

**Kennedy Health System, Inc.
and Subsidiaries**

Financial Statements and
Supplementary Information

December 31, 2014 and 2013



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Kennedy Health System, Inc. and Subsidiaries

Table of Contents

December 31, 2014 and 2013

	<u>Page</u>
Independent Auditors' Report	1
Financial Statements	
Consolidated Balance Sheet	3
Consolidated Statement of Operations	4
Consolidated Statement of Changes in Net Assets	5
Consolidated Statement of Cash Flows	6
Notes to Consolidated Financial Statements	7
Supplementary Information	
Consolidating Schedule, 2014 Balance Sheet	29
Consolidating Schedule, 2013 Balance Sheet	31
Consolidating Schedule, 2014 Statement of Operations	33
Consolidating Schedule, 2013 Statement of Operations	34



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Independent Auditors' Report

Board of Directors
Kennedy Health System, Inc. and Subsidiaries

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Kennedy Health System, Inc. and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kennedy Health System, Inc. and Subsidiaries as of December 31, 2014 and 2013, and the results of their operations and changes in their net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying 2014 and 2013 consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, changes in net assets, and cash flows of the individual entities and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Baker Tilly Viechow Krause, LLP

Clark, New Jersey
April 14, 2015

Kennedy Health System, Inc. and Subsidiaries

Consolidated Balance Sheet

(In Thousands)

December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>		<u>2014</u>	<u>2013</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 55,952	\$ 37,637	Long-term debt, current portion	\$ 6,216	\$ 6,235
Accounts receivable:			Accounts payable	38,897	32,056
Patients (net of estimated allowance for doubtful collections of \$23,245 in 2014 and \$23,092 in 2013)	61,803	56,361	Accrued expenses:		
Other	3,542	3,141	Payroll and benefits	29,001	27,871
Assets whose use is limited	1,794	2,671	Other	10,173	9,124
Inventories	8,496	8,194	Accrued interest	1,412	1,423
Prepaid expenses and other current assets	4,646	4,899	Estimated settlements with third party payors	3,858	3,916
			Deferred revenue	1,782	1,506
Total current assets	136,233	112,903	Total current liabilities	91,339	82,131
Property and Equipment, Net	250,549	247,651	Long-Term Debt	92,459	97,294
Assets Whose Use is Limited	176,761	144,738	Accrued Pension Cost	33,636	14,636
Investments in Joint Ventures	776	254	Other Liabilities	22,343	19,734
Interest Rate Cap	-	2	Total liabilities	239,777	213,795
Deferred Financing Costs and Other Assets	10,888	7,345			
			Net Assets		
			Unrestricted	334,664	298,488
			Temporarily restricted	766	610
Total assets	<u>\$ 575,207</u>	<u>\$ 512,893</u>	Total net assets	335,430	299,098
			Total liabilities and net assets	<u>\$ 575,207</u>	<u>\$ 512,893</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Operations

(In Thousands)

Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Unrestricted Revenues, Gains, and Other Support		
Net patient service revenues	\$ 566,046	\$ 521,796
Provision for doubtful collections	(25,063)	(30,495)
Net patient service revenue less provision for doubtful collections	540,983	491,301
Other revenues	12,979	14,190
Net assets released from restrictions	140	121
Total unrestricted revenues, gains, and other support	<u>554,102</u>	<u>505,612</u>
Expenses		
Employee salaries	223,668	207,940
Physician salaries and fees	30,424	32,908
Employee benefits	48,446	46,714
Supplies and expenses	173,970	164,198
Interest	3,491	3,722
Depreciation and amortization	27,918	29,588
Total expenses	<u>507,917</u>	<u>485,070</u>
Non-controlling Interest, Garden State Radiology	<u>63</u>	<u>-</u>
Income from Operations	46,248	20,542
Nonoperating Income		
Interest, dividends, and net realized gains and losses on investments	<u>2,742</u>	<u>3,591</u>
Revenue in Excess of Expenses	48,990	24,133
Change in Net Unrealized Gains on Securities	4,969	7,648
Net Assets Released from Restrictions for Property and Equipment	-	68
Donations for Property and Equipment	-	(150)
Non-controlling Interest, Garden State Radiology	2,105	-
Pension Liability Adjustment	<u>(19,888)</u>	<u>14,621</u>
Increase in unrestricted net assets	<u>\$ 36,176</u>	<u>\$ 46,320</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Changes in Net Assets

(In Thousands)

Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Unrestricted Net Assets		
Revenues in excess of expenses	\$ 48,990	\$ 24,133
Change in net unrealized gains on securities	4,969	7,648
Net assets released from restrictions used for property and equipment	-	68
Donations for property and equipment	-	(150)
Non-controlling interest, Garden State Radiology	2,105	-
Pension liability adjustment	(19,888)	14,621
	<u>36,176</u>	<u>46,320</u>
Temporarily Restricted Net Assets		
Contributions	296	137
Net assets released from restrictions used for property and equipment	-	(68)
Net assets released from restrictions used for operations	(140)	(121)
	<u>156</u>	<u>(52)</u>
Increase (decrease) in temporarily restricted net assets	<u>156</u>	<u>(52)</u>
Increase in net assets	36,332	46,268
Net Assets, Beginning	<u>299,098</u>	<u>252,830</u>
Net Assets, Ending	<u>\$ 335,430</u>	<u>\$ 299,098</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Cash Flows

(In Thousands)

Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash Flows from Operating Activities		
Increase in net assets	\$ 36,332	\$ 46,268
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for bad debts	25,063	30,495
Depreciation and amortization	27,918	29,588
Provision for obsolete inventory	-	18
Net unrealized and realized gains on securities	(4,969)	(8,898)
Pension liability adjustment	19,888	(14,621)
Changes in assets and liabilities:		
Patient accounts receivable	(30,505)	(34,253)
Other receivables	(401)	288
Inventories	(302)	(592)
Prepaid expenses and other current assets	253	(731)
Other long-term assets	(3,543)	(800)
Accounts payable	6,841	(1,375)
Accrued expenses	2,179	4,195
Accrued interest	(11)	213
Estimated settlements with third-party payors	1,204	(4,004)
Other long-term liabilities	1,447	30
Deferred revenue	156	586
Accrued pension costs	(888)	(2,120)
Net cash provided by operating activities	<u>80,662</u>	<u>44,287</u>
Cash Flows from Investing Activities		
Purchases of property and equipment	(29,251)	(17,897)
Net purchases of assets whose use is limited	(26,164)	(2,826)
Net investment in joint ventures	(522)	328
Net cash used in investing activities	<u>(55,937)</u>	<u>(20,395)</u>
Cash Flows from Financing Activities		
Principal payments on capital leases	(4,758)	(6,088)
Repayment of long-term debt	(1,652)	(2,543)
Loan to equity partnership	-	(31)
Net cash used in financing activities	<u>(6,410)</u>	<u>(8,662)</u>
Net increase in cash and cash equivalents	18,315	15,230
Cash and Cash Equivalents, Beginning	<u>37,637</u>	<u>22,407</u>
Cash and Cash Equivalents, Ending	<u>\$ 55,952</u>	<u>\$ 37,637</u>
Supplemental Disclosure of Cash Flow Information		
Interest paid	<u>\$ 3,579</u>	<u>\$ 3,816</u>
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Purchases of property and equipment in accounts payable	<u>\$ 10,964</u>	<u>\$ 4,697</u>
Capital lease obligation incurred for equipment	<u>\$ 1,565</u>	<u>\$ 2,917</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

