BerryDunn

PORTER HOSPITAL, INC.

FINANCIAL STATEMENTS

with

SUPPLEMENTARY INFORMATION

September 30, 2012 and 2011

With Independent Auditors' Report

September 30, 2012 and 2011

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BerryDunn

INDEPENDENT AUDITORS' REPORT

Board of Directors
Porter Hospital, Inc.

We have audited the accompanying balance sheets of Porter Hospital, Inc. (the Hospital), a subsidiary of Porter Medical Center, Inc., as of September 30, 2012 and 2011, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary schedule of required financial covenant ratios is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary schedule of required financial covenant ratios has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. generally accepted auditing standards. In our opinion, the supplementary schedule is fairly stated in all material respects in relation to the financial statements taken as a whole.

Berry, Dunn, McNeil & Parker

Manchester, New Hampshire
January 8, 2013
Registration No. 92-0000278

PORTER HOSPITAL, INC.

Balance Sheets

September 30, 2012 and 2011

ASSETS

	2012	2011
Current assets		
Cash and cash equivalents	**$ 3,442,461**	$ 3,100,982
Assets limited as to use, trustee held funds under debt agreements	**351,574**	337,031
Patient accounts receivable, net	**8,904,451**	10,069,880
Other receivables, net	**2,018,211**	1,121,383
Current portion of note receivable, related party	**3,294**	3,103
Supplies	**1,258,811**	1,178,244
Prepaid expenses and other	**585,376**	605,716
Due from affiliates	**344,340**	240,336
Total current assets	**16,908,518**	16,656,675
Assets limited as to use, deferred compensation plan assets	**559,266**	412,630
Long-term investments	**3,221,907**	3,101,976
Property and equipment, net	**26,418,583**	28,812,904
Beneficial interest in perpetual trusts	**2,978,834**	2,851,219
Deferred financing costs, net	**136,650**	142,662
Notes receivable	**147,750**	212,567
Note receivable, related party - noncurrent	**31,500**	34,794
Total assets	**$ 50,403,008**	$ 52,225,427

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

LIABILITIES AND NET ASSETS

	2012	2011
Current liabilities		
Current portion of long-term debt	**$ 1,365,754**	$ 1,385,558
Accounts payable and accrued expenses	**4,040,424**	1,642,934
Accrued payroll and related liabilities	**2,572,625**	2,051,341
Estimated third-party settlements	**665,000**	1,183,000
Accrued vacation	**2,453,786**	2,176,110
Due to affiliates	**147,572**	148,688
Total current liabilities	**11,245,161**	8,587,631
Liability for pension benefits	**3,837,478**	2,515,825
Deferred compensation	**559,266**	412,630
Long-term debt, excluding current portion	**14,816,330**	16,173,391
Total liabilities	**30,458,235**	27,689,477
Commitments and contingencies (Notes 5, 14, 15, 17 and 18)		
Net assets		
Unrestricted	**16,576,126**	21,283,161
Temporarily restricted	**272,131**	283,888
Permanently restricted	**3,096,516**	2,968,901
Total net assets	**19,944,773**	24,535,950
Total liabilities and net assets	**$ 50,403,008**	$ 52,225,427

PORTER HOSPITAL, INC.

Statements of Operations

Years Ended September 30, 2012 and 2011

	2012	2011
Unrestricted revenues, gains and other support		
Patient service revenue (net of contractual allowances and discounts)	**$ 65,313,229**	$ 58,979,939
Less provision for bad debts	**4,827,217**	2,326,120
Net patient service revenue	**60,486,012**	56,653,819
Other operating revenue	**1,804,378**	1,806,096
Net assets released from restrictions used for operations	**4,326**	79,302
Total unrestricted revenues, gains and other support	**62,294,716**	58,539,217
Expenses		
Professional care of patients	**36,543,490**	32,161,266
General services	**3,935,766**	3,800,481
Administrative and fiscal services	**19,223,964**	14,965,041
Health care improvement tax	**3,569,765**	3,158,424
Depreciation and amortization	**4,799,131**	3,431,186
Interest	**339,030**	314,456
Total expenses	**68,411,146**	57,830,854
Operating (loss) income	**(6,116,430)**	708,363
Nonoperating gains		
Contributions	**167,262**	186,633
Investment income	**558,421**	134,040
Other program income, net	**2,282,585**	1,428,863
Nonoperating gains	**3,008,268**	1,749,536
(Deficiency) excess of revenues, gains and other support over expenses and nonoperating gains	**(3,108,162)**	2,457,899
Net assets released from restrictions used for purchase of property and equipment	**10,000**	-
Change in net assets to recognize funded status of pension plan	**(1,608,873)**	(347,098)
Transfer to affiliate	**-**	(98,688)
Increase (decrease) in unrestricted net assets	**$ (4,707,035)**	$ 2,012,113

