Consolidated Financial Statements and Supplementary Information

Peninsula Regional Health System, Inc.
Years Ended June 30, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Peninsula Regional Health System, Inc.

Consolidated Financial Statements and Supplementary Information

Years Ended June 30, 2015 and 2014

Contents

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Report of Independent Auditors

The Board of Trustees
Peninsula Regional Health System, Inc.

We have audited the accompanying consolidated financial statements of Peninsula Regional Health System, Inc. (the Health System), which comprise the consolidated balance sheets as of June 30, 2015 and 2014, and the related consolidated statements of operations and 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 financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain subsidiaries and joint ventures of both Peninsula Health Ventures, Inc. (Health Ventures) and Peninsula Regional Medical Center (the Hospital), both of which are wholly-owned subsidiaries of the Heath System. Three of the entities, Delmarva Peninsula Insurance Company (DPIC), Delmarva Surgery Center, LLC, (Delmarva) and Peninsula Imaging, LLC (Imaging), reflect total assets constituting 4.8% in 2015 and 4.8% in 2014 and total revenues constituting 1.1% in 2015 and 1.2% in 2014 of the related consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for DPIC, Delmarva and Imaging, is based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peninsula Regional Health System, Inc. at June 30, 2015 and 2014, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The consolidating supplementary information is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the 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 auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

September 18, 2015

Peninsula Regional Health System, Inc.

Consolidated Balance Sheets
(In Thousands)

	June 30	
	2015	**2014**
Assets		
Current assets:		
Cash and cash equivalents	**$ 52,976**	$ 32,593
Short-term investments	**6,477**	4,899
Accounts receivable, less allowance for uncollectible accounts (2015 – $7,927; 2014 – $7,497)	**39,306**	39,019
Inventories and other	**10,561**	9,502
Prepaids	**4,922**	5,284
Total current assets	**114,242**	91,297
Long-term investments	**226,306**	204,703
Board-designated investments	**23,963**	22,224
Assets limited as to use:		
Construction fund	**18,863**	–
Debt service reserve fund	**–**	9,267
Donor-restricted fund	**31,922**	28,610
Self-insurance fund	**19,293**	17,152
	70,078	55,029
Property and equipment, net	**206,171**	207,174
Unamortized financing costs, net of accumulated amortization	**1,402**	2,208
Other assets	**19,405**	21,688
Total assets	**$ 661,567**	$ 604,323

	June 30	
	2015	**2014**
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 2,005**	$ 3,257
Current portion of accrued self-insured liabilities	**2,495**	2,495
Accounts payable	**17,941**	16,506
Accrued liabilities	**18,765**	14,942
Advances from third-party payors	**9,846**	9,221
Total current liabilities	**51,052**	46,421
Long-term debt, net	**146,494**	123,364
Other liabilities	**17,141**	14,648
Total liabilities	**214,687**	184,433
Net assets:		
Unrestricted	**413,327**	389,370
Temporarily restricted	**23,520**	20,361
Permanently restricted	**8,246**	8,093
Peninsula Regional Health System, Inc net assets	**445,093**	417,824
Minority interest	**1,787**	2,066
Total net assets	**446,880**	419,890
Total liabilities and net assets	**$ 661,567**	$ 604,323

See accompanying notes.

Peninsula Regional Health System, Inc.

Consolidated Statements of Operations and Changes in Net Assets
(In Thousands)

	Year Ended June 30	
	2015	**2014**
Unrestricted revenue and other support:		
Net patient service revenue	**$ 405,009**	$ 388,802
Provision for bad debts	**(10,785)**	(14,368)
Net patient service revenue less provision for bad debts	**394,224**	374,434
Other operating revenue	**3,711**	5,802
Total unrestricted revenue and other support	**397,935**	380,236
Operating expenses:		
Salaries and wages	**155,405**	150,202
Supplies and other expenses	**167,655**	154,219
Employee benefits	**32,187**	40,428
Depreciation	**22,571**	22,921
Interest	**6,186**	6,130
Total operating expenses	**384,004**	373,900
Income from operations	**13,931**	6,336
Nonoperating income (expense):		
Investment income	**18,945**	24,710
Loss on extinguishment of debt	**(7,309)**	–
Total nonoperating income	**11,636**	24,710
Excess of unrestricted revenue and other support over expenses	**25,567**	31,046
Minority interest in earnings of controlled subsidiaries	**279**	34
Excess of unrestricted revenue and other support over expenses attributable to Peninsula Regional Health System, Inc.	**25,846**	31,080

Peninsula Regional Health System, Inc.