1. Nature of Operations

Kennedy Health System, Inc. and Subsidiaries (the "System") has a combined profit, not-for-profit structure. The System's Board of Directors is responsible for the appointment of trustees for the subsidiary corporations. The System coordinates fund-raising activities and the management of other revenue generating opportunities as follows:

- Kennedy Health System, Inc. home office ("KHS") is a not-for-profit corporation which is responsible for the overall policy, management and financial support of all entities.
- Kennedy University Hospital, Inc. ("Hospital") is a non-profit New Jersey corporation which owns and operates a 607-bed multi-campus hospital system with hospital facilities in Stratford, Cherry Hill and Turnersville (Washington Township), New Jersey. The Hospital is the major teaching affiliate of the Rowan University School of Osteopathic Medicine. The Hospital provides inpatient, outpatient and emergency care services, as well as home health, dialysis, radiation oncology and rehabilitation services, principally to residents of Camden and Gloucester Counties, New Jersey.
- STAT Medical Transport, Inc. ("STAT") is a not-for-profit ambulance company which owns and operates ambulances that service the Hospital and the community.
- Kennedy Property Corporation ("KPC") is a not-for-profit property and development company. This corporation owns and operates buildings within the service area of the Hospital.
- Kennedy Health Facilities, Inc. ("Facility") is a not-for-profit nursing home company and currently has 190 beds consisting of 130 long-term care beds and 60 sub-acute beds.
- Kennedy Medical Group Practice PC, is a tax-exempt professional corporation and operates as a network of primary physician groups and specialists with offices located throughout the South Jersey region. Kennedy Medical Group, Inc. ceased operations on May 31, 2014 and was succeeded immediately by Kennedy Medical Group Practice, PC.
- Kennedy Management Group, Inc. ("KMG") is a for-profit corporation that invests in for-profit businesses to further its mission. KMG accounts for investments under the equity method and has a 50% interest in the operations of Healthtrax Fitness Gym, LLC, a 20% interest in MAB Building Associates, a 26% interest in KHS Ambulatory Surgery Center, LLC and a 37.5% interest in the operations of Velocity Sports Performance Washington Township. KMG files its federal tax return in consolidation with Professional Medical Management, Inc. For financial statement presentation purposes, the retained earnings and capital stock (no par value, 1,000 common shares authorized, 100 issued and outstanding) have been consolidated with net assets.
- Professional Medical Management, Inc. ("PMM") is a subsidiary of Kennedy Management Group, Inc. This corporation is a for-profit collection service company which has been operational since September of 1984. For financial statement presentation, the retained earnings and capital stock (no par value, 100 common shares authorized, issued and outstanding) have been consolidated with net assets.
- Kennedy Imaging, P.C. ("KIPC") is a for-profit professional corporation providing professional imaging services to the System.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

- On November 1, 2014, the System acquired 51 percent of the ownership in Garden State Radiology Network, L.L.C (“Garden State Radiology”). Kennedy Health System has established control of this company and as such includes the financial position and results of operations and changes in net assets of this company in its consolidated financial statements. Garden State Radiology will develop, own, operate and manage a diagnostic imaging network for the System. The following table summarizes the capital contributed for Garden State Radiology and the change in net assets that has occurred since the acquisition date, as well as the fair value at the consolidated financial statement date of KHS and the non-controlling interest in Garden State Radiology.

Net assets, Garden State Radiology, November 1, 2014	\$	-
Equity transfer, KHS		2,257
Equity transfer, non-controlling interest		<u>2,168</u>
Total contributions	\$	4,425
Less:		
Net loss		(129)
Fair value of non-controlling interest, December 31, 2014		<u>(2,105)</u>
Net assets attributable to KHS investment in Garden State Radiology, December 31, 2014	\$	<u>2,191</u>

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include accounts of KHS, its not-for-profit entities and its for-profit entities, as described in Note 1. All significant intercompany transactions and accounts are eliminated.

Footnote Presentation

Numerical schedules included in the notes to the consolidated financial statements are presented in thousands (000). All numbers included in the narrative portion of the notes are presented as whole numbers.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by Board designation or other arrangements under trust agreements.

Accounts Receivable, Patients

Accounts receivable, patients are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. The allowance for doubtful collections is estimated based upon a periodic review of the accounts receivable aging, payor classifications, and application of historical write-off percentages. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractual amounts due and provides an allowance for doubtful collections and a provision for doubtful collections, if necessary. For receivables associated with self-pay patients, the System records a significant provision for doubtful collections in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful collections.

The System's allowance for doubtful collections for self-pay patients was approximately 88% and 87% of self-pay accounts receivable at December 31, 2014 and December 31, 2013, respectively. The System's self-pay account write-offs (net of recoveries) decreased to \$25,566,000 in 2014 from \$34,653,000 in 2013. The decrease is a result of increased eligibility for Medicaid patients. The System has not changed its financial assistance policy in 2014 or 2013.

Other Receivables

Other receivables are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. No allowance for doubtful collections was recorded due to management's belief that realization losses on other receivables would be immaterial.

Investments and Investment Risk

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility risks. Due to the level of risks associated with certain investment securities, it is reasonably possible that changes in the value of investments could occur in the near term and that such changes could materially affect the amounts reported in the accompanying consolidated balance sheets.

The System reports investments in marketable equity securities with readily determinable fair values and all investments in debt securities at fair value in the consolidated balance sheet.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Investment income (including net realized gains and losses, interest, and dividends) on Board designated funds are recorded as nonoperating income. Certain declines in market value that are deemed to be other-than-temporary are reported as impairment losses in investment income (see note 5). Investment income on trustee held funds is recorded net against interest expense in the consolidated statement of operations. Investment income from all other unrestricted investments is recorded as nonoperating income.

Assets Whose Use is Limited

Assets whose use is limited include assets held by trustee under bond indenture agreements, designated assets set aside by the Board of Directors for future capital improvements or for other purposes at the Board's discretion, assets of donor restricted funds, and investments held by the System. Amounts required to meet current liabilities of the System have been reclassified to current assets.

Inventories

Inventories, which primarily consist of medical supplies, are stated at the lower of cost or market, using the first-in, first-out (FIFO) method.

Property and Equipment

Property and equipment acquisitions are recorded at cost. 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 estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated 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. Normal repairs and maintenance expenses are charged to operations as incurred. Gains and losses on sales or retirements are included in other operating revenue. Capitalized computer software costs are amortized over the estimated useful or economic lives of the software.

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

Deferred Financing Costs

Deferred financing costs, consisting of the cost of issuing revenue bonds, are amortized over the period the obligation is outstanding using the straight-line method. This does not result in a significant difference from the effective interest rate method.