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

PORTER HOSPITAL, INC.

Statements of Changes in Net Assets

Years Ended September 30, 2012 and 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balances, October 1, 2010	$ 19,271,048	$ 371,505	$ 3,070,087	$ 22,712,640
Excess of revenues, gains and other support over expenses and nonoperating gains	2,457,899	-	-	2,457,899
Net assets released from restrictions used for operations	-	(79,302)	-	(79,302)
Change in net assets to recognize funded status of pension plan	(347,098)	-	-	(347,098)
Transfer to affiliate	(98,688)	-	-	(98,688)
Contributions	-	1,203	-	1,203
Investment loss, net	-	(9,518)	-	(9,518)
Change in beneficial interest in perpetual trusts	-	-	(101,186)	(101,186)
Net increase (decrease) in net assets	2,012,113	(87,617)	(101,186)	1,823,310
Balances, September 30, 2011	21,283,161	283,888	2,968,901	24,535,950
Deficiency of revenues, gains and other support over (under) 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**

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

PORTER HOSPITAL, INC.

Statements of Cash Flows

Years Ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Change in net assets	$ (4,591,177)	$ 1,823,310
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Loss on disposal of property and equipment	750	20,022
Depreciation and amortization	4,799,131	3,431,186
Provision for bad debts	4,827,217	2,326,120
Net realized and unrealized (gain) loss on investments	(354,371)	92,069
Change in net assets to recognize funded statements of pension plan	1,608,873	347,098
Equity transfer to affiliate	-	98,688
Net unrealized loss (gain) on beneficial interest in perpetual trusts	(127,615)	101,186
(Increase) decrease in		
Patient accounts receivable	(3,661,788)	(5,611,843)
Due from affiliates	(104,004)	187,854
Supplies, prepaids and other current assets	(978,444)	(1,403,335)
Increase (decrease) in		
Accounts payable and accrued expenses	2,397,490	(243,165)
Accrued payroll and related liabilities	521,284	372,249
Estimated third party-settlements	(518,000)	583,000
Due to affiliates	(1,116)	(161,956)
Other current liabilities	(9,544)	(28,068)
Net cash provided by operating activities	3,808,686	1,934,415
Cash flows from investing activities		
Purchase of investments	(972,075)	(2,071,849)
Proceeds from sale of investments	1,206,515	1,812,137
Payments on note receivable from affiliates	3,103	2,921
Purchase of property and equipment	(2,392,702)	(3,851,570)
Notes receivable	64,817	(194,930)
Net cash used by investing activities	(2,090,342)	(4,303,291)
Cash flows from financing activities		
Equity transfer to affiliate	-	(98,688)
Principal payments on long-term debt	(1,376,865)	(1,168,626)
Net cash used by financing activities	(1,376,865)	(1,267,314)
Increase (decrease) in cash and cash equivalents	341,479	(3,636,190)
Cash and cash equivalents, beginning of year	3,100,982	6,737,172
Cash and cash equivalents, end of year	$ 3,442,461	$ 3,100,982
Supplemental cash flows information		
Interest paid	$ 339,030	$ 314,465
Capital lease obligation incurred for property and equipment	-	1,719,627

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 (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, 2012 and 2011, 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 (losses) 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 include 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 includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a 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 gain, 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 accrued 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. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. 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.