Consolidated Statements of Operations and Changes in Net Assets (continued)
(In Thousands)

	Year Ended June 30	
	2015	**2014**
Unrestricted net assets:		
Excess of unrestricted revenue and other support over expenses attributable to Peninsula Regional Health System, Inc.	**$ 25,846**	$ 31,080
Net assets released from restrictions	**–**	1,900
Unrealized gains on investments	**828**	13,566
Pension adjustment	**(2,717)**	12,084
Increase in unrestricted net assets	**23,957**	58,630
Temporarily restricted net assets:		
Donations	**1,313**	1,036
Net realized gains on investments	**1,690**	1,862
Unrealized gains on investments	**491**	1,513
Net assets released from restrictions	**(335)**	(2,049)
Increase in temporarily restricted net assets	**3,159**	2,362
Permanently restricted net assets:		
Net realized gains on investments	**152**	5
Unrealized gains on investments	**1**	5
Increase in permanently restricted net assets	**153**	10
Increase in net assets	**27,269**	61,002
Net assets at beginning of year	**417,824**	356,822
Net assets at end of year	**$ 445,093**	$ 417,824

See accompanying notes.

Peninsula Regional Health System, Inc.

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2015	**2014**
Operating activities		
Change in net assets	**$ 27,269**	$ 61,002
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation of property and equipment	**22,571**	22,921
Loss on advance refunding of debt	**7,309**	–
Amortization of original issue premium	**(166)**	(283)
Amortization of financing costs	**78**	107
(Gains) losses on sale of property and equipment	**(12)**	(14)
Net unrealized (gains) losses on investments	**372**	(15,079)
Net realized gains on investments	**(15,155)**	(17,790)
Proceeds from restricted contributions and realized gains on restricted investments	**(3,003)**	(2,898)
Minority interest in earnings of controlled subsidiaries	**(279)**	(34)
Changes in operating assets and liabilities:		
Accounts receivable	**(95)**	(967)
Inventories and other assets	**1,441**	(13,200)
Accounts payable and accrued liabilities	**5,259**	(3,219)
Other liabilities	**2,493**	402
Advances from third-party payors	**625**	1,166
Net cash provided by operating activities	**48,707**	32,114
Investing activities		
Purchase of investments	**(167,972)**	(136,140)
Proceeds from sales of investments	**146,946**	132,994
Purchases of property and equipment	**(21,576)**	(18,360)
Proceeds from disposal of assets	**14**	30
Change in assets limited to use	**(4,395)**	(7,108)
Net cash used in investing activities	**(46,983)**	(28,584)
Financing activities		
Proceeds from restricted contributions and realized losses on restricted investments	**3,003**	2,898
Proceeds from Bond Issuance	**147,435**	–
Deferred financing costs	**(1,375)**	–
Repayments of long-term debt	**(130,404)**	(3,124)
Net cash provided by (used in) financing activities	**18,659**	(226)
Net increase in cash and cash equivalents	**20,383**	3,304
Cash and cash equivalents at beginning of year	**32,593**	29,289
Cash and cash equivalents at end of year	**$ 52,976**	$ 32,593

See accompanying notes.

1. Organization and Mission

Peninsula Regional Health System, Inc. (the Health System) serves as the parent company to Peninsula Regional Medical Center (the Hospital), Peninsula Regional Medical Center Foundation, Inc. (the Foundation) and Peninsula Health Ventures, Inc. (Health Ventures). The Health System is a not-for-profit Maryland membership corporation established to manage the integrated delivery of health care services to the community. The Health System is the sole corporate member of the Hospital and the Foundation. In its capacity as sole corporate member, the Health System will appoint trustees, approve major expenditures and approve long-term borrowings.

The Hospital is a not-for-profit, nonstock corporation founded in 1897 to serve the health care needs of its region. Primary service areas include the Maryland counties of Wicomico, Somerset and Worcester, southern Delaware and the northern Eastern Shore of Virginia. The Hospital's mission is to improve the health care of the community by providing exceptional quality primary, secondary, and selected tertiary health care services to patients in a competent and compassionate manner, designed to elicit a high degree of customer satisfaction. The Hospital provides services regardless of race, creed, sex, national origin, handicap, or age. In May 2013, Delmarva Peninsula Insurance Company (DPIC) was formed as a wholly owned subsidiary of the Hospital. DPIC was formed as a captive insurer to provide professional and general liability insurance.

The Foundation is a not-for-profit, nonstock corporation organized to raise contributions exclusively for the benefit of charitable, educational, medical, and scientific purposes for the Hospital.

Health Ventures is a for-profit corporation organized for the purpose of owning, developing, operating and investing in health care enterprises on the Delmarva Peninsula. The Health System owns all of the outstanding shares of common stock of Health Ventures.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Health System and all wholly owned subsidiaries, principally the Hospital, the Foundation and Health Ventures. Additionally, the Health System has consolidated a 55%-owned affiliate, Delmarva Surgery Center, LLC, and recorded minority interest equal to the remaining ownership interest.

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 amounts could differ from those estimates.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and advances from third-party payors, approximate fair value given the short-term nature of these financial instruments.

