATP, paying the costs of issuance of the Series and providing funds for various capacity expansion and capital improvement projects at JFK Medical Center.

MRMC's long-term debt at December 31, 2012 and 2011 consists of the following:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| New Jersey Health Care Facilities Financing Authority Revenue and Refunding Bonds, Series 2009 A-1 Bonds, Obligated Group | \$ 17,275,000 | \$ 17,275,000 |
| Less current installments | 271,678 | - |
| Long-term debt, excluding current installments | <u>\$ 17,003,322</u> | <u>\$ 17,275,000</u> |

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MRMC's scheduled principal repayments for long-term debt are as follows:

Years ending December 31:

| | |
|------------|----------------------|
| 2013 | \$ 271,678 |
| 2014 | 398,198 |
| 2015 | 532,625 |
| 2016 | 675,524 |
| 2017 | 710,205 |
| Thereafter | <u>14,686,770</u> |
| Total | <u>\$ 17,275,000</u> |

Under the terms of the Series 2009 A-1 bond indenture agreement, the Borrowers collectively are required to maintain certain financial ratios and comply with other restrictive covenants as described in the respective agreement. The Borrowers are required to maintain a days cash on hand ratio minimum of 30 days and a days in accounts payable ratio maximum of 90 days. The compliance with the debt service coverage ratio covenant began in June 2010. As of December 31, 2012, the Borrowers were meeting these ratios.

Payments of principal and interest on the Series 2009 Bonds are collateralized by all property and gross receipts of the Borrowers.

9. Pension Plan And Postretirement Healthcare Benefits

Cash Balance Retirement Plan

JFK Health System has a defined benefit pension plan covering substantially all MRMC employees and the employees of other participating subsidiaries. Amounts are allocated by JFK Health System to its subsidiaries based upon relative service costs. JFK Health System uses a December 31 measurement date for its pension plan. The plan was frozen effective May 2, 2009.

The changes in projected benefit obligations allocated by JFK Health System to MRMC in 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Projected benefit obligation at beginning of year | \$ 44,740,058 | \$ 44,143,159 |
| Interest cost | 1,946,648 | 2,265,083 |
| Actuarial loss | 2,202,601 | 107,733 |
| Benefits paid | <u>(1,767,284)</u> | <u>(1,775,917)</u> |
| Projected benefit obligation at end of year | <u>\$ 47,122,023</u> | <u>\$ 44,740,058</u> |
| Accumulated benefit obligation | <u>\$ 47,122,023</u> | <u>\$ 44,740,058</u> |

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The changes in plan assets allocated by JFK Health System to MRMC in 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| Fair value of plan assets at beginning of year | \$ 30,945,930 | \$ 29,998,760 |
| Actual return on plan assets | 4,622,204 | 744,363 |
| Employer contributions | 2,168,520 | 1,978,724 |
| Benefits paid | <u>(1,767,284)</u> | <u>(1,775,917)</u> |
| Fair value of plan assets at end of year | <u>\$ 35,969,370</u> | <u>\$ 30,945,930</u> |

The following is a summary of the funded status of the plan allocated by JFK Health System to MRMC at December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Fair value of plan assets | \$ 35,969,370 | \$ 30,945,930 |
| Projected benefit obligation | <u>47,122,023</u> | <u>44,740,058</u> |
| Funded status of the plan (under funded) | <u>(11,152,653)</u> | <u>(13,794,128)</u> |

The amounts of net periodic pension (credit) cost allocated by JFK Health System to MRMC for 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|------------------------------------|---------------------|-------------------|
| Interest cost | \$ 1,946,648 | \$ 2,265,084 |
| Expected return on plan assets | (2,443,185) | (2,362,355) |
| Amortization of actuarial loss | <u>384,044</u> | <u>332,034</u> |
| Net periodic pension (credit) cost | <u>\$ (112,493)</u> | <u>\$ 234,763</u> |

A net actuarial loss of \$23,582 represents the previously unrecognized component of net periodic pension cost included in unrestricted net assets at December 31, 2012.