Bond Premiums and Discounts

Bond premiums and discounts are amortized using the straight-line method. This does not result in a significant difference from the effective interest rate method.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Resources restricted by donors for property and equipment are reclassified to unrestricted net assets to the extent expended within the period.

Revenues in Excess of Expenses

The consolidated statement of operations includes the determination of revenues in excess of expenses. Changes in unrestricted net assets which are excluded from the determination of revenues in excess of expenses, consistent with industry practice, include pension liability adjustments, unrealized gains and losses on investments other than trading securities, transfers to affiliates, equity transfers, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Estimated Malpractice Costs

The System is insured for medical malpractice claims under a claims-made policy and excess loss policies. The System records an estimated liability for medical malpractice costs related to reported claims that exceed insurance coverage, if any, and incurred claims that have not been reported. Anticipated insurance recoveries associated with reported claims are reported separately in the System's consolidated balance sheet at net realizable value.

Income Taxes

KHS and its not-for-profit subsidiaries qualify as tax-exempt organizations under section 501(c)(3) of the Internal Revenue Code, and accordingly, no provision for income taxes with respect to these entities has been made in the accompanying consolidated financial statements. The for-profit subsidiaries (as described in Note 1) account for income taxes in accordance with the provisions of ASC Topic 740, *Accounting for Income Taxes*, which requires the establishment of a deferred tax asset or liability for the recognition of future deductible or taxable amounts. Deferred tax expense or benefit is recognized as a result of the changes in the deferred tax assets or liabilities during the year.

The System accounts for uncertainty in income taxes using a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold is met. Management determined there were no tax uncertainties that met the recognition threshold in 2014 and 2013.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The System's federal income tax returns for the years ended December 31, 2013, 2012, and 2011 remain subject to examination by the Internal Revenue Service.

The System's policy is to recognize interest related to unrecognized tax benefits in interest expense, and penalties in supplies and expenses.

Accounting for Long-Lived Assets

In accordance with ASC Topic 360, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the System assesses their assets for impairment whenever events or changes in circumstances indicate that the carrying amount of a respective asset that the System expects to hold and use may not be recoverable. Management believes no impairment has occurred and therefore no write-downs were necessary as of December 31, 2014 and 2013.

Advertising Costs

The System expenses advertising costs as incurred. For the years ended December 31, 2014 and 2013, advertising costs totaled approximately \$2,457,000 and \$2,115,000, respectively.

Investments in Joint Ventures, Equity Method

The System has a financial interest in several entities. Where the System has the ability to influence management or has a twenty percent or more interest in the entity, the investment is recorded at initial cost, adjusted to the System's proportionate share of their undistributed earnings or losses. All other investments in such entities are recorded at cost.

Subsequent Events

The System evaluated subsequent events for recognition or disclosure through April 14, 2015, the date the consolidated financial statements were issued.

New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 supercedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU No. 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The System will be required to retrospectively adopt the guidance in ASU No. 2014-09 for years beginning after December 15, 2017. The System has not yet determined the impact of adoption of ASU No. 2014-09 on its consolidated financial statements.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

3. Net Patient Service Revenue

Net patient service revenue is reported on an accrual basis at the estimated net realizable amounts from patients, third party payors and others for services rendered. The System provides care to all patients, regardless of their ability to pay. For uninsured patients that do not qualify for charity care, the System recognizes revenues on the basis of its standard rates, discounted in accordance with the System's policy. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable to pay for the services provided. Thus, the System records a significant provision of doubtful collections related to uninsured patients in the period the services are provided. Patient service revenues, net of contractual allowances and discounts (but before the provision of doubtful collections), recognized in 2014 and 2013 from these major payor sources, are as follows:

	December 31, 2014			
	Third-Party Government Payors	Third-Party Commercial Payors	Self-Pay	Total All Payors
Patient service revenues (net of contractual allowances and discounts)	\$ 226,237	\$ 321,863	\$ 17,946	\$ 566,046
	December 31, 2013			
Patient service revenues (net of contractual allowances and discounts)	\$ 219,239	\$ 277,898	\$ 24,659	\$ 521,796

Inpatient acute care services for Medicare and Medicaid beneficiaries are paid at predetermined rates per discharge. Outpatient services for Medicare beneficiaries are paid at predetermined rates referred to as Ambulatory Payment Classifications (APC's). Medicaid outpatient services are paid at interim rates and reconciled to state specific payment amounts adjusted for certain hospital specific cost factors through submission and audit of the annual Medicaid cost report. Medicare Disproportionate Share (DSH), and Medicare Graduate Medical Education (GME) costs are paid at interim rates and reconciled to actual DSH eligible patient days and Intern and Resident-approved full time equivalents (FTEs) through Hospital submission and fiscal intermediary audit of the annual Medicare cost report. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as revisions or final settlements are determined. As a result, there is at least a reasonable possibility that recorded liabilities will change by a material amount in the near term. The estimated settlements recorded at December 31, 2014 and 2013, could differ from actual settlements based on the results of cost report audits. Net patient service revenues increased by approximately \$5,990,000 in 2014 and \$3,282,000 in 2013 for net adjustments and settlements related to prior years. The Hospital's cost reports for Medicare have been audited and settled by the fiscal intermediary through December 31, 2011 with the exception of December 31, 2005 and December 31, 2010 which have not yet been settled. The Hospital's cost reports for Medicaid have been audited and settled by the fiscal intermediary through December 31, 2011.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Chapter 160 of the Health Care Reform Act of 1992 of the State of New Jersey provides for the establishment of the Health Care Subsidy Fund (Subsidy Fund), which among other things distributes charity care and other uncompensated care payments subject to final settlement to eligible hospitals statewide. During 2014 and 2013, the Hospital received \$21,770,000 and \$22,715,000, respectively, from the Subsidy Fund. These amounts are included in net patient service revenue in the accompanying consolidated statements of operations. There can be no assurance that the subsidies received by the Hospital will continue at the same level in future years.

Charity Care

The System provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than the established rates. Criteria for charity care consider the patient's family income and net worth. The System maintains records to identify and monitor the level of charity care it provides. The estimated costs of providing charity care, which are based upon the direct and indirect costs identified with the specific charity care services provided, amounted to approximately \$9,209,000 in 2014 and \$26,827,000 in 2013. During 2014, the State of New Jersey expanded Medicaid eligibility as a result of the Affordable Care Act which resulted in a decrease in charity care provided. Charges for services rendered to patients who meet guidelines for charity care have been excluded from net patient service revenue.

4. Assets Whose Use is Limited

Under the provisions of the Hospital Revenue and Refunding Bonds, and Facility's 2009 Revenue and Refunding Bonds, certain trustee held funds were established to pay for the costs of certain capital projects and retirement of indebtedness. The terms of the bond indenture require that certain debt service funds be established and maintained by the System.

