BerryDunn

PORTER HOSPITAL, INC.

FINANCIAL STATEMENTS

September 30, 2013 and 2012

With Independent Auditor's Report

PORTER HOSPITAL, INC.

September 30, 2013 and 2012

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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. (the Hospital), a subsidiary of Porter Medical Center, Inc., which comprise the balance sheets as of September 30, 2013 and 2012, 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.

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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, 2013 and 2012, 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
January 23, 2014
Registration No. 92-0000278

PORTER HOSPITAL, INC.

Balance Sheets

September 30, 2013 and 2012

ASSETS

	2013	2012
Current assets		
Cash and cash equivalents	**$ 7,569,083**	$ 3,442,461
Assets limited as to use, trustee held funds under debt agreements	**365,000**	351,574
Patient accounts receivable, net	**8,644,728**	8,904,451
Other receivables, net	**3,119,430**	2,019,698
Current portion of note receivable, related party	**3,497**	3,294
Supplies	**1,244,257**	1,258,811
Prepaid expenses and other	**1,053,616**	731,639
Due from affiliates	**886,852**	344,340
Total current assets	**22,886,463**	17,056,268
Assets limited as to use, deferred compensation plan assets	**763,724**	559,266
Long-term investments	**3,798,204**	3,221,907
Property and equipment, net	**24,139,639**	26,418,583
Beneficial interest in perpetual trusts	**3,305,833**	2,978,834
Deferred financing costs, net	**130,637**	136,650
Note receivable, related party - noncurrent	**28,002**	31,500
Total assets	**$ 55,052,502**	$ 50,403,008

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

LIABILITIES AND NET ASSETS

	2013	2012
Current liabilities		
Current portion of long-term debt	$ 1,420,900	$ 1,365,754
Accounts payable and accrued expenses	5,043,352	4,040,424
Accrued payroll and related liabilities	1,948,861	2,572,625
Estimated third-party settlements	801,105	665,000
Accrued vacation	2,599,463	2,453,786
Due to affiliates	651,784	147,572
Total current liabilities	12,465,465	11,245,161
Liability for pension benefits	3,009,913	3,837,478
Deferred compensation	763,724	559,266
Long-term debt, excluding current portion	14,435,104	14,816,330
Total liabilities	30,674,206	30,458,235
Commitments and contingencies (Notes 5, 7, 14, 15, 17 and 18)		
Net assets		
Unrestricted	20,686,456	16,576,126
Temporarily restricted	268,325	272,131
Permanently restricted	3,423,515	3,096,516
Total net assets	24,378,296	19,944,773
Total liabilities and net assets	$ 55,052,502	$ 50,403,008

PORTER HOSPITAL, INC.

Statements of Operations

Years Ended September 30, 2013 and 2012

	2013	2012
Unrestricted revenues, gains and other support		
Patient service revenue (net of contractual allowances and discounts)	**$ 68,461,541**	$ 65,094,735
Less provision for bad debts	**3,895,584**	4,826,436
Net patient service revenue	**64,565,957**	60,268,299
Other operating revenue	**5,016,612**	2,022,091
Net assets released from restrictions used for operations	**2,982**	4,326
Total unrestricted revenues, gains and other support	**69,585,551**	62,294,716
Expenses		
Professional care of patients	**38,184,537**	36,543,490
General services	**3,742,681**	3,935,766
Administrative and fiscal services	**18,953,674**	19,223,964
Health care improvement tax	**3,717,145**	3,569,765
Depreciation and amortization	**4,828,182**	4,799,131
Interest	**275,537**	339,030
Total expenses	**69,701,756**	68,411,146
Operating loss	**(116,205)**	(6,116,430)
Nonoperating gains		
Contributions	**168,708**	167,262
Investment income	**520,277**	558,421
Other program income, net	**2,693,067**	2,282,585
Nonoperating gains	**3,382,052**	3,008,268
Excess (deficiency) of revenues, gains and other support over expenses and nonoperating gains	**3,265,847**	(3,108,162)
Net assets released from restrictions used for purchase of property and equipment	**52,000**	10,000
Change in net assets to recognize funded status of pension plan	**693,795**	(1,608,873)
Transfer from affiliate	**98,688**	-
Increase (decrease) in unrestricted net assets	**$ 4,110,330**	$ (4,707,035)

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

PORTER HOSPITAL, INC.