A net actuarial loss of \$375,395 represents the unrecognized component of net periodic benefit cost included in unrestricted net assets at December 31, 2012 expected to be amortized into net periodic pension cost in 2013.

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Notes to Consolidated Financial Statements December 31, 2012 and 2011

The following table provides the amounts recognized in the consolidated balance sheet at December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|-----------------------|----------------------|----------------------|
| Accrued pension cost | | |
| Noncurrent | \$ 12,463,613 | \$ 15,000,469 |
| Net amount recognized | <u>\$ 12,463,613</u> | <u>\$ 15,000,469</u> |

During 2012 and 2011, an additional \$1,310,960 and \$1,206,341, respectively, was accrued for in accrued pension cost to cover inactive MRMC participants through 2014 calculated by the actuary.

The contribution to the plan in 2013 is expected to be \$1,523,370.

The weighted-average assumptions used in computing the plan's benefit obligation at December 31, 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|-------------------------------|-------------|-------------|
| Discount rate | 3.57 % | 4.53 % |
| Rate of compensation increase | N/A | N/A |

The weighted-average assumptions used in the measurement of the plan's net periodic pension cost for the years ended December 31, 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| Discount rate | 4.53 % | 5.34 % |
| Expected long-term rate of return on plan assets | 8.00 | 8.00 |
| Rate of compensation increase | N/A | N/A |

The expected long-term rate of return on plan assets assumption was developed based on historical returns for the major asset classes. This review also considered both current market conditions and projected future conditions. Adjustments are made to the expected long-term rate of return assumption when deemed necessary based upon revised expectations of future investment performance of the overall capital markets. The expected long-term rate of return assumption used in computing 2012 net periodic pension cost was 8.0%.

The following table sets forth the actual asset allocation and target asset allocation for plan assets at December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> | <u>Target Asset Allocation</u> |
|---|-------------|-------------|--|
| Asset category: | | | |
| Equity securities | 52 % | 51 % | 50 % |
| Debt securities | 34 | 35 | 35 |
| Alternative investments – Collective fund | 14 | 14 | 15 |

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The plan assets are invested among and within various asset classes in order to achieve sufficient diversification in accordance with JFK Health System' risk tolerance. This is achieved through the utilization of asset managers and systemic allocation to investment management styles, providing a broad exposure to different segments of the fixed income and equity markets.

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

Years ending December 31

| | | |
|-------------|----|------------|
| 2013 | \$ | 2,211,081 |
| 2014 | | 1,915,236 |
| 2015 | | 1,990,595 |
| 2016 | | 2,505,606 |
| 2017 | | 2,274,766 |
| 2018 - 2021 | | 14,348,518 |

The plan's collective fund, an alternative investment, is comprised of limited partnerships that invest primarily in securities that are traded in active markets. Its investment objective is to deliver a 7% rate of return, but with approximately half of the annualized volatility of equities. This approach can generate investment results that achieve higher long-term returns; however, this approach can also produce negative results depending on market conditions.

The following table sets forth by level, within the fair value hierarchy, the plan assets at fair value as of December 31, 2012:

| | Assets at Fair Value as of December 31, 2012 | | |
|----------------------------|---|----------------------|---------------------|
| | Total | Level 1 | Level 3 |
| Mutual funds: | | | |
| Large cap | \$ 10,200,068 | \$ 10,200,068 | \$ - |
| Small cap | 2,201,060 | 2,201,060 | - |
| Equities | 6,316,918 | 6,316,918 | - |
| Emerging markets debt fund | 1,434,449 | 1,434,449 | - |
| High yield bond fund | 2,960,257 | 2,960,257 | - |
| Long duration funds | 7,932,732 | 7,932,732 | - |
| Money market funds | 104 | 104 | - |
| Collective funds | 4,923,782 | - | 4,923,782 |
| Total | <u>\$ 35,969,370</u> | <u>\$ 31,045,588</u> | <u>\$ 4,923,782</u> |