Assets whose use is limited at December 31, 2014 and 2013 consists of the following:

	<u>2014</u>	<u>2013</u>
Trustee held funds	\$ 5,875	\$ 11,551
Board designated funds	171,757	135,097
Special purpose funds - temporarily restricted	766	611
Patient security deposits	<u>157</u>	<u>150</u>
Total	178,555	147,409
Less current portion	<u>(1,794)</u>	<u>(2,671)</u>
Noncurrent portion	<u>\$ 176,761</u>	<u>\$ 144,738</u>

Interest and dividend income on assets whose use is limited was \$3,314,000 and \$2,962,000 in 2014 and 2013, respectively. Realized gains on sale of assets whose use is limited were \$207,000 and \$1,250,000 in 2014 and 2013, respectively. The change in net unrealized gains amounted to \$4,969,000 and \$7,648,000 in 2014 and 2013, respectively.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

5. Fair Value of Financial Instruments

The System follows the provisions of authoritative guidance relating to fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America, and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that this guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the System for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

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

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

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The fair value of the System's cash and cash equivalents, assets whose use is limited and long-term debt were measured using the following inputs at December 31, 2014 and 2013:

		2014				
		Carrying Value	Fair Value	Level 1	Level 2	Level 3
Reported at Fair Value						
Assets whose use is limited:						
Cash and cash equivalents	\$	2,947	\$ 2,947	\$ 2,947	\$ -	\$ -
U.S. Treasury obligations		59,786	59,786	59,786	-	-
Corporate bond obligations		58,847	58,847	-	58,847	-
Equity index fund		56,975	56,975	56,975	-	-
Disclosed at Fair Value						
Cash and cash equivalents	\$	55,952	\$ 55,952	\$ 55,952	\$ -	\$ -
Long-term debt:						
Bonds		79,465	84,954	-	84,954	-
Other		2,229	2,229	-	-	2,229
		2013				
		Carrying Value	Fair Value	Level 1	Level 2	Level 3
Reported at Fair Value						
Assets whose use is limited:						
Cash and cash equivalents	\$	1,382	\$ 1,382	\$ 1,382	\$ -	\$ -
U.S. Treasury obligations		61,182	61,182	61,182	-	-
Corporate bond obligations		36,575	36,575	-	36,575	-
Equity index fund		48,270	48,270	48,270	-	-
Interest rate cap agreement		2	2	-	2	-
Disclosed at Fair Value						
Cash and cash equivalents	\$	37,637	\$ 37,637	\$ 37,637	\$ -	\$ -
Long-term debt:						
Bonds		80,532	81,013	-	81,013	-
Other		2,683	2,683	-	-	2,683

There were no investments in 2014 or 2013 with inputs that cannot be corroborated by observable market data and therefore classified as level 3. There were no significant transfers between Levels 1 and 2 during 2014 and 2013.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The following table identifies securities with unrealized losses at December 31, 2014. There are certain risks and uncertainties inherent in the System's impairment methodology, such as the financial condition of specific industry sectors and the effect of underlying security collateral values. Should the System subsequently determine a decline in the fair value below the cost basis to be other than temporary, the security would be written down to its fair market value and the difference would be included in earnings as a realized loss for the period such determination was made.

	Total	
	Fair Value	Unrealized Losses
U.S. Treasury obligations	\$ 22,846	\$ 338
Corporate obligations	34,715	642
Total	<u>\$ 57,561</u>	<u>\$ 980</u>

Based upon the System's impairment evaluation as of December 31, 2014, it was concluded that the unrealized losses in the table above are not other than temporary.

The following methods and assumptions were used by the System in estimating fair value disclosures for the consolidated financial statements:

Cash and Cash Equivalents: The carrying amount of cash and cash equivalents, including amounts reported in assets whose use is limited, approximates fair value due to the short-term nature of these instruments.

Assets Whose Use Is Limited: The fair values for marketable equity, government, and fixed income securities included in assets whose use is limited are based on quoted market prices for identical or similar investments.

Long-Term Debt Obligations: The fair value of long-term debt is based on quoted market prices or estimates using discounted cash flow analyses, based on the participating institution's incremental borrowing rates for similar types of borrowing arrangements.

Interest Rate Cap Agreement: The fair value of the interest rate cap agreement is verified for reasonableness based on a quote provided by Barclay Bank PLC by comparing to a similar quote from a cap adviser and the results of similar observable inputs used in a pricing model. The System also assesses the risk of nonperformance by reviewing bond ratings, and accordingly considers the agreement to be Level 2 measurements in the fair value hierarchy.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

6. Investment in Joint Ventures

KMG has entered in joint venture relationships to further its missions. In 2007, KMG entered into an agreement with Washington Fitness Centers, LLC. for 50% interest in the operations of Healthtrax Fitness Gym, LLC., and a 20% interest in the real estate and construction of a seventy-two thousand square foot building located in Washington Township, New Jersey. The operations of Healthtrax Fitness Center, LLC commenced in February, 2009. The investment has been accounted for under the equity method. Under the operating agreement, KMG is part of a group of guarantors for the real estate joint venture's \$13,206,000 outstanding mortgage at December 31, 2014.

In 2008, KMG entered into an agreement with USP, a physician group, to form KHS/USP Surgery Centers, LLC ("JV"). The JV subsequently entered into an agreement for an interest in KHS Ambulatory Surgery Center (ASC), LLC. The purpose of the joint venture is to form a strategic alliance that will provide ambulatory services in South Jersey. KMG's effective share in ASC is 26%. The investment has been accounted for under the equity method.

In 2012, KMG entered into an agreement with S&H Sports of Washington Township, LLC and QRISP, LP for a 37.5% interest in the operations of VSP Washington Township, LLC. The purpose of the joint venture is to acquire a franchise agreement with S&H Sports of Washington Township, LLC and Velocity Sports Performance, Inc. to provide a facility that focuses on optimizing individual athletic performance. The investment has been accounted for under the equity method.

7. Property and Equipment

Property and equipment at December 31, 2014 and 2013 consists of the following:

	<u>2014</u>	<u>2013</u>
Land	\$ 6,445	\$ 6,445
Land improvements	6,490	6,333
Buildings	250,674	243,566
Fixed equipment	100,002	96,069
Major movable equipment	203,665	188,157
Capitalized leases	41,677	40,167
Leasehold improvements	4,172	4,147
Other properties	942	1,229
	<hr/>	<hr/>
Total property and equipment	614,067	586,113
Less accumulated depreciation and amortization	<u>(367,087)</u>	<u>(339,655)</u>
	246,980	246,458
Construction in progress	<u>3,569</u>	<u>1,193</u>
Property and equipment, net	<u>\$ 250,549</u>	<u>\$ 247,651</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

Total depreciation expense for 2014 and 2013 is \$27,918,000 and \$29,588,000, respectively. The amount of accumulated amortization related to capitalized leases was \$28,772,000 and \$24,314,000 for the years ended 2014 and 2013, respectively.