Statements of Changes in Net Assets

Years Ended September 30, 2013 and 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balances, October 1, 2011	$ 21,283,161	$ 283,888	$ 2,968,901	$ 24,535,950
Deficiency of revenues, gains and other support over expenses and nonoperating gains	(3,108,162)	-	-	(3,108,162)
Net assets released from restrictions used for operations	-	(4,326)	-	(4,326)
Net assets released from restrictions used for purchase of property and equipment	10,000	(10,000)	-	-
Change in net assets to recognize funded status of pension plan	(1,608,873)	-	-	(1,608,873)
Contributions	-	2,569	-	2,569
Change in beneficial interest in perpetual trusts	-	-	127,615	127,615
Net (decrease) increase in net assets	(4,707,035)	(11,757)	127,615	(4,591,177)
Balances, September 30, 2012	16,576,126	272,131	3,096,516	19,944,773
Excess of revenues, gains and other support over expenses and nonoperating gains	**3,265,847**	-	-	**3,265,847**
Net assets released from restrictions used for operations	-	**(2,982)**	-	**(2,982)**
Net assets released from restrictions used for purchase of property and equipment	**52,000**	**(52,000)**	-	-
Change in net assets to recognize funded status of pension plan	**693,795**	-	-	**693,795**
Transfer from affiliate	**98,688**	-	-	**98,688**
Contributions	-	**51,176**	-	**51,176**
Change in beneficial interest in perpetual trusts	-	-	**326,999**	**326,999**
Net increase (decrease) in net assets	**4,110,330**	**(3,806)**	**326,999**	**4,433,523**
Balances, September 30, 2013	**$ 20,686,456**	**$ 268,325**	**$ 3,423,515**	**$ 24,378,296**

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

PORTER HOSPITAL, INC.

Statements of Cash Flows

Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities		
Change in net assets	$ 4,433,523	$ (4,591,177)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	4,828,182	4,799,131
Provision for bad debts	3,895,584	4,826,436
Net realized and unrealized gain on investments	(294,192)	(354,371)
Change in net assets to recognize funded statements of pension plan	(693,795)	1,608,873
Restricted contributions	(51,176)	(2,569)
Equity transfer from affiliate	(98,688)	-
Net unrealized gain on beneficial interest in perpetual trusts	(326,999)	(127,615)
(Increase) decrease in		
Patient accounts receivable	(3,635,963)	(3,661,788)
Due from affiliates	(542,512)	(104,004)
Supplies, prepaids and other current assets	(1,421,154)	(913,627)
Increase (decrease) in		
Accounts payable and accrued expenses	1,002,928	2,397,490
Accrued payroll and related liabilities	(623,764)	521,284
Estimated third-party settlements	136,105	(518,000)
Due to affiliates	504,212	(1,116)
Other current liabilities	11,907	(9,544)
Net cash provided by operating activities	7,124,198	3,869,403
Cash flows from investing activities		
Purchase of investments	(846,568)	(972,075)
Proceeds from sale of investments	564,463	1,206,515
Payments on note receivable from affiliates	3,295	3,103
Purchase of property and equipment	(1,634,460)	(2,391,952)
Net cash used by investing activities	(1,913,270)	(2,154,409)
Cash flows from financing activities		
Proceeds from restricted contributions	51,176	2,569
Equity transfer from affiliate	98,688	-
Proceeds from issuance of long-term debt	140,800	-
Principal payments on long-term debt	(1,375,072)	(1,376,865)
Net cash used by financing activities	(1,084,408)	(1,374,296)
Increase in cash and cash equivalents	4,126,520	340,698
Cash and cash equivalents, beginning of year	3,441,680	3,100,982
Cash and cash equivalents, end of year	$ 7,568,200	$ 3,441,680
Supplemental cash flows information		
Interest paid	$ 275,537	$ 339,030
Capital lease obligation incurred for property and equipment	$ 908,192	$ -

