



PORTER HOSPITAL, INC.

FINANCIAL STATEMENTS

September 30, 2015 and 2014

With Independent Auditor's Report



PORTER HOSPITAL, INC.
September 30, 2015 and 2014

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Porter Hospital, Inc.

We have audited the accompanying financial statements of Porter Hospital, Inc. (Hospital), a subsidiary of Porter Medical Center, Inc., which comprise the balance sheets as of September 30, 2015 and 2014, and the related statements of operations, changes in net assets, 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 financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of 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 financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Board of Directors
Porter Hospital, Inc.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Porter Hospital, Inc. as of September 30, 2015 and 2014, and the results of its operations, changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Manchester, New Hampshire
February 4, 2016
Registration No. 92-0000278

PORTER HOSPITAL, INC.

Balance Sheets

September 30, 2015 and 2014

ASSETS

	<u>2015</u>	<u>2014</u>
Current assets		
Cash and cash equivalents	\$ 11,950,916	\$ 10,961,576
Assets limited as to use, trustee held funds under debt agreements	-	380,321
Patient accounts receivable, net	9,702,885	9,270,694
Other receivables, net	1,319,509	3,206,812
Current portion of note receivable, related party	3,497	3,497
Supplies	1,167,755	1,219,291
Prepaid expenses and other	1,106,119	1,300,287
Due from affiliates	<u>271,087</u>	<u>364,530</u>
Total current assets	25,521,768	26,707,008
Assets limited as to use, deferred compensation plan assets	715,055	816,648
Long-term investments	4,941,998	4,074,857
Property and equipment, net	20,947,612	20,905,488
Beneficial interest in perpetual trusts	3,431,932	3,485,489
Note receivable, related party - noncurrent	<u>20,307</u>	<u>24,290</u>
Total assets	<u>\$ 55,578,672</u>	<u>\$ 56,013,780</u>

The accompanying notes are an integral part of these financial statements.

LIABILITIES AND NET ASSETS

	<u>2015</u>	<u>2014</u>
Current liabilities		
Current portion of long-term debt	\$ 763,319	\$ 783,369
Accounts payable and accrued expenses	2,858,001	4,488,788
Accrued payroll and related liabilities	2,004,790	1,916,195
Accrued compensated absences	2,723,746	2,544,009
Estimated third-party settlements	1,558,015	1,968,929
Due to affiliates	<u>382,191</u>	<u>388,697</u>
Total current liabilities	10,290,062	12,089,987
Liability for pension benefits	5,295,827	3,762,025
Deferred compensation	714,382	815,975
Long-term debt, excluding current portion	<u>12,781,987</u>	<u>13,455,420</u>
Total liabilities	<u>29,082,258</u>	<u>30,123,407</u>
Net assets		
Unrestricted	22,544,986	22,003,895
Temporarily restricted	401,814	283,307
Permanently restricted	<u>3,549,614</u>	<u>3,603,171</u>
Total net assets	<u>26,496,414</u>	<u>25,890,373</u>
Total liabilities and net assets	<u>\$ 55,578,672</u>	<u>\$ 56,013,780</u>

PORTER HOSPITAL, INC.

Statements of Operations

Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Unrestricted revenues, gains and other support		
Patient service revenue (net of contractual allowances and discounts)	\$ 73,905,964	\$68,031,505
Less provision for bad debts	<u>3,256,616</u>	<u>2,006,720</u>
Net patient service revenue	70,649,348	66,024,785
Other operating revenue	3,517,252	3,519,978
Net assets released from restrictions used for operations	<u>2,040</u>	<u>3,993</u>
Total unrestricted revenues, gains and other support	<u>74,168,640</u>	<u>69,548,756</u>
Expenses		
Professional care of patients	40,977,211	38,225,919
General services	3,673,307	3,732,454
Administrative and fiscal services	22,823,156	20,923,093
Health care improvement tax	4,046,887	3,910,935
Depreciation and amortization	3,055,269	4,501,518
Interest	<u>322,120</u>	<u>409,969</u>
Total expenses	<u>74,897,950</u>	<u>71,703,888</u>
Operating loss	<u>(729,310)</u>	<u>(2,155,132)</u>
Nonoperating gains (losses)		
Contributions	185,276	178,329
Investment return	154,997	540,225
Other program income, net	3,269,712	3,222,964
Loss on early extinguishment of debt	<u>(119,617)</u>	<u>-</u>
Nonoperating gains, net	<u>3,490,368</u>	<u>3,941,518</u>
Excess of revenues, gains and other support over expenses and nonoperating gains (losses)	2,761,058	1,786,386
Net assets released from restrictions used for purchase of property and equipment	60,728	-
Change in net assets to recognize funded status of pension plan	(1,240,510)	(468,947)
Transfer to affiliate	<u>(1,040,185)</u>	<u>-</u>
Increase in unrestricted net assets	<u>\$ 541,091</u>	<u>\$ 1,317,439</u>

The accompanying notes are an integral part of these financial statements.

PORTER HOSPITAL, INC.