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The following table sets forth by level, within the fair value hierarchy, the plan assets at fair value as of December 31, 2011:

| | Assets at Fair Value as of December 31, 2011 | | |
|----------------------------|--|----------------------|---------------------|
| | Total | Level 1 | Level 3 |
| Mutual funds: | | | |
| Large cap | \$ 8,987,226 | \$ 8,987,226 | \$ - |
| Small cap | 1,923,738 | 1,923,738 | - |
| Equities | 4,893,428 | 4,893,428 | - |
| Emerging markets debt fund | 1,199,372 | 1,199,372 | - |
| High yield bond fund | 2,512,013 | 2,512,013 | - |
| Long duration funds | 7,128,975 | 7,128,975 | - |
| Collective funds | 4,301,178 | - | 4,301,178 |
| Total | <u>\$ 30,945,930</u> | <u>\$ 26,644,752</u> | <u>\$ 4,301,178</u> |

The following table summarizes changes in Level 3 instruments measured at fair value on a recurring basis:

| | Fair Value Measurements At Reporting Date Using Significant Unobservable Inputs (Level 3) | |
|----------------------------|---|---------------------|
| | Collective Fund | |
| | 2012 | 2011 |
| Balance, beginning of year | \$ 4,301,178 | \$ 4,356,835 |
| Unrealized gain (loss) | 622,604 | (55,657) |
| Balance, end of year | <u>\$ 4,923,782</u> | <u>\$ 4,301,178</u> |

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

- Mutual funds – Valued at the net asset value (“NAV”) of shares held by the plan at year-end.
- Collective funds (alternative investments) – Valued by an independent advisor that values the underlying investments of the partnership, which are substantially invested in an active market in which the individual securities are traded.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although MRMC 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.

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Postretirement Benefits

In addition to the JFK Health System defined benefit pension plan, MRMC sponsors defined benefit medical and life insurance plans for eligible retirees. To be eligible, a retiring employee must have at least 10 years of service and have attained age 55. Coverage under the life insurance benefit plan is provided on a noncontributory basis, and the medical insurance plan is partially contributory. MRMC's funding policy is on a "pay-as-you-go" basis; the life insurance plan is funded through individual life insurance contracts. Both coverages terminate at age 65, when a Medicare supplemental program is provided on a fully contributory basis.

In January 2011, MRMC approved a five year phase out of the retiree medical program. Beginning in 2012, the subsidy will be reduced each year by \$500 until January 1, 2016 when the medical program will end.

The changes in benefit obligations in 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-------------------|
| Benefit obligation at beginning of year | \$ 347,567 | \$ 1,512,236 |
| Service cost | - | 42 |
| Interest cost | 5,255 | 8,085 |
| Plan participants' contributions | 96,589 | 105,676 |
| Actuarial gain | (43,504) | (149,801) |
| Benefits paid | (168,781) | (153,887) |
| Plan curtailments | - | (75,933) |
| Plan changes | - | (898,851) |
| | <u> </u> | <u> </u> |
| Benefit obligation at end of year | <u>\$ 237,126</u> | <u>\$ 347,567</u> |

The changes in plan assets in 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|-------------------|
| Fair value of plan assets at beginning of year | \$ - | \$ - |
| Employer contribution | 72,192 | 48,211 |
| Plan participants' contributions | 96,589 | 105,676 |
| Benefits paid | (168,781) | (153,887) |
| | <u> </u> | <u> </u> |
| Fair value of plan assets at end of year | <u>\$ -</u> | <u>\$ -</u> |

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The following is a summary of the funded status and amounts recognized in the System's consolidated financial statements as of December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Fair value of plan assets | \$ - | \$ - |
| Accumulated benefit obligation | <u>237,126</u> | <u>347,567</u> |
| Funded status of the postretirement plan (underfunded) | <u>(237,126)</u> | <u>(347,567)</u> |
| Accrued postretirement healthcare benefit liability at end of year | (237,126) | (347,567) |
| Less current portion | <u>(96,425)</u> | <u>(116,472)</u> |
| Noncurrent portion of accrued postretirement healthcare benefit liability | <u>\$ (140,701)</u> | <u>\$ (231,095)</u> |