8. Long-Term Debt

A summary of long-term debt at December 31, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
<u>Kennedy University Hospital</u>		
Series 2012 New Jersey Health Care Facilities Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2042 plus interest at rates ranging from 2% to 5%	\$ 64,375	\$ 65,120
Note payable	918	1,237
Capitalized lease obligations	13,380	16,626
Unamortized original issued bond premium (net)	3,560	3,689
<u>Kennedy Health Facilities</u>		
Series 2009 Revenue and Refunding Bonds dated October 1, 2009, due in varying installments through October 1, 2039 plus interest of 4.55%	15,090	15,412
<u>Kennedy Property Corporation</u>		
4.5% fixed rate mortgage dated March 1, 2011 due June 1, 2015	16	51
4.5% fixed rate mortgage dated March 1, 2011 due June 1, 2015	11	34
3.75% fixed rate mortgage dated May 20, 2011 due September 1, 2022	290	320
3.75% fixed rate mortgage dated December 1, 2009 due December 1, 2029	694	726
3.75% fixed rate mortgage dated October 22, 2010 due November 1, 2030	300	314
<u>Garden State Radiology Network</u>		
Capitalized lease obligations	41	-
Total	98,675	103,529
Less current portion	<u>(6,216)</u>	<u>(6,235)</u>
Long-term debt	<u>\$ 92,459</u>	<u>\$ 97,294</u>

In August 2012, the Authority issued \$66,035,000 of the tax-exempt 2012 Bonds on behalf of the Hospital. The proceeds of the 2012 Bonds were used to refund the Series 1997A and 2001 Revenue and Refunding Bonds, fund certain capital projects, and pay the costs of issuance of the 2012 Bonds.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

In August 2012, the Hospital entered into a bank note for equipment purchases. The note bears interest of 4.01% and is payable in sixty monthly installments of \$30,285.

In October, 2009, the Facility issued \$16,340,000 Revenue Bonds in conjunction with the New Jersey Health Care Facilities Financing Authority. The Series 2009 Revenue Bonds were issued to pay a portion of the costs for construction of approximately 44,000 square feet 60 bed sub-acute nursing unit addition to the existing facility. In addition, the funds were also used for the purchase of capital equipment, fund capitalized interest, acquisition of an interest rate cap agreement, and to pay bond issuance costs.

The debt agreements contain covenants with respect to the maintenance of specific debt service coverage ratios and days cash on hand and other matters for which the System is in compliance.

Scheduled principal repayments on long-term debt and payments on capital lease obligations, for the next five years and thereafter are as follows:

	<u>Long-Term Debt</u>	<u>Capital Leases</u>
Years ending December 31:		
2015	\$ 1,542	\$ 5,006
2016	2,847	4,053
2017	2,838	2,356
2018	2,707	1,711
2019	2,731	843
Thereafter	69,029	44
Total	81,694	14,013
Less amount representing interest	-	592
Total	<u>\$ 81,694</u>	<u>\$ 13,421</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

9. Commitments and Contingencies

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred.

The following is a schedule by year of future minimum lease payments under operating leases as of December 31, 2014, that have initial or remaining lease terms in excess of one year:

Years ending December 31:	
2015	\$ 2,573
2016	2,329
2017	2,009
2018	1,782
Thereafter	<u>1,869</u>
Total	<u>\$ 10,562</u>

Total rental expense in 2014 and 2013 for all operating leases and other month-to-month leases was approximately \$3,905,000 and \$3,459,000, respectively.

Litigation

The System is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, all such matters are adequately covered by commercial insurance or by accruals. If not so covered, these matters are without merit or are of such kind, or involve such amounts, as would not have a material adverse effect on the consolidated financial position or consolidated results of operations.

Regulatory Compliance

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The System believes that it is in compliance with all applicable laws and regulations through the years ended December 31, 2014, and 2013. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid program.

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

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

Workers Compensation

The Hospital has been granted a letter of credit issued by TD Bank, dated April 28, 2011, in the amount of \$2,800,000 in favor of Pennsylvania Manufacturer's Association Insurance Co. The letter of credit expires June 30, 2015.

10. Pension Plan

The Hospital has a cash balance defined benefit pension plan (the "Plan") covering substantially all of its full-time employees. The benefits are based on years of service and the employee's compensation during the last five years of employment. The Hospital's funding policy is to contribute annually an amount equal to at least the minimum required contribution in accordance with minimum funding standards established by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The funded status of the plan is measured as the difference between the plan assets at fair value and the projected benefit obligation or accumulated post retirement benefit obligation. At December 31, 2014 and 2013, the Hospital recognized \$19,888,000 and \$(14,621,000), respectively, as the difference between actual amounts and estimates based on actuarial assumptions as a change in net assets.

The following table sets forth the funded status and amounts recognized in the Hospital's balance sheets for its defined benefit plan:

Change in Benefit Obligation

	<u>2014</u>	<u>2013</u>
Accumulated benefit obligation at the end of the year	<u>\$ 149,213</u>	<u>\$ 125,298</u>
Projected benefit obligation at the beginning of the year	\$ 127,107	\$ 130,154
Interest cost on projected benefit obligations	6,244	5,826
Service costs - during the year	5,036	5,086
Actuarial loss (gain) due to change in discount rates and updated mortality tables	21,465	(5,028)
Benefits paid	<u>(9,034)</u>	<u>(8,931)</u>
Projected benefit obligation at the end of the year	<u>\$ 150,818</u>	<u>\$ 127,107</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Change in Plan Assets

	<u>2014</u>	<u>2013</u>
Fair value of plan assets at beginning of year	\$ 112,471	\$ 98,777
Actual return on plan assets	8,793	15,442
Hospital contribution	5,500	7,700
Benefits and administrative expenses paid	<u>(9,582)</u>	<u>(9,448)</u>
Fair value of plan assets at end of year	<u>117,182</u>	<u>112,471</u>
Amounts recognized in the balance sheet		
Non-current liabilities	<u>\$ (33,636)</u>	<u>\$ (14,636)</u>

Amounts Recognized in Unrestricted Net Assets

	<u>2014</u>	<u>2013</u>
Prior service credit	\$ (36)	\$ (75)
Net actuarial loss	<u>56,943</u>	<u>37,094</u>
Total amount recognized in unrestricted net assets	<u>\$ 56,907</u>	<u>\$ 37,019</u>

Weighted Average Assumption at the End of the Year

	<u>2014</u>	<u>2013</u>
Weighted average discount rate	4.16 %	5.00 %
Rate of increase in compensation levels	3.00 %	3.00 %

Components of Net Periodic Benefit Cost

	<u>2014</u>	<u>2013</u>
Service cost – benefits earned during the period	\$ 5,037	\$ 5,086
Interest cost on projected benefit obligation	6,244	5,826
Expected return on plan assets	(9,236)	(8,764)
Amortization of prior service cost	(40)	(37)
Recognized net actuarial loss	<u>2,607</u>	<u>3,469</u>
Total net periodic benefit cost	<u>\$ 4,612</u>	<u>\$ 5,580</u>
Net actuarial loss (gain)	\$ 22,455	\$ (11,189)
Amortization of prior service cost	40	37
Amortization of net gain	<u>(2,607)</u>	<u>(3,469)</u>
Total recognized in net assets	<u>\$ 19,888</u>	<u>\$ (14,621)</u>
Total recognized in net benefit cost and net assets	<u>\$ 24,500</u>	<u>\$ (9,041)</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

The principal assumptions used in determining the net periodic benefit cost were as follows:

	<u>2014</u>	<u>2013</u>
Weighted average discount rate	5.00 %	4.50 %
Rate of increase in compensation levels	3.00	3.00
Expected long-term rate of return on assets	8.50	8.50

Expected Amortizations

	<u>12/31/2014</u>	<u>12/31/2013</u>
Expected amortization of prior service cost	\$ (36)	\$ (40)
Expected amortization of net loss	3,948	2,423

Other Accounting Items

	<u>2014</u>	<u>2013</u>
Measurement date used	12/31/14	12/31/13

Plan Assets

Diversification across and within asset classes is the primary means by which the Hospital mitigate's risk. The Hospital maintains guidelines for all asset and sub-asset categories in order to avoid excessive investment concentrations. Fund assets are monitored on a regular basis. If at any time the fund asset allocation is not within the acceptable allocation range, funds will be reallocated. The Hospital also reviews the fund on a regular basis to ensure that the investment returns received are consistent with the short-term and long-term goals of the fund and with comparable market returns.