Statements of Changes in Net Assets

Years Ended September 30, 2015 and 2014

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balances, October 1, 2013	\$ <u>20,686,456</u>	\$ <u>268,325</u>	\$ <u>3,423,515</u>	\$ <u>24,378,296</u>
Excess of revenues, gains and other support over expenses and nonoperating gains	1,786,386	-	-	1,786,386
Net assets released from restrictions used for operations	-	(3,993)	-	(3,993)
Change in net assets to recognize funded status of pension plan	(468,947)	-	-	(468,947)
Contributions	-	18,975	-	18,975
Change in beneficial interest in perpetual trusts	-	-	179,656	179,656
Net increase in net assets	<u>1,317,439</u>	<u>14,982</u>	<u>179,656</u>	<u>1,512,077</u>
Balances, September 30, 2014	<u>22,003,895</u>	<u>283,307</u>	<u>3,603,171</u>	<u>25,890,373</u>
Excess of revenues, gains and other support over expenses and nonoperating gains (losses)	2,761,058	-	-	2,761,058
Net assets released from restrictions used for operations	-	(2,040)	-	(2,040)
Net assets released from restrictions used for purchase of property and equipment	60,728	(60,728)	-	-
Change in unrealized loss on investment	-	-	-	-
Change in net assets to recognize funded status of pension plan	(1,240,510)	-	-	(1,240,510)
Transfer to affiliate	(1,040,185)	-	-	(1,040,185)
Contributions	-	181,275	-	181,275
Change in beneficial interest in perpetual trusts	-	-	(53,557)	(53,557)
Net increase (decrease) in net assets	<u>541,091</u>	<u>118,507</u>	<u>(53,557)</u>	<u>606,041</u>
Balances, September 30, 2015	<u>\$ 22,544,986</u>	<u>\$ 401,814</u>	<u>\$ 3,549,614</u>	<u>\$ 26,496,414</u>

The accompanying notes are an integral part of these financial statements.

PORTER HOSPITAL, INC.

Statements of Cash Flows

Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash flows from operating activities		
Change in net assets	\$ 606,041	\$ 1,512,077
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Loss on disposal of property and equipment	155,032	-
Depreciation and amortization	3,055,269	4,501,518
Provision for bad debts	3,256,616	2,006,720
Loss on early extinguishment of debt	119,617	-
Net realized and unrealized loss (gain) on investments	(131,006)	(292,268)
Change in net assets to recognize funded status of pension plan	1,240,510	468,947
Restricted contributions	(181,275)	(18,975)
Net unrealized loss (gain) on beneficial interest in perpetual trusts	53,557	(179,656)
(Increase) decrease in		
Patient accounts receivable	(3,688,807)	(2,632,686)
Due from affiliates	93,443	522,322
Supplies, prepaids and other current assets	2,513,328	(324,408)
Increase (decrease) in		
Accounts payable and accrued expenses	(1,643,287)	(554,564)
Accrued payroll and related liabilities	88,595	(32,666)
Estimated third-party settlements	(410,914)	1,167,824
Due to affiliates	(6,506)	(263,087)
Other current liabilities	485,529	227,038
Net cash provided by operating activities	<u>5,605,742</u>	<u>6,108,136</u>
Cash flows from investing activities		
Purchase of investments	(118,507)	(210,614)
Proceeds from sale of investments	4,158,924	226,229
Payments on note receivable from affiliates	3,983	3,712
Proceeds from sale of property and equipment	1,950	-
Purchase of property and equipment	(2,930,107)	(1,261,356)
Change in investments held by Middlebury College	(4,776,553)	-
Net cash used by investing activities	<u>(3,660,310)</u>	<u>(1,242,029)</u>
Cash flows from financing activities		
Proceeds from restricted contributions	181,275	18,975
Payment of bond issuance costs	(138,788)	-
Proceeds from issuance of long-term debt	12,650,000	-
Principal payments on long-term debt	(13,648,579)	(1,492,589)
Net cash used by financing activities	<u>(956,092)</u>	<u>(1,473,614)</u>
Net increase in cash and cash equivalents	989,340	3,392,493
Cash and cash equivalents, beginning of year	<u>10,961,576</u>	<u>7,569,083</u>
Cash and cash equivalents, end of year	<u>\$ 11,950,916</u>	<u>\$ 10,961,576</u>
Supplemental cash flows information		
Interest paid	\$ 322,048	\$ 390,190
Noncash transaction - acquisition of fixed assets in exchange for long-term debt	\$ 318,101	\$ -

The accompanying notes are an integral part of these financial statements.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

Nature of Operations

Porter Hospital, Inc. (Hospital) is a Vermont not-for-profit corporation which operates a 25-bed short-term critical access hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Middlebury, Vermont, and the surrounding area. Porter Medical Center, Inc. (PMC) is the parent holding company of the Hospital. In its capacity as sole member of the Hospital, PMC has the right to appoint Hospital directors, approve major Hospital expenditures, and approve Hospital long-term borrowings. As a subsidiary of PMC, the Hospital is also related to the following organizations: Helen Porter Nursing Home, Inc. (HPNH) and Porter Real Estate Holdings, LLC (PREH). These financial statements represent the operating results, financial position and cash flows of only the Hospital.