Cash and Cash Equivalents

Cash and cash equivalents include surplus operating funds invested in money market funds and highly liquid corporate, U.S. government and agency obligations, all with maturities of less than three months when purchased.

Investments and Investment Income

Investments are carried at fair value. All such investments are considered available for sale and are classified as current or noncurrent assets based on management's intention as to use. Short-term investments represent investments with contractual maturities within one year and current investments in money market funds which have been designated for long-term investment purposes. Assets limited as to use by donor restriction are recorded at fair value at the date of donation and changes in fair value are recognized in the period in which the change occurs. Investment income from all unrestricted investments is reported as nonoperating income. Investment income on investments of restricted assets is added to or deducted from the appropriate restricted net assets when restricted as to use by the donor.

The value of securities sold is based on the specific identification method.

2. Significant Accounting Policies (continued)

The Health System periodically evaluates whether any declines in the fair value of investments are other than temporary. This evaluation consists of a review of several factors, including but not limited to: length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; and the intent and ability of the Health System to hold the security until the market value recovers. Realized gains or losses are included in nonoperating income (expense) in the accompanying consolidated statements of operations and changes in net assets. Declines in fair value below cost that are deemed to be other than temporary would be recorded as realized losses within nonoperating income (expense). Based on its evaluation, the Health System has recorded no other-than-temporary impairments for the years ended June 30, 2015 and 2014.

Accounts Receivable and Contractual Allowances

The Health System, through its member companies, provides services to patients in the Eastern Shore area of Maryland, Delaware and Virginia, the majority of whom are covered by third-party health insurance. The Health System bills the insurer directly for services provided.

Insurance coverage and financial information is obtained from patients upon admission when available. The Health System's policy is to perform in-house collection procedures for approximately 85 days. A determination is made at that time as to what additional collection efforts to pursue. A provision for uncollectible accounts is recorded for amounts not yet written off, which are expected to become uncollectible.

Discounts ranging from 2% to 6% of charges are given to Medicare, Medicaid and certain approved commercial health insurance and health maintenance organization programs for regulated services. Discounts in varying percentages are given for certain unregulated services. These major payors routinely review patient billings and deny payment for certain charges as medically unnecessary or as performed without appropriate preauthorization. Discounts and denials are recorded as reductions of net patient service revenue. Revenue and accounts receivable from these third-party payors have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

Approximately 38% and 39% of accounts receivable were due from the Medicare program as of June 30, 2015 and 2014, respectively.

2. Significant Accounting Policies (continued)

The Medicare and Medicaid reimbursement programs represent a substantial portion of the Health System's revenues. The Health System's operations are subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare, and Medicaid fraud and abuse.

Over the past several years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. Compliance with fraud and abuse standards and other government regulations can be subject to future government review and interpretation. Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the Health System.

Inventories and Other

Inventories and other primarily includes inventories of supplies and prepaid expenses. Inventories of supplies are carried at lower of cost or market, using the first-in, first-out method.

Other Assets

Other assets primarily include a 50% non-controlling interest in each of the following entities, which are accounted for as equity method investments: Peninsula Imaging, LLC, AHP Delmarva, LLP, Genesis Healthcare, Peninsula-NRH Regional Rehabilitation, LLC, and Peninsula Home Care, LLC. The Hospital also has a 33.3% non-controlling interest in Peninsula Home Care at Nanticoke, which is accounted for as equity method investment. Additionally, other assets include a prepaid pension asset and a reinsurance receivable asset.

2. Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under indenture agreements, assets held by trustees under irrevocable self-insurance trust agreements and assets, including pledges receivable, whose use has been limited by the donor of the underlying funds. Amounts required to meet current liabilities have been classified in the consolidated balance sheets as current assets.

Board-Designated Investments

Board-designated investments include assets set aside by the Board of Trustees for future capital improvements and expansion. The Board of Trustees retains control of these assets and may, at its discretion, subsequently use them for other purposes.

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. 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 cash or other assets that must be used to acquire long-lived assets are reported as restricted donations. Absent explicit donor stipulations about how long those assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Construction Fund

This Construction Fund was created as a result the proceeds of the 2015 Maryland Health and Higher Educational Facilities Authority Revenue Bond Offering (MHHEFA), net of the advance refunding of the 2006 MHHEFA Bond offering. The net proceeds are required to be spent on capital improvements, and used for the acquisition, renovation or equipping of certain facilities of the Hospital.

2. Significant Accounting Policies (continued)

Unamortized Financing Costs

Financing costs incurred in issuing the Maryland Health and Higher Educational Facilities Authority Project and Refunding Revenue Bonds have been capitalized and are being amortized using the straight-line method over the life of the bonds, which approximates the effective interest method. The amount amortized is recorded as an operating expense.