Recently Issued Accounting Pronouncement

In August 2010, the FASB issued ASU No. 2010-24, "*Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*" Accounting Standards Update (ASU) 2010-24, which clarifies that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. ASU 2010-24 is effective for the Hospital's year ended September 30, 2012.

Subsequent Events

For purposes of the preparation of these financial statements in conformity with GAAP, the Hospital has considered transactions of events occurring through January 8, 2013, which was the date the financial statement were issued.

Reclassifications

Certain amounts in the 2011 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:

	2012	2011
Patient services		
Inpatient	**$ 27,986,532**	$ 22,985,718
Outpatient	**90,729,079**	80,168,219
Gross patient service revenue	**118,715,611**	103,153,937
Less Medicare and Medicaid allowances	**33,674,819**	26,494,947
Less other contractual allowances	**18,551,397**	16,573,892
Less charity care and other discounts	**1,176,166**	1,105,159
	53,402,382	44,173,998
Patient service revenue (net of contractual allowances and discounts)	**65,313,229**	58,979,939
Less provision for bad debts	**4,827,217**	2,326,120
Net patient service revenue	**$ 60,486,012**	$ 56,653,819

Patient Accounts Receivable

Patient accounts receivable consisted of the following at September 30:

	2012	2011
Gross patient accounts receivable	**$ 18,103,954**	$ 20,101,989
Less: Estimated contractual allowances	**6,179,490**	6,871,589
Estimated allowance for doubtful accounts and charity care	**3,020,013**	3,160,520
Net patient accounts receivable	**$ 8,904,451**	$ 10,069,880

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 2011, the Hospital decreased its estimate from $2,828,932 to $2,267,426 in the allowance for doubtful accounts relating to self-pay patients and increased such estimate from $643,881 to $893,094 for doubtful accounts relating to third-party payors. During 2012, self-pay write-offs increased from $3,572,590 to $6,824,422. During 2011, self-pay write-offs increased from $2,177,218 to $3,572,590. Such increases resulted from trends 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% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2012 and 2011. 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 that amounts become known. In 2012, net patient service revenue increased by approximately $384,000, and in 2011, net patient service revenue increased by approximately $95,000 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, 2012 totaled $65,313,229, of which $62,456,228 was revenue from third-party payors and $2,857,001 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, 2011 totaled $58,979,939, of which $55,772,535 was revenue from third-party payors and $3,207,404 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 $576,850 in 2012 and $619,000 in 2011. The total cost estimate is based on an overall financial statement cost to charge ratio applied against gross charity care charges. In 2012 and 2011, 1.0% and 1.1%, respectively, of all services as defined by percentage of gross revenue was provided on a charity basis.

In 2012, of a total of 42 inpatients received their entire episode of service on a charity case basis. In 2011, of a total of 44 inpatients 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. In 2011, of a total of 975 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:

	2012	2011
Held by trustee under debt agreement		
Cash and cash equivalents	**$ 351,574**	$ 337,031
Held by trustee - deferred compensation funding		
Cash and cash equivalents	**$ 559,266**	$ 412,630

Long-term investments include the following at September 30:

	2012	2011
Cash and cash equivalents	**$ -**	$ 264,947
Mutual funds	**340,365**	295,672
Marketable equity securities	**1,602,988**	1,313,725
Corporate and taxable bonds	**569,070**	562,000
U.S. Treasury obligations and government securities	**453,548**	510,041
Government sponsored enterprises	**240,232**	155,591
International bonds	**15,704**	-
	$ 3,221,907	$ 3,101,976

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

	2012	2011
Interest and dividend income	**$ 204,050**	$ 216,591
Net unrealized gains (losses)	**354,304**	(175,221)
Realized gains	**67**	83,152
	$ 558,421	$ 124,522

Total investment income is reflected in the statement of operations and changes in net assets as follows:

	2012	2011
Unrestricted net assets		
Other nonoperating income	**$ 558,421**	$ 134,040
Temporarily restricted net assets	**-**	(9,518)
	$ 558,421	$ 124,522