1. Summary of Significant Accounting Policies

Basis of Presentation

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic (ASC) 958, *Not-For-Profit Entities*. Under FASB ASC 958, and FASB ASC 954, *Health Care Entities*, all not-for-profit healthcare organizations are required to provide a balance sheet, a statement of operations, a statement of changes in net assets, and a statement of cash flows. FASB ASC 954 requires reporting amounts for an organization's total assets, liabilities, and net assets in a balance sheet; reporting the change in an organization's net assets in statements of operations and changes in net assets; and reporting the change in its cash and cash equivalents in a statement of cash flows.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) 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

Cash and cash equivalents include all liquid investments and long-term investments, with original maturities of three months or less, other than deferred compensation plan investments to be cash equivalents. At September 30, 2015 and 2014, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

Investments and Investment Income

Investments in equity securities having a readily determinable fair value and all investments in debt securities are measured at fair value in the balance sheets. The Hospital adopted FASB ASC 825, *Financial Investments*, effective October 1, 2008, and has elected the fair value option relative to its investments which consolidates all investment performance activity within the nonoperating gains section of the statements of operations.

Investments are exposed to various risks, such as interest rate, credit, and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the balance sheets and statements of operations and changes in net assets.

Assets Limited as to Use

Assets limited as to use are assets held by trustees under debt agreements and deferred compensation plan assets.

Patient Accounts Receivable

Patient accounts receivable are stated at the amount management expects to collect for services rendered from third-party payors, patients and others. Management provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. Accounts are considered delinquent and subsequently written off as uncollectible based on individual credit evaluation and specific circumstances of the account.

In evaluating the collectibility of accounts receivable, the Hospital analyzes past results and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources 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 bad debts. For receivables associated with self-pay patients (which include 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 provision for bad debts in the period of service based on past experience, which indicates that many patients are unable or unwilling to pay amounts for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or eligible) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for doubtful accounts.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

Supplies

The Hospital records supply inventories at the lower of cost, determined using the first-in, first-out method, or market.

Property and Equipment

Property and equipment acquisitions are recorded at cost, or, if contributed, at fair market value determined at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the asset's estimated useful life. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues, gains and other support over expenses and nonoperating gains (losses), 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-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital have been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered and includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and are adjusted in future periods as final settlements are determined.

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.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

Contributions

Unconditional promises to give cash and other assets are recorded at estimated fair value at the date each promise is received. Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Excess of Revenues, Gains and Other Support Over Expenses and Nonoperating Gains (Losses)

The statements of operations include excess of revenues, gains and other support over expenses and nonoperating gains (losses). Changes in unrestricted net assets which are excluded from this measure, consistent with industry practice, include defined benefit pension plan adjustments, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Income Taxes

The Hospital 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 related income.

New Accounting Pronouncement

Effective in the year ended September 30, 2015, the Hospital retrospectively adopted the provisions of FASB Accounting Standards Update (ASU) No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The ASU is limited to simplifying the presentation of debt issuance costs, and the recognition and measurement guidance for debt issuance costs is not affected by the ASU. As a result of the adoption, the Hospital has reclassified unamortized bond issuance costs in the amount of \$124,626 from deferred financing costs, net in the accompanying balance sheet for the year ended September 30, 2014, and presented the amount as a reduction of long-term debt as required by the ASU. The adoption had no effect on the Hospital's net assets, statement of operations or statement of cash flows for the year ended September 30, 2015.

Subsequent Events

For purposes of the preparation of these financial statements in conformity with U.S. GAAP, the Hospital has considered transactions or events occurring through February 4, 2016, which was the date the financial statements were issued.

Effective January 1, 2016, the Hospital changed from a premium based health insurance plan to a self-insured health plan.

PORTER HOSPITAL, INC.
Notes to Financial Statements
September 30, 2015 and 2014

2. Net Patient Service Revenue and Patient Accounts Receivable

Net Patient Service Revenue

Patient service revenue and contractual and other allowances consisted of the following for the years ended September 30:

	<u>2015</u>	<u>2014</u>
Inpatient	\$ 35,443,707	\$ 32,686,514
Outpatient	106,804,776	<u>100,996,251</u>
Gross patient service revenue	142,248,483	<u>133,682,765</u>
Less Medicare and Medicaid allowances	44,517,236	44,223,800
Less other contractual allowances	22,653,763	19,780,027
Less charity care and other discounts	1,171,520	<u>1,647,433</u>
	68,342,519	<u>65,651,260</u>
Patient service revenue (net of contractual allowances and discounts)	73,905,964	68,031,505
Less provision for bad debts	3,256,616	<u>2,006,720</u>
Net patient service revenue	\$ 70,649,348	\$ 66,024,785

Patient Accounts Receivable

Patient accounts receivable consisted of the following at September 30:

	<u>2015</u>	<u>2014</u>
Gross patient accounts receivable	\$ 20,517,556	\$ 18,594,913
Less: Estimated contractual allowances	7,356,659	6,582,776
Estimated allowance for doubtful accounts and charity care	3,458,012	<u>2,741,443</u>
Net patient accounts receivable	\$ 9,702,885	\$ 9,270,694

During 2015, the Hospital increased its estimate from \$1,993,840 to \$2,281,483 in the allowance for doubtful accounts relating to self-pay patients and increased such estimate from \$747,603 to \$1,176,529 for doubtful accounts relating to third-party payors. During 2014, the Hospital decreased its estimate from \$2,403,438 to \$1,993,840 in the allowance for doubtful accounts relating to self-pay patients and decreased such estimate from \$1,055,058 to \$747,603 for doubtful accounts relating to third-party payors. During 2015, self-pay write-offs increased from \$2,328,416 to \$3,050,571. During 2014, self-pay write-offs decreased from \$4,348,250 to \$2,328,416. Such variations resulted from changes experienced in the collection of amounts from self-pay patients and third-party payors.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare

On December 31, 2005, the Hospital became a Critical Access Hospital (CAH). As a CAH, the Hospital is reimbursed at 101% of reasonable allowable costs for its inpatient and outpatient services excluding ambulance services, provided to Centers for Medicare and Medicaid Services (Medicare or CMS) patients. The Hospital is reimbursed for cost reimbursable items at tentative rates, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2012.