The weighted average asset allocations by asset category for the Hospital's pension plan, at December 31, are as follows:

	<u>2014</u>	<u>2013</u>
Equity securities	71 %	69 %
Debt securities	27 %	29 %
Other	2 %	2 %
Total	<u>100 %</u>	<u>100 %</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The following table sets forth by level, within the fair value hierarchy, the Plan's investments at fair value as of December 31:

	2014			
	Basis of Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalent	\$ 1,848	\$ -	\$ -	\$ 1,848
U.S. Treasury obligations	8,393	-	-	8,393
Corporate bonds	-	23,476	-	23,476
Equities:				
Industrials	6,058	-	-	6,058
Consumer discretionary	8,573	-	-	8,573
Consumer staples	6,459	-	-	6,459
Energy	3,714	-	-	3,714
Financial	9,465	-	-	9,465
Materials	1,733	-	-	1,733
Information technology	10,012	-	-	10,012
Utilities	413	-	-	413
Health care	9,157	-	-	9,157
Telecommunication services	823	-	-	823
Unclassified stock	700	-	-	700
Equity mutual funds	12,628	-	-	12,628
Equity ETF	5,898	-	-	5,898
Other	-	7,832	-	7,832
Total	\$ 85,874	\$ 31,308	\$ -	\$ 117,182
	2013			
Cash and cash equivalent	\$ 2,596	\$ -	\$ -	\$ 2,596
U.S. Treasury obligations	8,318	-	-	8,318
Corporate bonds	-	23,497	-	23,497
Equities:				
Industrials	7,493	-	-	7,493
Consumer discretionary	8,292	-	-	8,292
Consumer staples	7,084	-	-	7,084
Energy	6,255	-	-	6,255
Financial	12,673	-	-	12,673
Materials	2,378	-	-	2,378
Information technology	9,547	-	-	9,547
Utilities	755	-	-	755
Health care	9,648	-	-	9,648
Telecommunication services	1,450	-	-	1,450
Unclassified stock	1,141	-	-	1,141
Equity mutual funds	4,577	-	-	4,577
Other	-	6,767	-	6,767
Total	\$ 82,207	\$ 30,264	\$ -	\$ 112,471

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

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

- Cash and cash equivalents - Include certain instruments in highly liquid debt instruments with original maturities of three months or less at date of purchase.
- Corporate debt securities and U.S. government obligations - Valued based on spreads of published interest rate curves.
- Equity securities & ETF's - Valued at closing price reported on the active market on which the individual securities are traded.
- Mutual funds - Valued at the net asset value ("NAV") of shares held by the Plan at year-end.
- Other investments are valued by an independent advisor that values the underlying investments of the securities, which are substantially invested in an active market in which the individual securities are traded.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Hospital believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

There were no transfers between levels during 2014 and 2013.

The table below provides an estimate of the plan contributions for the next year. The table also presents the benefits expected to be paid in each of the next five fiscal years and in the aggregate for the five fiscal years thereafter.

Cash Flows

Contributions for the period of 01/01/2015 - 12/31/2015	
Expected employer amount	\$ 5,237
Expected employee amount	-
	<hr/>
Total	<u>\$ 5,237</u>
Estimated future benefit payments reflecting expected future service:	
01/01/2015 - 12/31/2015	\$ 7,336
01/01/2016 - 12/31/2016	7,650
01/01/2017 - 12/31/2017	8,176
01/01/2018 - 12/31/2018	9,000
01/01/2019 - 12/31/2019	9,586
01/01/2020 - 12/31/2023	56,220

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
December 31, 2014 and 2013

11. Professional Liability Insurance

The System has malpractice insurance coverage on a claims-made basis under a guaranteed cost program. It is management's intention to continue existing coverage. The amount of malpractice coverage is \$1,000,000 per claim, with a \$3,000,000 annual aggregate. The System's umbrella policy and excess liability coverage is \$10,000,000 per occurrence with an annual aggregate of \$10,000,000 for its first layer of coverage. The System also maintains a second layer of coverage at \$10,000,000 per occurrence with an annual aggregate of \$10,000,000. The estimated liability for claims and incidents not reported to the insurance carrier at December 31, 2014 and 2013 was approximately \$1,958,000 and \$2,415,000, respectively. The medical malpractice accrual is discounted at 3.5% for 2014 and 2013. The System has recorded a receivable for anticipated insurance recoveries at December 31, 2014 and 2013 of \$8,047,000 and \$6,122,000, respectively. The estimated insurance recoveries receivable is included in deferred financing costs and other assets on the consolidated balance sheet. The System has recorded a related claim liability for December 31, 2014 and 2013 of \$10,005,000 and \$8,537,000, respectively. The total claims liability is included in other liabilities in the consolidated balance sheet.

12. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Healthcare Services:		
Purchase of equipment	\$ 312	\$ 356
Health education	17	19
Research	85	39
Community wellness	293	122
Scholarships	59	74
	<u>59</u>	<u>74</u>
Total	<u>\$ 766</u>	<u>\$ 610</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

13. Functional Expenses

In accordance with FASB ASC Topic 958, *Financial Statements of Not-for-Profit Organizations*, the System has elected to report its natural expenses on its consolidated statement of operations. Accordingly, the System's functional expenses are as follows:

	<u>2014</u>	<u>2013</u>
Program services	\$ 434,653	\$ 419,184
Management and general	73,193	65,819
Fundraising	71	67
Total	<u>\$ 507,917</u>	<u>\$ 485,070</u>

14. Concentration of Credit Risk

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	<u>2014</u>	<u>2013</u>
Medicare	24 %	26 %
Medicaid	4	3
Blue Cross	13	16
Other third-party payors	48	45
Patients (self-pay)	11	10
Total	<u>100 %</u>	<u>100 %</u>

The System routinely invests its excess cash with local banks. At December 31, 2014 and 2013, the System had cash balances with these local banks which exceeded Federal Depository insurance limits. Management believes that credit risk related to these deposits is minimal.