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

Nature of Operations

Porter Hospital, Inc. (the 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), Porter Management Services, Inc. (PMS) 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 (ASC) 958, *Not-For-Profit Entities*. Under FASB ASC 958, all not-for-profit organizations are required to provide a balance sheet, a statement of operations, and a statement of cash flows. The Statement 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 a statement of operations; 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 with original maturities of three months or less other than deferred compensation plan investments to be cash equivalents. At September 30, 2013 and 2012, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

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 ASC 825, 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.

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 (deficiency) of revenue, gains, and other support over expenses and nonoperating gains, 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.

Deferred Financing Costs

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

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.

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

The statements of operations include excess (deficiency) of revenues, gains, and other support over expenses and nonoperating gains. 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.

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 January 23, 2014, which was the date the financial statement were issued.

On November 7, 2013, a petitioned vote for Union representation for Registered Nurse staff took place. The vote resulted "in favor" of having the Vermont American Federation of Teachers (AFT) Union represent Porter Medical Center's Registered Nurses, as defined in the negotiated definition of the RN bargaining unit.

Reclassifications

Certain amounts in the 2012 financial statements have been reclassified to conform to the current year's presentation.

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:

	2013	2012
Patient services		
Inpatient	**$ 30,915,301**	$ 27,986,532
Outpatient	**93,464,123**	90,511,630
Gross patient service revenue	**124,379,424**	118,498,162
Less Medicare and Medicaid allowances	**36,686,306**	33,674,819
Less other contractual allowances	**17,725,644**	18,552,442
Less charity care and other discounts	**1,505,933**	1,176,166
	55,917,883	53,403,427
Patient service revenue (net of contractual allowances and discounts)	**68,461,541**	65,094,735
Less provision for bad debts	**3,895,584**	4,826,436
Net patient service revenue	**$ 64,565,957**	$ 60,268,299

Patient Accounts Receivable

Patient accounts receivable consisted of the following at September 30:

	2013	2012
Gross patient accounts receivable	**$ 18,001,017**	$ 18,103,954
Less: Estimated contractual allowances	**5,897,793**	6,179,490
Estimated allowance for doubtful accounts and charity care	**3,458,496**	3,020,013
Net patient accounts receivable	**$ 8,644,728**	$ 8,904,451

During 2013, the Hospital decreased its estimate from $2,497,589 to $2,403,438 in the allowance for doubtful accounts relating to self-pay patients and increased such estimate from $522,424 to $1,055,058 for doubtful accounts relating to third-party payors. During 2012, the Hospital increased its estimate from $2,267,426 to $2,497,589 in the allowance for doubtful accounts relating to self-pay patients and decreased such estimate from $893,094 to $522,424 for doubtful accounts relating to third-party payors. During 2013, self-pay write-offs decreased from $6,824,422 to $4,348,250. During 2012, self-pay write-offs increased from $3,572,590 to $6,824,422. Such variations resulted from changes experienced in the collection of amounts from self-pay patients and third-party payors.

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 Medicare 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, 2009.

Medicaid

Inpatient services rendered to 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, 2009.

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 55% and 51% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2013 and 2012, respectively. The Hospital has agreements with the Centers for Medicare and Medicaid Services (Medicare) and the Office of Vermont Health Access (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 2013, net patient service revenue increased by approximately $1,182,000, and in 2012, net patient service revenue increased by approximately $384,000 due to removal of allowances or recognition of settlements no longer subject to audits, reviews and investigations.