Medicaid

Inpatient services rendered to Office of Vermont Health Access (Medicaid) program beneficiaries are reimbursed at prospectively determined rates. The prospectively determined rates are not subject to retroactive adjustment. Outpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates and therefore are not subject to retroactive adjustments. The Hospital's Medicaid cost reports have been audited through September 30, 2012.

Other Arrangements

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Approximately 48% and 47% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2015 and 2014, respectively. The Hospital has agreements with Medicare and Medicaid. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Differences between amounts previously estimated and amounts subsequently determined to be recoverable or payable are included in net patient service revenue in the year the amounts become known. In 2015, net patient service revenue increased by approximately \$899,000, and in 2014, net patient service revenue decreased by approximately \$277,000 due to removal of allowances or recognition of settlements no longer subject to audits, reviews and investigations.

PORTER HOSPITAL, INC.

Notes to Financial Statements

September 30, 2015 and 2014

The Hospital recognizes patient service revenue associated with services rendered to patients who have third-party payor coverage on the basis of contractual rates for such services. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates (or on the basis of discounted rates, if negotiated or provided by policy). Based on historical trends, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services rendered. Thus, the Hospital records a provision for bad debts related to uninsured patients in the period the services are rendered. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized during the fiscal year ended September 30, 2015 totaled \$73,905,964, of which \$71,133,144 was revenue from third-party payors and \$2,772,820 was revenue from self-pay patients. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized during the fiscal year ended September 30, 2014 totaled \$68,031,505, of which \$65,418,960 was revenue from third-party payors and \$2,612,545 was revenue from self-pay patients.

3. Community Benefit

The Hospital provides services without charge, or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. The criteria for charity care, which is granted on a sliding scale, consider gross income and family size as compared to the federal poverty guidelines (FPL). The maximum of 100% charity care will be granted if the gross income of the individual is up to 200% of FPL.

The net cost of charity care provided was approximately \$618,135 in 2015 and \$883,637 in 2014. The total cost estimate is based on an overall financial statement cost to charge ratio applied against gross charity care charges. In 2015 and 2014, 0.82% and 1.23%, respectively, of all services as defined by percentage of gross revenue was provided on a charity basis.

In 2015, a total of 80 inpatients received their entire episode of service on a charity case basis. In 2014, a total of 102 inpatients received their entire episode of service on a charity case basis.

In 2015, a total of 2,044 outpatients received their entire episode of service on a charity case basis. In 2014, a total of 1,974 outpatients received their entire episode of service on a charity case basis.

4. Investments and Investment Return

Assets limited as to use include the following at September 30:

	<u>2015</u>	<u>2014</u>
Held by trustee under debt agreement		
Cash and cash equivalents	\$ <u> -</u>	\$ <u> 380,321</u>
Held by trustee - deferred compensation funding		
Mutual funds	\$ <u> 715,055</u>	\$ <u> 816,648</u>

PORTER HOSPITAL, INC.
Notes to Financial Statements
September 30, 2015 and 2014

Total investment return is comprised of the following for the years ended September 30:

	<u>2015</u>	<u>2014</u>
Interest and dividend income	\$ 247,438	\$ 247,957
Net unrealized losses	(396,175)	(169,286)
Realized gains	527,181	461,554
Depreciation of investments held at Middlebury College	<u>(233,447)</u>	<u>-</u>
	<u>\$ 154,997</u>	<u>\$ 540,225</u>

Long-term investments include the following at September 30:

	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	\$ 165,445	\$ 320,971
Mutual funds	-	383,021
Marketable equity securities	-	2,124,307
Corporate and taxable bonds	-	428,798
U.S. Treasury obligations and government securities	-	526,223
Government sponsored enterprises	-	207,070
International bonds	-	84,467
Investments held by Middlebury College	<u>4,776,553</u>	<u>-</u>
	<u>\$ 4,941,998</u>	<u>\$ 4,074,857</u>

Investments held by Middlebury College are part of a pooled fund, the Hospital is unable to determine a breakdown of investment by type.

5. Property and Equipment

The major categories of property and equipment are as follows at September 30:

	<u>2015</u>	<u>2014</u>
Land and land improvements	\$ 2,195,591	\$ 2,188,641
Buildings and leasehold improvements	26,126,556	25,970,829
Equipment	25,313,261	22,746,537
Construction in progress	<u>306,001</u>	<u>111,353</u>
	<u>53,941,409</u>	51,017,360
Less accumulated depreciation	<u>32,993,797</u>	<u>30,111,872</u>
Property and equipment, net	<u>\$ 20,947,612</u>	<u>\$ 20,905,488</u>

PORTER HOSPITAL, INC.
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6. Beneficial Interest in Perpetual Trusts

The Hospital is an income beneficiary of two perpetual trusts controlled by an unrelated third-party trustee. The beneficial interests in the assets of these trusts are included in the Hospital's financial statements as permanently restricted net assets. Income is distributed in accordance with the individual trust documents and is included in investment return. Trust income distributed to the Hospital for the years ended September 30, 2015 and 2014 was \$151,446 and \$146,826, respectively.