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2014

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc	Kennedy Health System	STAT Medical Transport, Inc.	Kennedy Property Corporation	Kennedy Health Facilities, Inc.	Kennedy Management Group, Inc.	Professional Medical Management, Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
												Eliminations	Consolidated
Assets													
Current Assets													
Cash and cash equivalents	\$ 45,525	\$ 210	\$ 2,438	\$ 120	\$ 3,502	\$ 40	\$ 1,782	\$ 915	\$ 69	\$ 88	\$ 1,263	\$ -	\$ 55,952
Accounts receivable:													
Patients (net of estimated allowance for doubtful collections of \$23,245)	56,708	-	1,359	-	2,385	-	-	2,467	-	-	-	(1,116)	61,803
Other	2,210	-	-	29	-	21	856	306	-	-	376	(256)	3,542
Due from affiliates	2,222	1,979	693	-	-	-	6,633	179	-	-	-	(11,706)	-
Assets whose use is limited	1,794	-	-	-	-	-	-	-	-	-	-	-	1,794
Inventories	8,352	-	-	-	37	-	-	107	-	-	-	-	8,496
Prepaid expenses and other current assets	3,875	-	149	1	174	183	84	173	-	-	7	-	4,646
Total current assets	120,686	2,189	4,639	150	6,098	244	9,355	4,147	69	88	1,646	(13,078)	136,233
Property and Equipment	219,087	6	754	8,202	19,586	-	340	816	-	-	1,758	-	250,549
Assets Whose Use is Limited	169,902	3,201	788	-	798	-	2,062	-	-	10	-	-	176,761
Loans to Affiliates	-	1,852	-	-	-	-	-	-	-	-	-	(1,852)	-
Investments in Joint Ventures	-	2,191	-	-	-	776	-	-	-	-	-	(2,191)	776
Deferred Financing Costs and Other Assets	8,436	-	3	5	626	94	-	-	-	-	1,724	-	10,888
Total assets	\$ 518,111	\$ 9,439	\$ 6,184	\$ 8,357	\$ 27,108	\$ 1,114	\$ 11,757	\$ 4,963	\$ 69	\$ 98	\$ 5,128	\$ (17,121)	\$ 575,207

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2014

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc	Kennedy Health System	STAT Medical Transport, Inc.	Kennedy Property Corporation	Kennedy Health Facilities, Inc.	Kennedy Management Group, Inc.	Professional Medical Management, Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
												Eliminations	Consolidated
Liabilities and Net Assets (Deficit)													
Current Liabilities													
Long-term debt, current portion	\$ 5,772	\$ -	\$ -	\$ 1,085	\$ 338	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (979)	\$ 6,216
Accounts payable	40,055	-	45	35	31	-	37	338	4	-	304	(1,952)	38,897
Accrued expenses:													
Payroll and benefits	26,153	20	288	-	822	-	256	1,413	-	-	49	-	29,001
Other	7,185	3	93	3	1,945	-	491	3	-	15	435	-	10,173
Accrued interest	1,412	-	-	-	-	-	-	-	-	-	-	-	1,412
Due to affiliates	-	219	27	1,365	248	6,636	207	1,377	68	-	-	(10,147)	-
Estimated settlements with third party payors	3,792	-	-	-	66	-	-	-	-	-	-	-	3,858
Deferred revenue	1,448	-	-	63	-	-	12	256	-	-	3	-	1,782
Total current liabilities	85,817	242	453	2,551	3,450	6,636	1,003	3,387	72	15	791	(13,078)	91,339
Long-Term Debt	76,461	-	-	3,057	14,752	-	-	-	-	-	41	(1,852)	92,459
Accrued Pension Cost	33,636	-	-	-	-	-	-	-	-	-	-	-	33,636
Other Liabilities	22,068	-	-	-	275	-	-	-	-	-	-	-	22,343
Total liabilities	217,982	242	453	5,608	18,477	6,636	1,003	3,387	72	15	832	(14,930)	239,777
Net Assets (Deficit)													
Unrestricted	299,756	8,814	5,731	2,749	8,631	(5,522)	10,754	1,576	(3)	73	4,296	(2,191)	334,664
Temporarily restricted	373	383	-	-	-	-	-	-	-	10	-	-	766
Total net assets (deficit)	300,129	9,197	5,731	2,749	8,631	(5,522)	10,754	1,576	(3)	83	4,296	(2,191)	335,430
Total liabilities and net assets (deficit)	\$ 518,111	\$ 9,439	\$ 6,184	\$ 8,357	\$ 27,108	\$ 1,114	\$ 11,757	\$ 4,963	\$ 69	\$ 98	\$ 5,128	\$ (17,121)	\$ 575,207

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2013

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Consolidation	
										Eliminations	Consolidated
Assets											
Current Assets											
Cash and cash equivalents	\$ 28,866	\$ 451	\$ 1,739	\$ 199	\$ 3,913	\$ 42	\$ 1,612	\$ 778	\$ 37	\$ -	\$ 37,637
Accounts receivable:											
Patients (net of estimated allowance for doubtful collections of \$23,092)	53,100	-	1,232	-	1,759	-	-	1,292	-	(1,022)	56,361
Other	2,150	-	6	3	-	15	744	370	-	(147)	3,141
Due from affiliates	1,147	12,254	707	-	-	-	5,729	-	-	(19,837)	-
Assets whose use is limited	1,795	-	-	-	-	-	-	-	876	-	2,671
Inventories	8,129	-	-	-	42	-	-	23	-	-	8,194
Prepaid expenses and other current assets	3,768	-	133	1	175	525	105	192	-	-	4,899
Total current assets	98,955	12,705	3,817	203	5,889	582	8,190	2,655	913	(21,006)	112,903
Property and Equipment	217,591	6	706	8,593	19,782	-	390	583	-	-	247,651
Assets Whose Use is Limited	138,459	2,839	769	-	776	-	1,895	-	-	-	144,738
Loans to Affiliates	-	2,040	-	-	-	-	-	-	-	(2,040)	-
Investments in Joint Ventures	-	-	-	-	-	254	-	-	-	-	254
Interest Rate Cap	-	-	-	-	2	-	-	-	-	-	2
Deferred Financing Costs	6,586	-	3	16	590	92	-	-	58	-	7,345
Total assets	\$ 461,591	\$ 17,590	\$ 5,295	\$ 8,812	\$ 27,039	\$ 928	\$ 10,475	\$ 3,238	\$ 971	\$ (23,046)	\$ 512,893

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2013

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Consolidation	
										Eliminations	Consolidated
Liabilities and Net Assets (Deficit)											
Current Liabilities											
Long-term debt, current portion	\$ 5,776	\$ -	\$ -	\$ 928	\$ 323	\$ -	\$ -	\$ -	\$ -	\$ (792)	\$ 6,235
Accounts payable	33,458	-	26	247	9	-	1	168	3	(1,856)	32,056
Accrued expenses:											
Payroll and benefits	24,580	13	259	-	750	-	260	1,133	876	-	27,871
Other	6,517	21	97	2	1,916	-	568	3	-	-	9,124
Accrued interest	1,423	-	-	-	-	-	-	-	-	-	1,423
Due to affiliates	-	100	57	1,136	174	5,728	172	10,901	90	(18,358)	-
Estimated settlements with third party payors	3,792	-	-	-	124	-	-	-	-	-	3,916
Deferred revenue	1,421	-	-	59	-	-	14	-	12	-	1,506
Total current liabilities	76,967	134	439	2,372	3,296	5,728	1,015	12,205	981	(21,006)	82,131
Long-Term Debt	80,896	-	-	3,349	15,089	-	-	-	-	(2,040)	97,294
Accrued Pension Cost	14,636	-	-	-	-	-	-	-	-	-	14,636
Other Liabilities	19,499	-	-	-	235	-	-	-	-	-	19,734
Total liabilities	191,998	134	439	5,721	18,620	5,728	1,015	12,205	981	(23,046)	213,795
Net Assets (Deficit)											
Unrestricted	269,189	17,250	4,856	3,091	8,419	(4,800)	9,460	(8,967)	(10)	-	298,488
Temporarily restricted	404	206	-	-	-	-	-	-	-	-	610
Total net assets (deficit)	269,593	17,456	4,856	3,091	8,419	(4,800)	9,460	(8,967)	(10)	-	299,098
Total liabilities and net assets (deficit)	\$ 461,591	17,590	5,295	8,812	27,039	928	10,475	3,238	971	(23,046)	512,893