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 fiscal year ended September 30, 2013 totaled $68,461,541, of which $65,767,917 was revenue from third-party payors and $2,968,005 was revenue from self-pay patients. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized during fiscal year ended September 30, 2012 totaled $65,094,735, of which $61,678,383 was revenue from third-party payors and $3,634,846 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 $843,889 in 2013 and $576,850 in 2012. The total cost estimate is based on an overall financial statement cost to charge ratio applied against gross charity care charges. In 2013 and 2012, 1.2% and 1.0%, respectively, of all services as defined by percentage of gross revenue was provided on a charity basis.

In 2013, of a total of 56 inpatients received their entire episode of service on a charity case basis. In 2012, of a total of 42 inpatients received their entire episode of service on a charity case basis.

In 2013, of a total of 2,085 outpatients received their entire episode of service on a charity case basis. In 2012, of a total of 1,082 outpatients received their entire episode of service on a charity case basis.

4. Investments and Investment Income

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

	2013	2012
Held by trustee under debt agreement		
Cash and cash equivalents	**$ 365,000**	$ 351,574
Held by trustee - deferred compensation funding		
Cash and cash equivalents	**$ 763,724**	$ 559,266

Total investment income is comprised of the following for the years ending September 30:

	2013	2012
Interest and dividend income	$ 226,085	$ 204,050
Net unrealized gains	240,873	354,304
Realized gains	53,319	67
	$ 520,277	$ 558,421

Long-term investments include the following at September 30:

	2013	2012
Cash and cash equivalents	$ 300,651	$ -
Mutual funds	343,709	340,365
Marketable equity securities	1,887,929	1,602,988
Corporate and taxable bonds	459,571	569,070
U.S. Treasury obligations and government securities	547,084	453,548
Government sponsored enterprises	210,937	240,232
International bonds	48,323	15,704
	$ 3,798,204	$ 3,221,907

5. Property and Equipment

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

	2013	2012
Land and land improvements	$ 2,188,641	2,185,776
Buildings and leasehold improvements	25,869,889	25,607,863
Equipment	21,406,913	20,242,383
Construction in progress	290,652	232,718
	49,756,095	48,268,740
Less accumulated depreciation	25,616,456	21,850,157
Property and equipment, net	$ 24,139,639	$ 26,418,583

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, 2013 and 2012, was $139,106 and $130,085, respectively.

7. Borrowings

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

	2013	2012
Vermont Educational and Health Buildings Financing Agency Variable Rate Demand Hospital Revenue Bonds, 2005 Series A bonds with variable interest (.07% at September 30, 2013), payable in annual installments ranging from $365,000 to $890,000 through December 2035; collateralized by the gross receipts of the Hospital.	**$ 13,535,000**	$ 13,885,000
Note payable at a fixed interest rate of 4.7%, monthly payments of $24,400, due March 2015; collateralized by certain equipment.	**423,363**	688,708
Note payable at variable interest rate of (4% at September 30, 2012), monthly payments of $1,743, with the remaining principal, due March 2019; collateralized by certain property.	**179,636**	192,789
Note payable at a fixed interest rate of 4.0%, monthly payments of $2,597, due in full in September 2018; collateralized by certain property.	**140,800**	-
Capital lease obligations at various rates with monthly payments ranging from $1,303 to $37,467, due 2014 through 2018; collateralized by leased equipment.	**1,577,205**	1,415,587
	15,856,004	16,182,084
Less current portion	**1,420,900**	1,365,754
	$ 14,435,104	$ 14,816,330

Letter of Credit

As part of the bond agreements, the Hospital is required to maintain a letter of credit. The letter of credit is issued by a bank in the amount of the outstanding principal balance plus 45 days interest calculated at 10%, which, in turn, is secured by the gross receipts of the Hospital. The current letter of credit expires June 30, 2014.

The Trust Agreement associated with the bond issue has mandatory tender provisions should the letter of credit expire and not be replaced with a substitute credit facility. These provisions are outlined in Section 3.11 of the Trust Agreement.

In connection with the letter of credit securing the 2005 Series A bonds, the Hospital is subject to certain financial covenants. The Hospital is in compliance with these financial covenants at September 30, 2013.