7. Borrowings

Long-term debt consisted of the following as of September 30:

	<u>2015</u>	<u>2014</u>
Vermont Educational and Health Buildings Financing Agency (VEHBFA) Variable Rate Demand Hospital Revenue Bonds, 2005 Series A bonds with variable interest (.03% at September 30, 2014), collateralized by the gross receipts of the Hospital and supported by a letter of credit. The bonds were refunded during 2015.	\$ -	\$ 13,170,000
VEHBFA Revenue Bond Refunding Series 2015A, with fixed interest at 2.85%, payable in monthly payments of \$69,211 including principal and interest, through August 2035; collateralized by the gross receipts of the Hospital. These bonds are callable by the purchaser on or after August 1, 2025.	12,609,832	-
Note payable at a fixed interest rate of 2.78%, monthly payments of \$5,690, including principal and interest, due February 2020; collateralized by certain equipment.	282,975	-
Note payable at a fixed interest rate of 4.7%. The note was paid off in 2015.	-	144,690
Note payable at variable interest rate of (4.7% at September 30, 2015), monthly payments of \$1,743, including principal and interest, with the remaining principal due March 2019; collateralized by certain property.	151,588	165,747
Note payable at a fixed interest rate of 4.0%, monthly payments of \$2,597, including principal and interest, due in full in September 2018; collateralized by certain property.	87,825	114,873

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	<u>2015</u>	<u>2014</u>
Capital lease obligations at various rates with monthly payments ranging from \$1,303 to \$14,317, due 2015 through 2018; collateralized by leased equipment.	<u>550,717</u>	<u>768,105</u>
Total long-term debt before unamortized premiums and debt issuance costs	13,682,937	14,363,415
Unamortized debt issuance costs	<u>(137,631)</u>	<u>(124,626)</u>
Total long-term debt	13,545,306	14,238,789
Less current portion	<u>763,319</u>	<u>783,369</u>
	<u>\$ 12,781,987</u>	<u>\$ 13,455,420</u>

Aggregate annual maturities of long-term debt and payments on capital lease obligations at September 30, 2015 are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2016	\$ 581,468	\$ 196,181
2017	598,800	196,181
2018	616,600	183,991
2019	691,400	-
2020	562,700	-
Thereafter	<u>10,081,252</u>	<u>-</u>
	<u>\$ 13,132,220</u>	576,353
Less amounts representing interest		<u>(25,636)</u>
		<u>\$ 550,717</u>

In connection with the bond issuance, the Hospital is a member of an Obligated Group which includes HPNH and PMC. The Obligated Group is required to meet certain financial covenants. The Obligated Group is in compliance with these financial covenants at September 30, 2015 as defined in the Master Trust Indenture and its supplements.

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8. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	<u>2015</u>	<u>2014</u>
Health care services	\$ 163,977	\$ 44,270
Purchase of equipment	2,657	2,657
Indigent care	<u>235,180</u>	<u>236,380</u>
	<u>\$ 401,814</u>	<u>\$ 283,307</u>

Permanently restricted net assets are restricted to:

	<u>2015</u>	<u>2014</u>
Investments to be held in perpetuity, the income is restricted for indigent care	\$ 117,682	\$ 117,682
Beneficial interest in perpetual trusts, the income is unrestricted	<u>3,431,932</u>	<u>3,485,489</u>
	<u>\$ 3,549,614</u>	<u>\$ 3,603,171</u>

9. Assets Held in Trust

The Hospital is the income beneficiary of various trusts, over which the trustee has variance power. Because the Hospital has only a contingent interest in the assets of the trust, they are not included in the Hospital's financial statements. The fair value of the assets totaled approximately \$4,160,000 and \$4,230,000 on September 30, 2015 and 2014, respectively. Distributions of income are made at the discretion of the trustees. Income distributed to the Hospital by the trust is restricted for indigent care and amounted to \$185,186 in 2015 and \$178,329 in 2014.

10. Other Operating Revenue

Other operating revenue consisted of the following for the years ended September 30:

	<u>2015</u>	<u>2014</u>
Rental income	\$ 158,671	\$ 150,160
Cafeteria and coffee shop income	233,645	215,042
Disproportionate Share payments	847,101	691,760
Meaningful Use Incentive payments	681,617	751,268
Miscellaneous revenue	<u>1,596,218</u>	<u>1,711,748</u>
Total other revenue	<u>\$ 3,517,252</u>	<u>\$ 3,519,978</u>

PORTER HOSPITAL, INC.

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11. **Other Program Income, Net**

Other program income, net represents the net income resulting from the federal 340(b) Drug Pricing Program (Program). The Program provides for discounts and reduced prices on medications because the Hospital is a qualified federal grantee (as a CAH). In addition to savings for medications used within the Hospital, the Hospital has also established contracts with five local pharmacies during 2015. Revenue from prescriptions filled by these contract pharmacies is recorded as "other program revenue." The Hospital paid all expenses for the drugs dispensed by the contract pharmacies at wholesaler cost. The Hospital also paid the contract pharmacies a dispensing fee for filling the prescriptions. These expenses are treated as "other expense" by the Hospital. The net of these three amounts resulted in net program income of \$3,269,712 and \$3,222,964 for the years ended September 30, 2015 and 2014, respectively.