The amounts of net periodic postretirement benefit cost (credit) in 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Interest cost | \$ 5,255 | \$ 8,085 |
| Service cost | - | 42 |
| Amortization of prior service credit | (179,835) | (179,835) |
| Unrecognized net loss | 13,395 | 35,814 |
| Curtailment gain recognized | <u>-</u> | <u>(16,032)</u> |
| Net periodic postretirement benefit (credit) cost | <u>\$ (161,185)</u> | <u>\$ (151,926)</u> |

A net actuarial gain of \$43,504 and a prior service credit of \$179,835 represent the previously unrecognized components of net periodic postretirement benefit cost included in unrestricted net assets at December 31, 2012.

A net actuarial loss of \$467 and a prior service credit of \$179,835 are expected to be recognized in net periodic postretirement benefit cost in 2013.

The weighted-average assumptions used in determining the actuarial present value of the projected benefit obligation for 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|--------------------------------|-------------|-------------|
| Discount rate | .74 % | 1.87 % |
| Healthcare cost trend rate | N/A | N/A |
| Year ultimate increase reached | N/A | N/A |

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Assumed healthcare cost trend rates have a significant effect on the amounts reported for postretirement benefit plans. However, since MRMC has reached the employer-paid cap on benefits, a one percentage point change in assumed healthcare cost trend rates would not have an effect on the components of net periodic postretirement benefit cost and the postretirement benefit obligations for 2012.

MRMC expects to contribute \$96,425 to its postretirement benefit plan in 2013.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years ending December 31:

| | | |
|------|----|--------|
| 2013 | \$ | 96,425 |
| 2014 | | 79,619 |
| 2015 | | 63,474 |

10. Professional and General Liability Insurance

JFK Health System maintains professional and general liability insurance coverage for all subsidiaries and their employees. JFK Health System's insurance coverages are provided under the provisions of two insurance arrangements, as follows:

- **Primary coverage:** Primary coverage is provided by Atlantic Insurance Exchange, Ltd. ("AIE"). Professional liability is under the terms of a claims-made insurance policy. General liability is under the terms of an occurrence based policy. Both policies have an individual claim limit of \$3,000,000 and an annual aggregate limit of \$10,000,000.
- **Excess coverage:** JFK Health System has excess liability insurance coverage which insures against losses in excess of the above primary coverage reported during the period of policy coverage. This commercial excess liability insurance policy has an individual occurrence limit of \$30,000,000 and an annual aggregate limit of \$30,000,000.

AIE was incorporated under the laws of Bermuda on June 24, 1987 and insures the risks of JFK Health System and its subsidiaries. During 2012 and 2011, there were no AIE premiums charged to MRMC as a result of the tail coverage that was purchased and expensed in 2010. The fair value of assets in AIE was approximately \$36,445,000 and \$35,922,000 at December 31, 2012 and 2011, respectively. AIE assets are controlled by JFK Health System and are not reflected in the accompanying financial statements. In addition, AIE liabilities include the asserted and unasserted professional and general claims of MRMC.

MRMC believes that it has adequate insurance coverages for all asserted claims and has no knowledge of unasserted claims which would exceed its liabilities at AIE or insurance coverages.

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11. Health Insurance Benefits

MRMC self-insures its employee health insurance coverages. MRMC accrues the estimated costs of incurred and reported and incurred but not reported claims, after consideration of its individual and aggregate stop-loss insurance coverages, based upon data provided by the third-party administrator of the program and its historical claims experience. MRMC recorded a liability of \$20,710 and \$23,353 at December 31, 2012 and 2011, respectively, related to health insurance. The amount is included in employee benefits in accrued expenses in the accompanying consolidated balance sheet.