Estimated Self-Insurance Liabilities and Workers' Compensation

The provision for estimated professional liability claims, general liability claims, and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Pension Benefits

Pension benefits are recorded in accordance with ASC No. 715, *Compensation – Retirement Benefits*, which requires the recognition of the funded status of pension plans within the accompanying consolidated balance sheets. As of June 30, 2015 and 2014, the funded status of the pension plan has been recorded within other assets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Health System has been limited by donors to a specific time period or purpose. Temporarily restricted net assets are to be used for capital purposes and other health care services.

Permanently restricted net assets have been restricted by donors to be maintained by the Health System in perpetuity.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated realizable amounts from patients, third-party payors and others for services rendered. During 2015 and 2014, approximately 49% and 48% of net patient service revenue was received under the Medicare program, 12% and 13% from CareFirst Blue Cross Blue Shield, 34% and 33% from contracts with other third parties, and 5% and 7% from other sources, respectively.

(In Thousands)

2. Significant Accounting Policies (continued)

The following table sets forth the detail of net patient service revenue:

	Year Ended June 30	
	2015	**2014**
Gross patient service revenue	**$ 506,851**	$ 496,169
Revenue deductions:		
Charity care	**9,408**	16,369
Contractual and other allowances	**92,434**	90,998
Patient revenue, net of deductions	**405,009**	388,802
Less: Provision for bad debts	**10,785**	14,368
Net patient service revenue less bad debts	**$ 394,224**	$ 374,434

The Health System employs physicians in several hospital-based specialties. The Health System bills for the services provided by these physicians. Net physician revenue is recognized when the services are provided and recorded at the estimated net realizable amount based on the contractual arrangements with third-party payors and the expected payments from the third-party payors and the patients. The difference between the billed charges and the estimated net realizable amounts are recorded as a reduction in physician revenue when the services are provided. For the years ended June 30, 2015 and 2014, the Health System recorded $29,460 and $26,497 of net physician revenue, respectively.

Patient accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Health System analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Health System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. 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 Health System records a provision for bad debts in the period of service on the basis of its past experience. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts. The Health System has not changed its charity care or uninsured discount policies during fiscal years 2015 or 2014.

2. Significant Accounting Policies (continued)

Other Operating Revenue

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology. For Medicare and Medicaid EHR incentive payments, the Hospital uses a gain contingency accounting method to recognize the revenues. Under this accounting policy, EHR incentive payments are recognized as revenue upon the completion of the meaningful use period and completion of the related 12-month cost report. Accordingly, the Hospital recognized approximately $1,974 of EHR revenues for the year ended June 30, 2015, and $3,905 for the year ended June 30, 2014. This is based on cost report data which is subject to audit by CMS or its intermediaries, and the amounts recognized are subject to change.

These amounts are included in other operating revenue in the consolidated statements of operations. The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. The recognition of revenues is based on management's best estimate. Any subsequent changes in the recognition of the revenue will impact the results of operations in the period in which they occur.

Charity Care

The Health System provided care to patients who met certain criteria under its charity care policy, without charge or at amounts less than its approved rates. Because the Health System did not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amounts written off as charity care for 2015 and 2014, were $7,402 and $12,957, respectively. These amounts represent direct and indirect charity care costs, which are calculated using the Health System's cost to charge ratio. The state of Maryland rate system includes components within the rates to partially compensate Health Systems for uncompensated care.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Health 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 donations if they are received with donor

(In Thousands)

2. Significant Accounting Policies (continued)

stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets 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.

Investment Income

Investment income primarily includes income from short-term and long-term investments, board-designated investments and investments within assets limited as to use. In addition, investment income is also recorded for certain equity method investments that are included within other assets.

The components of investment income are as follows:

	Year Ended June 30 2015	2014
Interest and dividend income	**$ 4,300**	$ 3,697
Realized gains, net	**11,373**	15,343
Income earned on equity method investments	**3,155**	5,423
Other	**117**	247
Total	**$ 18,945**	$ 24,710

Income Taxes

The Health System 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 pursuant to Section 501(a) of the Code.

(In Thousands)

2. Significant Accounting Policies (continued)

Performance Indicator

The performance indicator for the Health System is excess of unrestricted revenue and other support over expenses, which includes all changes in unrestricted net assets except for changes in unrealized gains and losses on investments, pension adjustments in accordance with ASC No. 958-715 – *Not for Profit Entities – Compensation – Retirement Benefits* and net assets released from restrictions for property acquisitions.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 *Revenue from Contracts with Customers (Topic 606).* This guidance is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. It will be effective for fiscal year 2019 and early adoption is permitted beginning in fiscal year 2018. We have not yet determined the impact from adoption of this new accounting pronouncement on our financial statements.