Aggregate annual maturities of long-term debt and payments on capital lease obligations at September 30, 2013, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2014	$ 683,313	$ 778,228
2015	566,000	284,693
2016	438,000	225,685
2017	454,800	196,181
2018	471,700	183,992
Thereafter	11,664,986	-
	$ 14,278,799	1,668,778
Less amounts representing interest		(91,573)
		$ 1,577,205

8. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purpose or periods:

	2013	2012
Health care services	**$ 29,288**	$ 33,094
Purchase of equipment	**2,657**	2,657
Indigent care	**236,380**	236,380
	$ 268,325	$ 272,131

Permanently restricted net assets are restricted to:

	2013	2012
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	3,305,833	2,978,834
	$ 3,423,515	$ 3,096,516

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 $4,010,000 and $3,613,000 on September 30, 2013 and 2012, 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 $168,738 in 2013 and $167,482 in 2012.

10. Other Operating Revenue

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

	2013	2012
Rental income	$ 152,581	$ 143,808
Cafeteria and coffee shop income	184,757	156,136
Disproportionate Share payments	769,765	771,959
Meaningful Use Incentive payments	2,613,339	-
Miscellaneous revenue	1,296,170	950,188
Total other revenue	$ 5,016,612	$ 2,022,091

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 Critical Access Hospital). In addition to savings for medications used within the Hospital, the Hospital has also established contracts with six local pharmacies during 2013. 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 $2,693,067 and $2,282,585 for the years ended September 30, 2013 and 2012, 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:

	2013	2012
Health care services	**$ 61,119,896**	$ 60,080,331
General and administrative	**8,581,860**	8,330,815
	$ 69,701,756	$ 68,411,146

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, 2013 and 2012, is:

	2013	2012
Medicare	**29 %**	25 %
Medicaid	**12**	14
Commercial and other	**30**	33
Self-pay	**29**	28
	100 %	100 %

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.

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 9 and 14 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, 2013 and 2012, the total outstanding balances on the guaranteed loans were approximately $299,000 and $376,000, respectively.

Self-Insurance

PMC was self-insured for employee health care benefits in 2012. PMC accrued a liability for employee health care by charging the statements of operations for certain known claims and reasonable estimates for incurred, but not reported, claims based on claims experience.

Effective January 1, 2013, PMC terminated its self-insurance program and has purchased a fully-insured health insurance program for its employees.

Information Technology Systems Conversion/Electronic Medical Record Project (the Project)

The Project was approved by the Vermont Department of Financial Regulations via the Certificate of Need (CON) process for a total expenditure of $7,113,290. The Project was substantially complete as of September 2013, with expenditures totaling $6,513,748. The Hospital anticipates completion of this Project by August 2014 coincident with implementation in the final physician practices.

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, 2012.

The Hospital has estimated a liability of approximately $849,000 and $961,000 at September 30, 2013 and 2012, respectively, related to the 403(b) plan. This amount has been included in other accrued expenses. Contributions are calculated on a calendar year basis, and are paid following the end of the calendar year. Contributions to the plan were approximately $1,017,000 and $949,000 for calendar years 2012 and 2011, respectively.

Deferred Compensation Plan

The Hospital has a nonqualified deferred compensation plan established under section 457 of the Internal Revenue Code of 1986. 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 does not expect to contribute to the plan in 2013.

PMC has adopted FASB ASC 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 $3,009,913 and $3,837,478 at September 30, 2013 and 2012, respectively. The Hospital's share of the pension expense was $254,941 and $224,498 for the years ending September 30, 2013 and 2012, respectively. The Hospital contributed $345,000 and $512,000 to the plan in 2013 and 2012, respectively.