5. Property and Equipment

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

	2012	2011
Land and land improvements	**$ 2,185,776**	2,146,053
Buildings and leasehold improvements	**25,607,863**	24,934,247
Equipment	**20,242,383**	18,675,744
Construction in progress	**232,718**	120,744
	48,268,740	45,876,788
Less accumulated depreciation	**21,850,157**	17,063,884
Property and equipment, net	**$ 26,418,583**	$ 28,812,904

Construction in progress as of September 30, 2012 and 2011, consists of costs related to the replacement of the fire alarm system and an information technology system conversion, respectively. The fire alarm system replacement is expected to be completed by December 2012, and the information technology system conversion project was substantially completed in September 2012. As of September 30, 2012, the Hospital has committed $50,000 to complete the project.

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, 2012 and 2011, was $130,085 and $138,366, respectively.

7. Borrowings

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

	2012	2011
Vermont Educational and Health Buildings Financing Agency Variable Rate Demand Hospital Revenue Bonds, 2005 Series A bonds with variable interest (.17% at September 30, 2012), payable in annual installments ranging from $350,000 to $890,000 through December 2035; collateralized by the gross receipts of the Hospital.	**$ 13,885,000**	$ 14,220,000

	2012	2011
Note payable at a fixed interest rate of 4.7%, monthly payments of $24,400, due March 2015; collateralized by certain equipment.	**688,708**	928,113
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.	**192,789**	207,292
Capital lease obligations at various rates with monthly payments ranging from $349 to $37,110, due 2013 through 2016; collateralized by leased equipment.	**1,415,587**	2,203,544
	16,182,084	17,558,949
Less current portion	**1,365,754**	1,385,558
	$ 14,816,330	$ 16,173,391

Letter of Credit

As part of the bond covenants, 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 September 30, 2013.

In connection with the letter of credit securing the 2005 Series A bonds, the Hospital is subject to certain financial covenants. The Hospital is not in compliance with one of these financial covenants at September 30, 2012. The Hospital has obtained a waiver of this financial covenant from TD Bank as of September 30, 2012.

Aggregate annual maturities of long-term debt and payments on capital lease obligations at September 30, 2012, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2013	$ 629,131	$ 736,623
2014	657,700	628,071
2015	539,000	88,512
2016	410,200	88,512
2017	425,800	-
Thereafter	12,104,666	-
	$ 14,766,497	1,541,718
Less amounts representing interest		(126,131)
		$ 1,415,587

8. Temporarily and Permanently Restricted Net Assets

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

	2012	2011
Health care services	$ 33,094	$ 44,721
Purchase of equipment	2,657	2,787
Indigent care	236,380	236,380
	$ 272,131	$ 283,888

Permanently restricted net assets are restricted to:

	2012	2011
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	2,978,834	2,851,219
	$ 3,096,516	$ 2,968,901

9. Assets Held in Trust

The Hospital is a contingent income beneficiary of various trusts. 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 $3,613,000 and $3,458,000 on September 30, 2012 and 2011, 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 $167,482 in 2012 and $186,633 in 2011.

10. Other Operating Revenue

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

	2012	2011
Rental income	$ 143,808	$ 125,193
Cafeteria and coffee shop income	156,136	137,529
Disproportionate Share Payments	771,959	1,158,110
Lifeline income	-	109,827
Miscellaneous revenue	732,475	275,437
Total other revenue	$ 1,804,378	$ 1,806,096

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 2012. 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 $2,282,585 and $1,428,863 for the years ended September 30, 2012 and 2011, 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:

	2012	2011
Health care services	**$ 60,080,331**	$ 50,753,256
General and administrative	**8,408,815**	7,077,598
	$ 68,489,146	$ 57,830,854

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, 2012 and 2011, is:

	2012	2011
Medicare	**25 %**	36 %
Medicaid	**14**	9
Commercial and other	**33**	28
Self-pay	**28**	27
	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 on a fixed premium basis. 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. 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, 2012 and 2011, the total outstanding balances on the guaranteed loans were approximately $376,000 and $447,000, respectively.