3. Property and Equipment

A summary of property and equipment follows:

	Estimated Useful Lives	**June 30 2015**	**2014**
Land	–	**$ 11,385**	$ 11,385
Land improvements	20	**13,997**	13,997
Buildings and improvements	15–40	**220,063**	208,614
Fixed equipment	20	**34,115**	34,115
Movable equipment	7–10	**201,143**	215,498
		480,703	483,609
Less accumulated depreciation		**(290,123)**	(292,497)
		190,580	191,112
Construction in progress		**15,591**	16,062
Property and equipment, net		**$ 206,171**	$ 207,174

As of June 30, 2015, the Hospital was committed to building and equipment purchases totaling approximately $7,723.

(In Thousands)

4. Other Liabilities

The components of other liabilities are as follows:

	June 30 2015	June 30 2014
Self-insurance obligations	**$ 15,847**	$ 13,819
Other	**1,294**	829
Total	**$ 17,141**	$ 14,648

5. Long-Term Debt

Long-term debt consists of the following:

	June 30, 2015
Maryland Health and Higher Educational Facilities Authority Revenue Bonds Series 2015:	
Series 2015 Serial bonds with interest rates ranging from 3.00% to 5.00% and effective rates ranging from 2.57% to 3.01% due in various annual amounts on July 1 of each year from 2015 through 2034	**$ 57,895**
Series 2015 5.00% term bonds with effective rate of 3.99% due July 1, 2039	**26,445**
Series 2015 5.00% term bonds with effective rate of 4.13% due July 1, 2045	**41,550**
Building and equipment collateral loans:	
4.40% fixed rate due monthly from 2012 to 2022	**1,849**
	127,739
Less: Current portion of Maryland Health and Higher Educational Facilities Authority Series 2015 serial bonds	**1,930**
Less: Current portion of building and equipment collateral loans	**75**
	125,734
Original issue premium	**20,760**
Long-term debt, less current portion	**$ 146,494**

(In Thousands)

5. Long-Term Debt (continued)

	June 30, 2014
Maryland Health and Higher Educational Facilities Authority	
Revenue Bonds Series 2006:	
Serial bonds with interest rates ranging from 3.50% to 5.00% and effective rates ranging from 3.49% to 4.67% due in various annual amounts on July 1 of each year from 2007 through 2021 and 2027	27,810
5.00% term bonds with effective rate of 4.44% due July 1, 2026	24,635
5.00% term bonds with effective rate of 4.63% due July 1, 2036	69,505
Property acquisition note:	
5.50% due March 1 of each year from 2007 to 2015	15
Building and equipment collateral loans:	
4.40% fixed rate due monthly from 2012 to 2022	1,919
	123,884
Less: Current portion of Maryland Health and Higher Educational Facilities Authority Series 2006 serial bonds	3,170
Less: Property acquisition note	15
Less: Current portion of building and equipment collateral loans	72
	120,627
Original issue premium	2,737
Long-term debt, less current portion	$ 123,364

Series 2015 Revenue Bonds

On February 5, 2015, the Maryland Health and Higher Educational Facilities Authority (MHHEFA) authorized the issuance of $126,665 aggregate principal amount of Revenue Bonds (Series 2006 Bonds) at a premium of $20,770. The proceeds of the issue, after payment of financing costs, were used primarily: (i) to advance refund outstanding 2006 bonds; (ii) to finance $25,000 of capital purchases.

The Hospital is required to make semiannual payments to the trustee sufficient to meet the annual debt service requirements of the refunding bond issue for the succeeding year. Annual sinking fund installments for the term bonds range from $3,322 on July 1, 2015, to $8,189 on July 1, 2020. The premium on the Series 2015 Bonds is being amortized over the life of the bonds using the effective interest method.

5. Long-Term Debt (continued)

As security for the debt service requirements of the Series 2015 Bonds, the MHHEFA has a first lien and claim on all receipts of the Hospital. The terms of the indenture agreement restrict the Hospital's ability to create additional indebtedness and its use of the facilities, and require the Hospital to maintain stipulated insurance coverage and a rate structure in each year sufficient to meet certain rate covenant requirements.

Series 2006 Revenue Bonds

On February 9, 2006, the Maryland Health and Higher Educational Facilities Authority (MHHEFA) authorized the issuance of $142,910 aggregate principal amount of Revenue Bonds (Series 2006 Bonds) at a premium of $5,333. The proceeds of the issue, after payment of financing costs, were used primarily: (i) to finance and refinance a portion of the costs of construction, renovation, acquisition and equipping of the 2006 Project; (ii) to refund outstanding 1993 bonds; (iii) to pay a portion of the interest accruing on the Series 2006 Bonds for a period to extend to January 1, 2009; and (iv) to pay the Counterparty a termination payment of $1,575 in connection with a forward starting interest rate exchange agreement entered into on August 9, 2005, and unwound on January 24, 2006.

The Series 2006 Revenue Bonds were refunded in February 2015 upon the issuance of the Series 2015 Revenue Bonds. The Company incurred a $7.3 million loss on advance refunding of Series 2006 Revenue Bonds which relates to advance refunding amounts in excess of principal payments and the write off of unamortized financing costs, partially offset by the write-off of the unamortized bond premium.