12. **Functional Expenses**

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

	<u>2015</u>	<u>2014</u>
Health care services	\$ 67,938,340	\$ 64,009,706
General and administrative	<u>6,959,610</u>	<u>7,694,182</u>
	<u>\$ 74,897,950</u>	<u>\$ 71,703,888</u>

13. **Concentration of Credit Risk**

The Hospital grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2015 and 2014, is:

	<u>2015</u>	<u>2014</u>
Medicare	28 %	28 %
Medicaid	16	15
Commercial and other	38	36
Self-pay	<u>18</u>	<u>21</u>
	<u>100 %</u>	<u>100 %</u>

The Hospital maintains a substantial portion of its cash and cash equivalents in bank accounts which at times may exceed federally insured limits. The Hospital has not experienced any losses on such accounts. The Hospital believes it is not exposed to any significant risk on cash and cash equivalents.

Labor Force

The Hospital's unionized labor workforce are members of the Porter Federation of Nurses and Health Professionals, AFT Vermont Local Unit # 5753. The Union contract has been negotiated through September 30, 2017.

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14. Commitments and Contingencies

Medical Malpractice Claims

The Hospital carries malpractice insurance coverage under a claims-made policy. The Hospital intends to renew its coverage on a claims-made basis and anticipates such coverage will be available. The Hospital is subject to complaints, claims and litigation due to potential claims which arise in the normal course of business. U.S. GAAP requires the Hospital to accrue the ultimate cost of malpractice claims when the incident that gives rise to the claim occurs, without consideration of insurance recoveries. Expected recoveries are presented as a separate asset. Amounts accrued under this provision are included in other receivables and accounts payable and accrued expenses on the balance sheets.

Guarantees

The Hospital guarantees certain third-party debts of an unconsolidated affiliated organization. The guarantee terms are for periods of nine and fourteen years. Should the Hospital be obligated to perform under the guarantee agreements, the Hospital may seek reimbursement from the related organization of amounts expended under the guarantees. At September 30, 2015 and 2014, the total outstanding balances on the guaranteed loans were approximately \$140,000 and \$216,000, respectively. Management does not currently expect the Hospital will be required to perform under those guarantees.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. 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.

15. Benefit Plans

Defined Contribution Plan

PMC has a 403(b) defined contribution pension plan covering substantially all Hospital employees. PMC makes an employer contribution to the plan. In order to receive the contribution, employees must meet certain eligibility requirements. PMC will make contributions between 3% and 6% of covered payroll based on the employee's years of service and employees' ages as of January 1, 2014.

The Hospital has estimated a liability of approximately \$877,000 and \$833,000 at September 30, 2015 and 2014, respectively, related to the 403(b) plan. This amount has been included in accrued payroll and other liabilities. Contributions are calculated on a calendar year basis, and are paid following the end of the calendar year. Contributions to the plan were approximately \$1,127,000 and \$963,000 for calendar years 2014 and 2013, respectively.

PORTER HOSPITAL, INC.

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Deferred Compensation Plan

The Hospital has a nonqualified deferred compensation plan established under Section 457 of the Internal Revenue Code. This plan covers a key employee of the Hospital. The Hospital does not contribute to this plan.

Defined Benefit Plan

PMC has a noncontributory defined benefit pension plan covering all Hospital employees who meet the eligibility requirements. PMC's funding policy is to make the minimum annual contribution that is required by applicable regulations, plus such amounts as PMC may determine to be appropriate from time to time. PMC expects to contribute to the Plan in 2016.

PMC has adopted FASB ASC 958-715, *Compensation-Retirement Benefits*. The defined benefit pension plan has been frozen since April 2007; therefore, the adoption of these provisions had no effect on the balance sheets and statements of operations and changes in net assets of PMC.

The Hospital's share of the net pension accrual was a pension liability of \$5,295,827 and \$3,762,025 at September 30, 2015 and 2014, respectively. The Hospital's share of the pension expense was \$286,289 and \$282,457 for the years ended September 30, 2015 and 2014, respectively. The Hospital made no contributions to the plan in 2015 or 2014.

PMC uses a September 30, 2015 measurement date for the plan. Significant balances for the Plan as a whole are:

	<u>2015</u>	<u>2014</u>
Benefit obligations	\$(16,013,887)	\$(14,919,052)
Fair value of Plan assets	<u>9,539,564</u>	<u>10,324,258</u>
Funded status	<u>\$ (6,474,323)</u>	<u>\$ (4,594,794)</u>

The tables below present details about the Plan, including its funded status, components of net periodic benefit cost and certain assumptions used to determine the funded status and cost:

	<u>2015</u>	<u>2014</u>
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 14,919,052	\$13,501,286
Interest cost	624,183	642,168
Actuarial loss	962,615	1,178,468
Benefits paid	<u>(491,963)</u>	<u>(402,870)</u>
Benefit obligation at end of year	<u>\$ 16,013,887</u>	<u>\$14,919,052</u>