PMC uses a September 30, 2013 measurement date for the plan. Significant balances, costs and assumptions for the plan as a whole are:

	2013	2012
Benefit obligations	**$(13,501,286)**	$(14,202,606)
Fair value of plan assets	**9,831,467**	9,206,866
Funded status	**$ (3,669,819)**	$ (4,995,740)

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:

	2013	2012
Change in benefit obligation		
Benefit obligation at beginning of year	**$14,202,606**	$10,942,491
Interest cost	**594,225**	592,876
Actuarial (gain) loss	**(926,953)**	3,045,711
Benefits paid	**(368,592)**	(378,472)
Benefit obligation at end of year	**$13,501,286**	$14,202,606

	2013	2012
Change in plan assets		
Fair value of plan assets at beginning of year	**$ 9,206,866**	$ 7,679,106
Actual return on plan assets	**571,981**	1,394,514
Employer contributions	**421,212**	511,718
Benefits paid	**(368,592)**	(378,472)
Fair value of plan assets at end of year	**$ 9,831,467**	$ 9,206,866
Components of net periodic benefit cost		
Interest cost	**$ 594,225**	$ 592,876
Expected return on plan assets	**(624,543)**	(519,420)
Amortization of net loss	**341,153**	201,333
Net periodic benefit cost	**$ 310,835**	$ 274,789

	2013	2012
Weighted average assumptions used to determine benefit obligation		
Discount rate	**4.84 %**	4.25 %
Weighted average assumptions used to determine benefit cost		
Discount rate	**4.25**	5.50
Expected return on assets	**6.85**	6.85

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 as of September 30, 2013:

2013	$ 466,717
2014	522,751
2015	546,928
2016	573,046
2017	593,590
2018 - 2022	3,801,840

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.

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, 2013 and 2012, plan assets by category are as follows:

	2013	2012
Equity securities	**49.2 %**	48.2 %
Debt securities	**48.5**	43.8
Cash and cash equivalents	**2.3**	8.0
	100.0 %	100.0 %

In the next year, $252,627 is expected to be recognized as components of net periodic benefit cost related to items previously recognized in unrestricted net assets. No plan assets are expected to be returned to PMC in 2014.

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.

17. Operating Leases

Noncancelable operating leases for primary care outpatient offices expire in various years through May 2018. 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, 2013, were:

2014	$ 933,000
2015	637,000
2016	577,000
2017	584,000
2018	591,000
	$ 3,322,000

Rent expense during 2013 and 2012 amounted to $1,049,087 and $838,530, respectively.

18. Related Party Transactions

Revenues and Expenses

The Hospital contracts for services 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:

	2013	2012
HPNH		
Medical Director	$ 15,444	$ 15,444
Employee physicals	16,512	19,614
Speech therapy services	(3,303)	(6,863)
Resident medical testing	51,455	44,449
PMS		
Management services	(1,077,698)	(773,160)
Administrative services	(1,161,607)	(977,340)
Employee physicals	836	267
PREH		
Facility rent	(118,680)	(123,868)
Interest income	1,998	2,189

Accounts Receivable

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

	2013	2012
HPNH	$ 196,778	$ 87,787
PREH	97,542	-
PMS	592,034	137,582
PMC	498	118,971
	$ 886,852	$ 344,340

Accounts Payable

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

	2013	2012
HPNH	$ 11,010	$ 1,697
PREH	650	-
PMS	627,074	145,875
PMC	13,050	-
	$ 651,784	$ 147,572

Note Receivable

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

	2013	2012
6% unsecured note receivable, monthly payments of $441 including principal and interest, due February 21, 2021	$ 31,499	$ 34,794
Less current portion	3,497	3,294
	$ 28,002	$ 31,500

19. Fair Value Measurements

FASB ASC 820 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.