Delmarva Surgery Center, LLC Building Loan

On June 1, 2012, Delmarva Surgery Center, LLC (the Company), a 55% owned subsidiary of Health Ventures, entered into a fixed rate loan agreement with BB&T Bank in the amount of $2,059 ($1,849 outstanding at June 30, 2015), with fixed monthly payments through June 1, 2022.

(In Thousands)

5. Long-Term Debt (continued)

Scheduled principal repayments on long-term debt for the years ending June 30 are as follows:

2016	$ 2,005
2017	2,069
2018	2,173
2019	2,282
2020	2,396
2021 and thereafter	116,814
	$ 127,739

Fair values of long-term debt are estimated using discounted cash flow analyses, based on current incremental borrowing rates for similar types of borrowing arrangements.

The fair value of the Health System's long-term debt outstanding as of June 30, 2015 and 2014, was $139,628 and $127,675, respectively.

Total interest paid for fiscal years 2015 and 2014, was $6,133 and $6,081, respectively.

6. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	June 30	
	2015	**2014**
Health care services:		
Capital purposes	**$ 17,208**	$ 15,044
Patient services	**5,185**	4,324
Educational purposes	**1,127**	993
	$ 23,520	$ 20,361

(In Thousands)

6. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets are restricted to:

	June 30	
	2015	**2014**
Investments to be held in perpetuity, the income from which is expendable to support health care services	**$ 8,246**	$ 8,093

The Foundation initiated a major fundraising campaign for capital funds during fiscal year 2005 to support the Hospital's capital plans that include expansion and modernization of facilities. The Foundation has raised approximately $14,629 as of June 30, 2015, which includes net pledges receivable present valued at approximately $626. There is one large donation that represents approximately 92% of the net pledges receivable at year-end. The Foundation expects to receive payment on the majority of the pledges by 2020 and all payments by 2025. Additionally, during 2011, the Foundation launched a fundraising campaign to support the Operating Room expansion. This campaign has raised $2,894 as of June 30, 2015, which includes net pledges receivable present valued at $297. Additionally during 2015, the Foundation initiated a Behavioral Health campaign which has raised $242 as of June 30, 2015, which includes net pledges receivable present valued at $190. Pledges receivable are included in assets limited as to use in the accompanying balance sheets.

Scheduled payments on pledges receivable for the years ending June 30 are as follows:

2016	$ 274
2017–2020	711
2021 and thereafter	430
	1,415
Less:	
Impact of discounting of pledges receivable to net present value	134
Allowance for uncollectible pledges	168
Net pledges receivable, capital campaign	$ 1,113

(In Thousands)

7. Functional Expenses

The Health System considers health care services and management and general to be its primary functional categories for purposes of expense classification. Depreciation and interest costs are included in health care services. The Health System's operating expenses by functional classification are as follows:

	Year Ended June 30	
	2015	**2014**
Health care services	**$ 345,559**	$ 336,854
Management and general	**38,445**	37,046
	$ 384,004	$ 373,900

8. Malpractice Insurance Costs, Self-Insured Professional Liability and Workers Compensation

Effective July 1, 2013, Delmarva Peninsula Insurance Captive (DPIC) was formed as a captive insurer to provide professional liability insurance. DPIC is a wholly-owned subsidiary of Peninsula Regional Medical Center. The primary layer of professional and general liability insurance coverage is self-insured through DPIC and the secondary layer is fully insured through a commercial carrier.

Effective July 1, 2013, under a loss portfolio transfer agreement (LPT), the DPIC assumed the MPL and GL coverage previously included under PRMC's self-insurance plan for incidents occurring between March 1, 1986, and June 30, 2013, for MPL and for occurrences between March 1, 2004 and June 30, 2013, for GL, that were reported to PRMC prior to June 30, 2013. The policy provides MPL coverage limits varying from $1 million to $2 million each and every medical incident, with policy aggregates varying from $3 million to $8 million. The policy provides GL coverage limits of $1 million per occurrence and $3 million policy aggregates. This policy is retrospectively rated.

DPIC is fully insured by commercial carriers in excess of the coverage limits discussed above up to $25 million per claim and in the aggregate. As of June 30, 2015 and 2014, the accrued self-insured professional liability losses have been discounted at 0% for both years. As of June 30, 2015 and 2014, respectively, $14,146 and $12,503 have been reserved for professional liability loss contingencies, including excess coverage. A related reinsurance receivable of $4,010 and $3,664 has been recorded in Other Assets as of June 30, 2015 and June 30, 2014, respectively.