Self-Insurance

PMC is self-insured for employee health care benefits. PMC accrues 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. The amount of actual losses incurred could differ materially from these estimates in the near term.

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

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, 2011.

The Hospital has estimated a liability of approximately $961,000 and $794,000 at September 30, 2012 and 2011, 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 $949,000 and $935,000 for calendar years 2011 and 2010, respectively.

Deferred Compensation Plan

The Hospital has a nonqualified deferred compensation plan established under section 457 of the Internal Revenue Code of 1986. These plans cover 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 $262,812 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 $3,837,478 and $2,515,825 at September 30, 2012 and 2011, respectively. The Hospital's share of the pension expense was $224,498 and $162,051 for the years ending September 30, 2012 and 2011, respectively. The Hospital contributed $512,000 and $411,000 to the plan in 2012 and 2011, respectively.

PMC uses a September 30, 2012 measurement date for the plan. Significant balances, costs and assumptions for the plan as a whole are:

	2012	2011
Benefit obligations	$(14,202,606)	$(10,942,491)
Fair value of plan assets	9,206,866	7,679,106
Funded status	$ (4,995,740)	$ (3,263,385)

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:

	2012	2011
Change in benefit obligation		
Benefit obligation at beginning of year	$10,942,491	$10,690,102
Interest cost	592,876	554,076
Actuarial loss (gain)	3,045,711	(24,710)
Benefits paid	(378,472)	(276,977)
Benefit obligation at end of year	$14,202,606	$10,942,491
Change in plan assets		
Fair value of plan assets at beginning of year	$ 7,679,106	$ 7,646,052
Actual return on plan assets	1,394,514	(101,595)
Employer contributions	511,718	411,626
Benefits paid	(378,472)	(276,977)
Fair value of plan assets at end of year	$ 9,206,866	$ 7,679,106
Components of net periodic benefit cost		
Interest cost	$ 592,876	$ 554,076
Expected return on plan assets	(519,420)	(516,972)
Amortization of net loss	201,333	163,718
Net periodic benefit cost	$ 274,789	$ 200,822

	2012	2011
Weighted average assumptions used to determine benefit obligation		
Discount rate	**4.25 %**	5.50 %
Weighted average assumptions used to determine benefit cost		
Discount rate	**5.50**	5.25
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, 2012:

2012	$ 441,701
2013	448,733
2014	504,041
2015	527,827
2016	559,744
2017 - 2021	3,458,805

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, 2012 and 2011, plan assets by category are as follows:

	2012	2011
Equity securities	**48.2 %**	43.0 %
Debt securities	**43.8**	49.2
Cash and cash equivalents	**8.0**	7.8
	100.0 %	100.0 %

No amounts are expected to be recognized in the next year 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 2013.

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 2013. 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, 2012, were:

2013	$ 931,000
2014	716,000
2015	680,000
2016	542,000
2017	525,000
	$ 3,394,000

Rent expense during 2012 and 2011 amounted to $838,530 and $766,981, 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:

	2012	2011
HPNH		
Medical Director	**$ 15,444**	$ 15,444
Employee physicals	**19,614**	31,419
Speech therapy services	**(6,863)**	(8,988)
Resident medical testing	**44,449**	69,436
PMS		
Management services	**(773,160)**	(594,312)
Administrative services	**(977,340)**	(1,107,456)
Employee physicals	**267**	901
PREH		
Facility rent	**(123,868)**	(108,970)
Interest income	**2,189**	2,370

Accounts Receivable

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

	2012	2011
HPNH	**$ 87,787**	$ 102,114
PREH	**-**	66,926
PMS	**137,582**	70,516
PMC	**118,971**	780
	$ 344,340	$ 240,336

Accounts Payable

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

	2012	2011
HPNH	**$ 1,697**	$ 1,650
PMS	**145,875**	146,775
PMC	**-**	263
	$ 147,572	$ 148,688

Note Receivable

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

	2012	2011
6% unsecured note receivable, monthly payments of $441 including principal and interest, due February 21, 2021	**$ 34,794**	$ 37,897
Less current portion	**3,294**	3,103
	$ 31,500	$ 34,794