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

(In Thousands)

Year Ended December 31, 2014

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
												Eliminations	Consolidated
Unrestricted Revenues, Gains, and Other Support													
Net patient services revenue	\$ 529,314	\$ -	\$ 5,537	\$ -	\$ 20,494	\$ -	\$ -	\$ 12,507	\$ -	\$ -	\$ 404	\$ (2,210)	\$ 566,046
Provision for doubtful collections	(24,043)	-	-	-	(680)	-	-	(340)	-	-	-	-	(25,063)
Net patient service revenue less provision for doubtful collections	505,271	-	5,537	-	19,814	-	-	12,167	-	-	404	(2,210)	540,983
Other operating revenue	7,000	(66)	810	1,249	47	(384)	5,996	4,530	77	456	-	(6,736)	12,979
Net assets released from restrictions	72	68	-	-	-	-	-	-	-	-	-	-	140
Total unrestricted revenues, gains and other support	512,343	2	6,347	1,249	19,861	(384)	5,996	16,697	77	456	404	(8,946)	554,102
Expenses													
Employee salaries	195,164	370	3,164	-	9,011	-	2,222	13,421	-	156	160	-	223,668
Physician salaries and fees	34,041	-	-	-	-	-	-	-	-	-	61	(3,678)	30,424
Employee benefits	43,425	45	787	-	1,941	-	664	1,584	-	-	-	-	48,446
Supplies and expenses	162,583	205	1,231	995	7,361	343	1,803	4,122	67	297	297	(5,334)	173,970
Interest	3,032	-	-	138	406	-	-	144	-	-	-	(229)	3,491
Depreciation and amortization	25,987	1	298	456	935	-	99	127	-	-	15	-	27,918
Total expenses	464,232	621	5,480	1,589	19,654	343	4,788	19,398	67	453	533	(9,241)	507,917
Non-controlling Interest, Garden State Radiology	-	-	-	-	-	-	-	-	-	-	63	-	63
Income (Loss) from Operations	48,111	(619)	867	(340)	207	(727)	1,208	(2,701)	10	3	(66)	295	46,248
Nonoperating Income (Loss)													
Interest, dividends, and net realized gains and losses on investments	2,751	264	8	(2)	5	5	(41)	(16)	(3)	-	-	(229)	2,742
Revenues in excess of (less than) expenses	50,862	(355)	875	(342)	212	(722)	1,167	(2,717)	7	3	(66)	66	48,990
Change in Net Unrealized Gains on Securities	4,715	127	-	-	-	-	127	-	-	-	-	-	4,969
Loan Forgiveness	-	(11,670)	-	-	-	-	-	11,670	-	-	-	-	-
Pension Liability Adjustment	(19,888)	-	-	-	-	-	-	-	-	-	-	-	(19,888)
Investment in Garden State Radiology	-	-	-	-	-	-	-	-	-	-	4,362	(2,257)	2,105
Transfer (to) from Affiliate	(5,122)	3,462	-	-	-	-	-	1,590	-	70	-	-	-
Increase (decrease) in unrestricted net assets	\$ 30,567	\$ (8,436)	\$ 875	\$ (342)	\$ 212	\$ (722)	\$ 1,294	\$ 10,543	\$ 7	\$ 73	\$ 4,296	\$ (2,191)	\$ 36,176

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

(In Thousands)

Year Ended December 31, 2013

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Imaging, P.C.	Consolidation	
										Eliminations	Consolidated
Unrestricted Revenues, Gains, and Other Support											
Net patient services revenue	\$ 486,437	\$ -	\$ 5,196	\$ -	\$ 20,468	\$ -	\$ -	\$ 10,472	\$ 1,364	\$ (2,141)	\$ 521,796
Provision for doubtful collections	(29,451)	-	-	-	(782)	-	-	(262)	-	-	(30,495)
Net patient services revenue less provision for doubtful collections	456,986	-	5,196	-	19,686	-	-	10,210	1,364	(2,141)	491,301
Other operating revenue	8,538	463	791	1,079	63	(682)	5,726	3,203	-	(4,992)	14,190
Net assets released from restrictions	45	76	-	-	-	-	-	-	-	-	121
Total unrestricted revenues, gains and other support	465,569	539	5,987	1,079	19,749	(682)	5,726	13,413	1,364	(7,133)	505,612
Expenses											
Employee salaries	181,928	234	2,914	-	8,631	-	2,249	10,872	1,112	-	207,940
Physician salaries and fees	35,381	-	-	-	-	-	-	-	-	(2,473)	32,908
Employee benefits	41,784	36	828	-	1,940	-	673	1,328	125	-	46,714
Supplies and expenses	153,909	408	1,243	805	7,120	107	1,767	3,374	124	(4,660)	164,198
Interest	3,225	-	-	171	437	-	-	285	-	(396)	3,722
Depreciation and amortization	27,762	1	268	438	928	-	97	94	-	-	29,588
Total expenses	443,989	679	5,253	1,414	19,056	107	4,786	15,953	1,361	(7,529)	485,070
Income (Loss) from Operations	21,580	(140)	734	(335)	693	(789)	940	(2,540)	3	396	20,542
Nonoperating Income (Loss)											
Interest, dividends, and net realized gains and losses on investments	3,606	437	18	-	10	4	(50)	(35)	(3)	(396)	3,591
Revenues in excess of (less than) expenses	25,186	297	752	(335)	703	(785)	890	(2,575)	-	-	24,133
Change in Net Unrealized Gains (losses) on Securities	7,301	187	(31)	-	(25)	-	216	-	-	-	7,648
Net Assets Released from Restrictions for Property and Equipment	68	-	-	-	-	-	-	-	-	-	68
Pension Liability Adjustment	14,621	-	-	-	-	-	-	-	-	-	14,621
Donations for Property and Equipment	-	(150)	-	-	-	-	-	-	-	-	(150)
Transfer from (to) Affiliate	(1,542)	1,414	-	128	-	-	-	-	-	-	-
Increase (decrease) in unrestricted net assets	\$ 45,634	\$ 1,748	\$ 721	\$ (207)	\$ 678	\$ (785)	\$ 1,106	\$ (2,575)	\$ -	\$ -	\$ 46,320