(In Thousands)

8. Malpractice Insurance Costs, Self-Insured Professional Liability and Workers Compensation (continued)

Effective July 1, 2013, DPIC provides excess umbrella liability coverage on a mature claims-made basis with a retroactive date of March 1, 2005. The excess medical professional liability tower follows form of the underlying primary MPL coverage providing a total of $25 million limits of liability. The umbrella liability coverage provides $25 million limits of liability excess of scheduled underlying coverages including the primary GL coverage. The excess umbrella liability coverage is 100% reinsured with Darwin for the first $10 million limit and OneBeacon for the second $15 million limit.

The Hospital is also self-insured for workers' compensation up to an annual limit of $500 per occurrence. The Hospital carries an excess liability insurance policy for workers' compensation claims above this limit. As of June 30, 2015 and 2014, respectively, $4,200 and $3,600 have been reserved for workers' compensation loss contingencies.

9. Investments

The following methods and assumptions were used by the Health System in estimating the fair value of its financial instruments:

Fair values of all investments, including short-term investments, long-term investments, board-designated investments, and assets limited to use are based on quoted market prices and/or prices obtained from a third party using other market data for the same or comparable instruments and transactions in establishing the prices. Certain long-term pledges receivable have been discounted.

Fair value of investments and certain assets limited as to use held by the Health System is summarized as follows:

	June 30	
	2015	**2014**
Investments:		
Cash and Cash equivalents	**$ 19,149**	$ 12,924
U.S. treasury securities	**12,789**	11,835
Corporate bonds	**54,843**	56,783
Mortgage-backed securities	**39,909**	23,914
Equity securities	**198,168**	176,759
Other (including pledges receivable held at the Foundation)	**1,966**	4,640
Total	**$ 326,824**	$ 286,855

9. Investments (continued)

ASC No. 320, *Investments – Debt and Equity Securities*, provides guidance on the recognition and presentation of other-than-temporary impairments. If a debt security is in an unrealized loss position and the Health System has the intent to sell the debt security, or it is more likely than not that the Health System will have to sell the debt security before recovery of its amortized cost basis, the decline in value is deemed to be other-than-temporary and is recorded to other-than-temporary impairment losses recognized in the performance indicator in the consolidated statements of operations. For impaired debt securities that the Health System does not intend to sell or it is more likely than not that the Health System will not have to sell such securities, but the Health System expects that it will not fully recover the amortized cost basis, the credit component of the other-than-temporary impairment is recognized in other-than-temporary impairment losses recognized in income in the consolidated statements of operations and the non-credit component of the other-than-temporary impairment is recognized as a change in unrestricted net assets.

The credit component of other-than-temporary impairment is determined by comparing the net present value of projected future cash flows with the amortized cost basis of the debt security. The net present value is calculated by discounting the best estimate of projected future cash flows at the effective interest rate implicit in the debt security at the date of acquisition. Cash flow estimates are driven by assumptions regarding probability of default, including changes in credit ratings, and estimates regarding timing and amount of recoveries associated with a default. Furthermore, unrealized losses entirely caused by non-credit-related factors related to debt securities for which the Health System expects to fully recover the amortized cost basis continue to be recognized as an unrealized loss on investments within the changes in unrestricted net assets.

(In Thousands)

9. Investments (continued)

The following table shows the gross unrealized losses and fair value of the Health System's investments with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2015 and 2014:

	Fair Value < 1 year	Unrealized Losses < 1 year	Fair Value > 1 year	Unrealized Losses > 1 year	Total Unrealized Losses
June 30, 2015					
U.S. Treasury	**$ 4,334**	**$ 63**	**$ 3,869**	**$ 218**	**$ 281**
Mortgage-backed securities	**2,690**	**25**	**4,869**	**235**	**260**
Corporate bonds	**20,204**	**299**	**7,000**	**408**	**707**
Equity securities	**33,149**	**1,910**	**204**	**19**	**1,929**
Total investments	**$ 60,377**	**$ 2,297**	**$ 15,942**	**$ 880**	**$ 3,177**
June 30, 2014					
U.S. Treasury	$ 829	$ 1	$ 8,153	$ 233	$ 234
Government sponsored mortgage-backed securities	3,953	58	8,838	372	430
Corporate bonds	4,878	47	6,219	215	262
Equity securities	14,670	894	749	52	946
Total investments	$ 24,330	$ 1,000	$ 23,959	$ 872	$ 1,872

10. Fair Value Measurements

ASC No. 820, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC No. 820 are described below:

- Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Health System has the ability to access.
- Level 2 – Inputs to the valuation methodology include:
  - Quoted prices for similar assets or liabilities in active markets;
  - Quoted prices for identical or similar assets or liabilities in inactive markets;
  - Inputs other than quoted prices that are observable for the asset or liability;
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

(In Thousands)

10. Fair Value Measurements (continued)

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Health System 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.