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, 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 trusts	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 the year ended September 30, 2012 for assets measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows:

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

	Fair Value Measurements at September 30, 2011			
	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	$ 264,927	$ 264,927	$ -	$ -
Corporate and taxable bonds	562,000	-	562,000	-
U.S. Treasury obligations and government securities	510,041	510,041	-	-
Government sponsored enterprises	155,591	-	155,591	-
Marketable equity securities	-	-	-	-
Basic materials	28,845	28,845	-	-
Communication services	39,013	39,013	-	-
Consumer staple	142,096	142,096	-	-
Consumer discretionary	126,126	126,126	-	-
Energy	149,719	149,719	-	-
Financial services	169,501	169,501	-	-
Healthcare	170,202	170,202	-	-
Industrials	121,547	121,547	-	-
Technology	233,005	233,005	-	-
Utilities	30,679	30,679	-	-
Miscellaneous	102,992	102,992	-	-
Total marketable equity securities	1,313,725	1,313,725	-	-
Mutual funds				
Growth funds	87,789	87,789	-	-
Equity funds	158,604	158,604	-	-
Bond funds	15,197	15,197	-	-
International funds	34,082	34,082	-	-
Total mutual funds	295,672	295,672	-	-
Deferred compensation plan assets: cash and cash equivalents	412,630	412,630	-	-
Beneficial interest in perpetual trust	2,851,219	-	-	2,851,219
Total assets	$ 6,365,805	$ 2,796,995	$ 717,591	$ 2,851,219

	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	$ 591,426	$ 591,426	$ -	$ -
Mutual funds				
Growth funds	972,862	972,862	-	-
Equity funds	2,330,897	2,330,897	-	-
Bond funds	3,777,562	3,777,562	-	-
Total mutual funds	7,081,321	7,081,321	-	-
Accrued interest	6,359	6,359	-	-
Total pension assets	$ 7,679,106	$ 7,679,106	$ -	$ -

Significant activity for the year ended September 30, 2011, for assets measured at fair value on a recurring basis using unobservable inputs (Level 3) is as follows:

Level 3 investments at October 1, 2010	$ 2,952,405
Net depreciation of beneficial interest in perpetual trusts	(101,186)
Level 3 investments at September 30, 2011	$ 2,851,219

The fair value of Level 2 assets is primarily based on quoted market prices of underlying assets or 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 payor settlements and long-term debt. The fair values of all financial instruments approximate their carrying values at September 30, 2012 and 2011.

SUPPLEMENTARY INFORMATION

PORTER HOSPITAL, INC.

Schedule of Required Financial Covenant Ratios

Year Ended September 30, 2012

Debt Service Coverage Ratio

Income available for debt service:	
Increase in unrestricted net assets	$ (4,707,035)
Net unrealized gains on investments	(354,304)
Depreciation and amortization	4,799,131
Interest expense	339,030
Change in net assets to recognize funded status of pension plan	1,608,873
Income available for debt service	$ 1,685,695
Interest expense	$ 339,030
Current portion of long-term debt	1,365,754
Annual debt service	$ 1,704,784
Debt service coverage ratio required to be no less than 1.5	0.99
Financial covenant met	No

Debt to Total Capitalization

Long-term debt	$ 16,182,084
Long-term debt	$ 16,182,084
Unrestricted net assets	16,576,126
Temporarily restricted net assets	272,131
Total capitalization	$ 33,030,341
Debt to total capitalization required to be less than 60%	49 %
Financial covenant met	Yes

PORTER HOSPITAL, INC.

Note to Supplemental Schedule of Calculations of Required Financial Covenant Ratios

Year Ended September 30, 2012

Basis of Accounting

The accompanying Supplemental Schedule of Required Financial Covenant Ratios has been prepared in accordance with Section 5.09 of the Letter of Credit Reimbursement Agreement dated June 1, 2005, between Porter Hospital, Inc. and TD Bank. The Debt Service Coverage Ratio and Debt to Total Capitalization have been derived from the financial statements of Porter Hospital, Inc. for the year ended September 30, 2012.