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	<u>2015</u>	<u>2014</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 10,324,258	\$ 9,831,467
Actual (loss) return on Plan assets	(254,295)	895,661
Benefits paid	(491,963)	(402,870)
Expenses paid	<u>(38,436)</u>	<u>-</u>
Fair value of Plan assets at end of year	<u>\$ 9,539,564</u>	<u>\$10,324,258</u>
Components of net periodic benefit cost		
Interest cost	\$ 624,183	\$ 642,168
Expected return on plan assets	(563,214)	(547,092)
Amortization of net loss	<u>291,460</u>	<u>252,627</u>
Net periodic benefit cost	<u>\$ 352,429</u>	<u>\$ 347,703</u>
Weighted average assumptions used to determine benefit obligation		
Discount rate	4.35 %	4.26 %
Weighted average assumptions used to determine benefit cost		
Discount rate	4.26	4.84
Expected return on assets	5.60	5.70

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

The following benefit payments are expected to be paid over the next ten years as of September 30, 2015:

2016	\$ 591,921
2017	619,045
2018	640,570
2019	699,160
2020	752,972
2021 - 2025	4,485,738

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

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Asset allocation is primarily based on a strategy to provide stable earnings while still permitting the plans to recognize potentially higher returns through a limited investment in equity securities. Plan assets are rebalanced quarterly. At September 30, 2015 and 2014, plan assets by category are as follows:

	<u>2015</u>	<u>2014</u>
Equity funds	52 %	47 %
Debt funds	29	50
Cash and cash equivalents	3	3
International funds	<u>16</u>	<u>-</u>
	<u>100 %</u>	<u>100 %</u>

The targeted asset allocation ranges for the Plan are as follows:

	<u>Ranges</u>
Equity funds	0 - 60%
Fixed income funds	30 - 100
Short term investments or funds	0 - 20
Alternative investments or funds	0 - 10

In the next year, \$340,532 is expected to be recognized as a component of net periodic benefit cost related to net actuarial loss previously recognized in unrestricted net assets. The total amount to be amortized to pension expired in future years is \$4,800,000. No plan assets are expected to be returned to PMC in 2016. PMC expects to contribute \$1,000,000 to the Plan in 2016.

Risks

The Plan 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 changes could materially affect the amounts reported.

16. Health Care Improvement Tax

Effective July 1, 1991, a health care improvement tax was imposed on medical centers, nursing homes and home health agencies as part of a program to upgrade services in Vermont. The State of Vermont pays the Hospital with funds received from the health care improvement trust fund and federal matching funds. The assessment rate for subsequent years will be determined annually by the General Assembly.

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17. Operating Leases

Noncancelable operating leases for primary care outpatient offices expire in various years through September 2025. These leases generally contain renewal options for periods ranging from three to six years and require the Hospital to pay all executory costs.

Future minimum lease payments at September 30, 2015 were:

2016	\$ 868,000
2017	686,000
2018	647,000
2019	544,000
2020	483,000
Thereafter	<u>671,000</u>
	<u>\$ 3,899,000</u>

Rent expense during 2015 and 2014 amounted to \$1,024,895 and \$1,020,857, respectively.

18. Related Party Transactions

Revenues and Expenses

The Hospital contracts for services with and provides services to related parties. A description of the services provided and amounts recorded as revenue (expense) by the Hospital is as follows during the years ended September 30:

	<u>2015</u>	<u>2014</u>
HPNH		
Medical director	\$ 26,004	\$ 26,004
Employee physicals	21,854	26,463
Resident medical testing	42,702	45,569
PMC		
Management services	(1,210,698)	(1,036,999)
Administrative services	(1,499,342)	(1,210,459)
PREH		
Facility rent	(118,680)	(118,680)
Interest income	1,448	1,795

Accounts Receivable

Accounts receivable from related parties were as follows as of September 30:

	<u>2015</u>	<u>2014</u>
HPNH	\$ 122,320	\$ 158,510
PREH	11,117	61,855
PMC	<u>137,650</u>	<u>144,165</u>
	<u>\$ 271,087</u>	<u>\$ 364,530</u>

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Accounts Payable

Accounts payable to related parties were as follows as of September 30:

	<u>2015</u>	<u>2014</u>
HPNH	\$ 34,768	\$ 37,571
PMC	<u>347,423</u>	<u>351,126</u>
	<u>\$ 382,191</u>	<u>\$ 388,697</u>

Note Receivable

Note receivable from PREH is as follows as of September 30:

	<u>2015</u>	<u>2014</u>
6% unsecured note receivable, monthly payments of \$441 including principal and interest, due February 21, 2021	\$ 23,804	\$ 27,787
Less current portion	<u>3,497</u>	<u>3,497</u>
	<u>\$ 20,307</u>	<u>\$ 24,290</u>

19. Fair Value Measurements and Disclosures

FASB ASC 820, *Fair Value Measurement*, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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Assets measured at fair value on a recurring basis are summarized below.