12. Deferred Compensation Plans

MRMC has certain deferred compensation and supplemental income plans for key employees. The actuarially determined costs of such plans are accrued. The plans' accumulated benefit obligations amounted to \$36,996 and \$36,334 at December 31, 2012 and 2011, respectively. MRMC funds the entire amount of accumulated benefit obligations which is included in assets whose use is limited in the accompanying consolidated balance sheet. Benefit payments of \$-0- and \$76,445 were made during 2012 and 2011, respectively.

13. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are related to, or restricted for, the following:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Assets held for betterments to plant facilities and purchases of equipment | \$ 222,321 | \$ 258,989 |
| Interest in temporarily restricted net assets of Muhlenberg Foundation, Inc. | <u>5,692,299</u> | <u>5,605,842</u> |
| Total | <u>\$ 5,914,620</u> | <u>\$ 5,864,831</u> |

Permanently restricted net assets are related to the following:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Investments to be held in perpetuity, the income from which is generally available for MRMC operations and programs | \$ 1,328,059 | \$ 1,328,059 |
| Interest in permanently restricted net assets of Muhlenberg Foundation, Inc. | 3,985,515 | 3,840,188 |
| Beneficial interest in perpetual trust | <u>2,441,020</u> | <u>2,261,137</u> |
| Total | <u>\$ 7,754,594</u> | <u>\$ 7,429,384</u> |

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Endowment Funds

MRMC's endowment funds consist of one fund established to support the operations of MRMC. The endowment includes only donor-restricted endowment funds at the current time. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

Management has interpreted relevant New Jersey state law governing the net asset classification of endowment funds as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, MRMC classifies as permanently restricted net assets (a) the original value of gifts donated as permanent endowments; (b) the original value of subsequent gifts to the permanent endowments, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. Interest income earned on the endowment funds or market losses in excess of original value of the gift are recorded in either unrestricted or temporarily restricted net assets, depending upon the donor designation.

The endowment fund is invested consistent with an investment policy statement that is monitored by MRMC's board of directors. The investment policy employed is meant to achieve long-term growth while providing modest investment income which would be available for current funding. Funds in the trust are primarily invested in cash and cash equivalents, fixed income securities, mutual funds and equities and in total strive for a forty/sixty split between fixed income securities and equities.

Donor-restricted endowment net assets totaling \$1,328,059 at December 31, 2012 and 2011, respectively, are classified as permanently restricted net assets in the accompanying balance sheet. During 2012 and 2011, there were approximately \$223,000 and \$149,000, respectively, of unrealized gains recorded to unrestricted net assets for gains related endowment funds which cannot be recorded to increase the principal of the endowment fund and was recorded against unrestricted net assets.

Changes in permanently restricted endowment net assets for the years ended December 31, 2012 and 2011 is comprised of the following:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Endowment net assets, beginning of year | \$ 1,328,059 | \$ 1,328,059 |
| Total investment return | <u>223,252</u> | <u>149,259</u> |
| Total assets restricted by donor for permanently restricted endowment funds | 1,551,311 | 1,477,318 |
| Unrestricted net assets increased for unrealized gains | <u>(223,252)</u> | <u>(149,259)</u> |
| Endowment net assets, end of year | <u>\$ 1,328,059</u> | <u>\$ 1,328,059</u> |

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14. Concentrations of Credit Risk

MRMC maintains its cash and cash equivalents with several financial institutions. Cash and cash equivalents on deposit with any one financial institution are insured up to \$250,000.

15. Contingencies

Reopening of Cost Reports

In October 2006, MRMC received a letter from Riverbend, the previous New Jersey's Medicare fiscal intermediary, indicating their intention to reopen previously final settled Medicare cost reports for 2001 through 2003. Riverbend cited that the calculations for Disproportionate Share Hospital ("DSH") reimbursement for these years may have contained errors in the number of Medicaid eligible days, which is a critical component of the DSH calculation. For these years, Riverbend received information on Medicaid eligible days from the New Jersey Medicaid Agency, The Division of Medical Assistance and Health Services. During 2009 CMS decided not to reopen cost reports for the fiscal years 2001 to 2003. The balances for these years were moved to the 2005 to 2006 cost report years.