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

	Fair Value Measurements at September 30, 2013			
	Total	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	$ 300,651	$ 300,651	$ -	$ -
Corporate and taxable bonds	459,571	-	459,571	-
U.S. Treasury obligations and government securities	547,084	547,084	-	-
Government sponsored enterprises	210,937	-	210,937	-
International bonds	48,323	-	48,323	-
Marketable equity securities	-	-	-	-
Basic materials	64,075	64,075	-	-
Communication services	32,673	32,673	-	-
Consumer staple	154,246	154,246	-	-
Consumer discretionary	216,798	216,798	-	-
Energy	185,741	185,741	-	-
Financial services	274,009	274,009	-	-
Healthcare	230,690	230,690	-	-
Industrials	240,070	240,070	-	-
Technology	328,277	328,277	-	-
Utilities	36,072	36,072	-	-
Miscellaneous	125,278	125,278	-	-
Total marketable equity securities	1,887,929	1,887,929	-	-
Mutual funds				
Growth funds	104,915	104,915	-	-
Equity funds	183,598	183,598	-	-
International funds	55,196	55,196	-	-
Total mutual funds	343,709	343,709	-	-
Deferred compensation plan assets:				
Cash and cash equivalents	763,724	763,724	-	-
Beneficial interest in perpetual trusts	3,305,833	-	-	3,305,833
Total assets	$ 7,867,761	$ 3,843,097	$ 718,831	$ 3,305,833

	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Pension assets:				
Cash and cash equivalents	$ 224,321	$ 224,321	$ -	$ -
Mutual funds	-	-	-	-
Growth funds	1,468,647	1,468,647	-	-
Equity funds	3,357,272	3,357,272	-	-
Bond funds	4,766,477	4,766,477	-	-
Total mutual funds	9,592,396	9,592,396	-	-
Accrued interest	14,750	14,750	-	-
Total pension assets	$ 9,831,467	$ 9,831,467	$ -	$ -

	Fair Value Measurements at September 30, 2012			
	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Investments				
Corporate and taxable bonds	$ 569,070	$ -	$ 569,070	$ -
U.S. Treasury obligations and government securities	453,548	453,548	-	-
Government sponsored enterprises	240,232	-	240,232	-
International bonds	15,704	-	15,704	-
Marketable equity securities	-	-	-	-
Basic materials	53,787	53,787	-	-
Communication services	31,899	31,899	-	-
Consumer staple	161,193	161,193	-	-
Consumer discretionary	177,353	177,353	-	-
Energy	176,893	176,893	-	-
Financial services	217,848	217,848	-	-
Healthcare	192,523	192,523	-	-
Industrials	156,976	156,976	-	-
Technology	292,728	292,728	-	-
Utilities	35,992	35,992	-	-
Miscellaneous	105,796	105,796	-	-
Total marketable equity securities	1,602,988	1,602,988	-	-
Mutual funds				
Growth funds	110,515	110,515	-	-
Equity funds	173,973	173,973	-	-
Bond funds	16,240	16,240	-	-
International funds	39,637	39,637	-	-
Total mutual funds	340,365	340,365	-	-
Deferred compensation plan assets:				
Cash and cash equivalents	559,266	559,266	-	-
Beneficial interest in perpetual trust	2,978,834	-	-	2,978,834
Total assets	$ 6,760,007	$ 2,956,167	$ 825,006	$ 2,978,834

	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Pension assets:				
Cash and cash equivalents	$ 739,608	$ 739,608	$ -	$ -
Mutual funds				
Growth funds	1,320,572	1,320,572	-	-
Equity funds	3,111,309	3,111,309	-	-
Bond funds	4,024,362	4,024,362	-	-
Total mutual funds	8,456,243	8,456,243	-	-
Accrued interest	11,015	11,015	-	-
Total pension assets	$ 9,206,866	$ 9,206,866	$ -	$ -

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, 2011	$ 2,851,219
Net appreciation of beneficial interest in perpetual trusts	127,615
Level 3 investments at September 30, 2012	2,978,834
Net appreciation of beneficial interest in perpetual trusts	326,999
Level 3 investments at September 30, 2013	$ 3,305,833

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 underlying assets of the trust. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The Hospital's financial instruments consist of cash and cash equivalents, marketable securities, trade accounts receivable and payable, estimated third-party settlements and long-term debt. The fair values of all financial instruments approximate their carrying values at September 30, 2013 and 2012.

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 from fiscal year 2012 through 2016. 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.

During 2013, 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 $2,600,000 in other operating revenue.

As of September 30, 2013, the Hospital had not received approximately $2,200,000 of the incentive payments, which is included in estimated third-party settlements.

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