	<u>Fair Value Measurements at September 30, 2015</u>			
	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Investments				
Cash and cash equivalents	\$ 165,445	\$ 165,445	\$ -	\$ -
Investments held by Middlebury College	4,776,553	-	-	4,776,553
Deferred compensation plan assets:				
Mutual funds	715,055	715,055	-	-
Beneficial interest in perpetual trusts	<u>3,431,932</u>	<u>-</u>	<u>-</u>	<u>3,431,932</u>
Total assets	<u>\$ 9,088,985</u>	<u>\$ 880,500</u>	<u>\$ -</u>	<u>\$ 8,208,485</u>
	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Pension assets (total for Plan - see Note 15):				
Cash and cash equivalents	\$ 300,214	\$ 300,214	\$ -	\$ -
Mutual funds				
Growth funds	2,465,682	2,465,682	-	-
Equity funds	2,442,984	2,442,984	-	-
Bond funds	2,776,001	2,776,001	-	-
International funds	1,554,683	1,554,683	-	-
Total mutual funds	<u>9,239,350</u>	<u>9,239,350</u>	<u>-</u>	<u>-</u>
Total pension assets	<u>\$ 9,539,564</u>	<u>\$ 9,539,564</u>	<u>\$ -</u>	<u>\$ -</u>

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	<u>Fair Value Measurements at September 30, 2014</u>			
	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:				
Investments				
Cash and cash equivalents	\$ 320,971	\$ 320,971	\$ -	\$ -
Corporate and taxable bonds	428,798	-	428,798	-
U.S. Treasury obligations and government securities	526,223	526,223	-	-
Government sponsored enterprises	207,070	-	207,070	-
International bonds	84,467	-	84,467	-
Marketable equity securities	-	-	-	-
Basic materials	108,297	108,297	-	-
Communication services	36,392	36,392	-	-
Consumer staple	145,201	145,201	-	-
Consumer discretionary	235,859	235,859	-	-
Energy	167,579	167,579	-	-
Financial services	468,015	468,015	-	-
Healthcare	210,191	210,191	-	-
Industrials	196,797	196,797	-	-
Technology	380,599	380,599	-	-
Utilities	54,934	54,934	-	-
Miscellaneous	120,443	120,443	-	-
Total marketable equity securities	<u>2,124,307</u>	<u>2,124,307</u>	<u>-</u>	<u>-</u>
Mutual funds				
Growth funds	120,009	120,009	-	-
Equity funds	205,292	205,292	-	-
Bond funds	16,599	16,599	-	-
International funds	41,121	41,121	-	-
Total mutual funds	<u>383,021</u>	<u>383,021</u>	<u>-</u>	<u>-</u>
Deferred compensation plan assets: Cash and cash equivalents	816,648	816,648	-	-
Beneficial interest in perpetual trusts	<u>3,485,489</u>	<u>-</u>	<u>-</u>	<u>3,485,489</u>
Total assets	<u>\$ 8,376,994</u>	<u>\$ 4,171,170</u>	<u>\$ 720,335</u>	<u>\$ 3,485,489</u>

PORTER HOSPITAL, INC.

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	<u>Total</u>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Pension assets (total for Plan - see Note 15):				
Cash and cash equivalents	\$ 325,426	\$ 325,426	\$ -	\$ -
Mutual funds				
Growth funds	1,422,414	1,422,414	-	-
Equity funds	3,375,833	3,375,833	-	-
Bond funds	<u>5,188,552</u>	<u>5,188,552</u>	-	-
Total mutual funds	<u>9,986,799</u>	<u>9,986,799</u>	-	-
Accrued interest	<u>12,033</u>	<u>12,033</u>	-	-
Total pension assets	<u>\$ 10,324,258</u>	<u>\$ 10,324,258</u>	<u>\$ -</u>	<u>\$ -</u>

Significant activity for assets measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows:

Level 3 investments at October 1, 2013	\$ 3,305,833
Net appreciation of beneficial interest in perpetual trusts	<u>179,656</u>
Level 3 investments at September 30, 2014	3,485,489
Net depreciation of beneficial interest in perpetual trusts	(53,557)
Transfer of assets to Middlebury College	5,000,000
Net depreciation of assets held by Middlebury College	<u>(223,447)</u>
Level 3 investments at September 30, 2015	<u>\$ 8,208,485</u>

The fair value of Level 2 assets is primarily based on quoted market prices of comparable securities. The fair value of Level 3 assets is based on the Hospital's share of the quoted market prices of the underlying assets of the trust or similar securities. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. All fair values are provided by investment mergers.

The Hospital's financial instruments consist of cash and cash equivalents, investments, beneficial interest in perpetual trusts, trade accounts and a note receivable and payable, estimated third-party settlements, the deferred compensation liability and long-term debt. The carrying values of cash and cash equivalents, estimated third-party payor settlements, the deferred compensation liability, and long-term debt approximate their fair values using Level 1 inputs. The fair values of investments and beneficial interest in perpetual trusts were determined using the methods and inputs described in the first section of this Note.

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20. Meaningful Use Revenues

The Medicare and Medicaid electronic health record (EHR) incentive programs provide a financial incentive for achieving "meaningful use" of certified EHR technology. The criteria for meaningful use will be staged in three steps with stage 3 beginning in 2018. The meaningful use attestation is subject to audit by CMS in future years. As part of this process, a final settlement amount for the incentive payments could be established that differs from the initial calculation, and could result in return of a portion or all of the incentive payments received by the Hospital.

The Medicaid program will provide incentive payments to hospitals and eligible professionals as they adopt, implement, upgrade or demonstrate meaningful use in the first year of participation and demonstrate meaningful use for up to five remaining participation years. The Hospital recorded meaningful use revenues of approximately \$528,300 and \$600,000 in other operating revenue during 2015 and 2014, respectively.

During 2015 and 2014, the Hospital demonstrated meaningful use related to its certified EHR system, allowing the Hospital to be eligible to receive EHR incentive payments from Medicare. The Hospital recorded meaningful use revenues of approximately \$153,300 and \$150,000 in other operating revenue in 2015 and 2014, respectively.