Utilizing Medicaid eligible days based on the final settled Medicare cost report for 2004, MRMC estimated a potential overpayment of DSH reimbursement for 2005 through 2007 of \$2,684,051 as of December 31, 2012. These amounts are included in estimated third-party payor settlements at December 31, 2012 in the accompanying consolidated balance sheet.

Asbestos

MRMC's building, which was constructed prior to the passage of the Clean Air Act, contains encapsulated asbestos material. Current law requires that this asbestos be removed in an environmentally safe fashion prior to the demolition and renovation of the building. At this time, MRMC does not have plans to renovate this building; and, therefore, a liability for such asbestos removal cannot be reasonably estimated and there is no liability recognized in the accompanying consolidated financial statements.

Other

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance that have not been provided for in the accompanying consolidated financial statements; however, the possible future financial effects of this matter on MRMC, if any, are not presently determinable.

Muhlenberg Regional Medical Center, Inc.

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16. Lease Commitments

Rental expense on operating leases which ended in 2012, was \$18,000 and \$41,159 in 2012 and 2011, respectively.

17. Related Party Transactions

At December 31, 2012 and 2011, MRMC and other affiliates were indebted to each other as follows:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Due from affiliates: | | |
| Muhlenberg Foundation, Inc. (net of reserve for \$1,681,940 for 2012 and 2011) | \$ 34,713 | \$ 32,762 |
| Mediplex Surgery Center | - | 18 |
| Atlantic Insurance Exchange, Ltd. | <u>205,093</u> | <u>244,456</u> |
| Total due from affiliates | 239,806 | 277,236 |
| Less current portion | <u>205,093</u> | <u>244,474</u> |
| Noncurrent portion | <u>\$ 34,713</u> | <u>\$ 32,762</u> |
| | <u>2012</u> | <u>2011</u> |
| Due to affiliates, noncurrent: | | |
| JFK Health System Health System, Inc. | <u>\$ 41,938,173</u> | <u>\$ 41,938,173</u> |

The affiliates periodically advance funds for working capital purposes. Interest is not charged on these balances and there are no formal repayment terms.

The Foundation made transfers to MRMC totaling \$95,414 in 2012 and \$97,062 in 2011 for use in operating activities. In addition, the Foundation made transfers of \$-0- in 2012 and \$28,275 in 2011 for capital purchase activities.

During years ended December 31, 2012 and 2011, JFK Medical Center transferred \$2,454,441 and \$3,066,689, respectively, to MRMC to forgive intercompany balances.

On January 1, 2009, the operations of the School of Nursing and School of Radiology were transferred to JFK Medical Center. JFK pays rental income to MRMC for operations on the MRMC campus which were \$1,697,000 and \$1,965,000 for the years ended December 31, 2012 and 2011, respectively.

Muhlenberg Regional Medical Center, Inc.

Notes to Consolidated Financial Statements

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18. Discontinued Operations

On August 13, 2008, the acute care hospital operation of MRMC was closed as noted in Note 1. During 2011, Midtown Shops was sold. The following represents costs associated with the operation of the hospital and Midtown Shops that closed and were classified and presented in discontinued operations for 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Unrestricted Revenues, Gains, and Other Support: | | |
| Net patient service revenues | \$ 1,312,356 | \$ 330,989 |
| Total unrestricted revenues, gains, and other support | 1,312,356 | 330,989 |
| Expenses: | | |
| Employee benefits | (6,450) | (132,667) |
| Supplies and expenses | 1,545,223 | 143,304 |
| Impairment building (See Note 6) | 295,055 | 607,570 |
| Total expenses | 1,833,828 | 618,207 |
| Loss from Discontinued Operations | <u>\$ (521,472)</u> | <u>\$ (287,218)</u> |

Accounts payable, accrued expenses, and other liabilities accrued associated with discontinued operations will be satisfied through remaining assets, support from JFK Health System or through proceeds from bond refinancing.