The following table presents the Health System's assets and liabilities measured at fair value, aggregated by level in the fair value hierarchy within which those measurements fall:

	Assets at Fair Value as of June 30, 2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Cash and cash equivalents	**$ 19,149**	**$ –**	**$ –**	**$ 19,149**
U.S. government securities	**12,789**	**–**	**–**	**12,789**
Corporate bonds	**–**	**54,843**	**–**	**54,843**
Government sponsored mortgage–backed securities	**–**	**39,909**	**–**	**39,909**
Equity securities	**198,168**	**–**	**–**	**198,168**
Other	**853**	**–**	**1,113**	**1,966**
Total assets	**$ 230,959**	**$ 94,752**	**$ 1,113**	**$ 326,824**

	Assets at Fair Value as of June 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Cash and cash equivalents	$ 12,924	$ –	$ –	$ 12,924
U.S. government securities	11,835	–	–	11,835
Corporate bonds	–	56,783	–	56,783
Government sponsored mortgage–backed securities	–	23,914	–	23,914
Equity securities	176,759	–	–	176,759
Other	3,137	–	1,503	4,640
Total assets	$ 204,655	$ 80,697	$ 1,503	$ 286,855

(In Thousands)

10. Fair Value Measurements (continued)

The fair values of securities are determined by third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the securities are classified within Level 2.

Long-term pledges receivable, which are measured at fair value on a non-recurring basis, are discounted to net present value upon receipt using an appropriate risk-free discount rate based on the term of the receivable. Pledges receivable are recorded net of an allowance for uncollectible pledges. The following table provides a reconciliation of the beginning and ending balances of pledges receivable at fair value that used significant unobservable inputs (Level 3):

	Year Ended June 30	
	2015	**2014**
Pledges receivable		
Balance at July 1	**$ 1,503**	$ 2,035
New pledges	**257**	337
Collections on pledges	**(726)**	(623)
Write-off of pledges	**(1)**	(2)
Changes in reserves	**80**	93
Balance at June 30	**$ 1,113**	$ 1,503

11. Pension Plan

The Health System has a cash balance-type defined benefit pension plan covering substantially all of its employees. The Plan benefits are based on years of service and the employees' compensation during the last five years of covered employment. The Health System's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act. 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 Peninsula Regional Medical Center Pension Plus Plan (the Plan) provides annual allocations to a participant's hypothetical account. When a participant retires, the participant has the choice to receive a lump-sum distribution equal to the value of the hypothetical account or to receive an annuity based on the value of the hypothetical account.

(In Thousands)

11. Pension Plan (continued)

Prior to January 1, 2009, the Plan provided three different allocations: (i) a service-related allocation, (ii) an age-related allocation, and (iii) a matching allocation. Both the service-related allocation and the age-related allocation were determined by multiplying a participant's annual compensation by a certain percentage. The matching allocation operated to provide an annual allocation in the Plan based on the participant's contribution to the Health System's 403(b) Plan.

The IRS issued new regulations that were effective as of January 1, 2009. The new regulations prohibited a pension plan from providing a matching allocation based on a participant's contributions to a different plan. The Plan provided a matching allocation based on a participant's contribution to a 403(b) Plan. In order to comply with the new tax law requirements, the Plan was amended effective as of December 31, 2008, to eliminate future matching allocations in the Plan. At the same time, the Health System adopted a 403(b) plan effective as of January 1, 2009, and provided a replacement matching contribution in the 403(b) plan.

The following provides a reconciliation of the changes in fair value of the Plans' assets and projected benefit obligations, and the Plans' funded status:

	2015	**2014**
Accumulated benefit obligation	**$ 108,280**	$ 99,255
Projected benefit obligation, beginning of year	**$ 106,976**	$ 107,740
Service cost	**5,126**	4,941
Interest cost	**3,587**	4,177
Actuarial loss	**6,318**	4,642
Benefits paid	**(4,677)**	(14,524)
Projected benefit obligation, end of year	**117,330**	106,976
Fair value of plan assets, beginning of year	**113,002**	104,754
Actual gain on plan assets	**8,086**	16,772
Employer contributions	**3,000**	6,000
Benefits paid	**(4,677)**	(14,524)
Fair value of plan assets, end of year	**119,411**	113,002
Fair value of plan assets greater than the projected benefit obligation	**$ 2,081**	$ 6,026
Prepaid pension cost recorded in the consolidated balance sheets	**$ 2,081**	$ 6,026

(In Thousands)

11. Pension Plan (continued)

Components of net periodic benefit cost are as follows:

	Year Ended June 30	
	2015	**2014**
Service cost	**$ 5,126**	$ 4,942
Interest cost	**3,587**	4,176
Expected return on plan assets	**(7,088)**	(6,998)
Amortization of prior service credit	**(126)**	(126)
Partial Plan Settlement	**–**	3,853
Recognized net actuarial loss	**2,729**	3,225
Net periodic benefit cost	**$ 4,228**	$ 9,072

During the year ended June 30, 2014, a partial settlement of the Plan's defined benefit obligation was recognized. Since the settlement was more than minor, ASC 715 requires that a pro rata amount of the net loss in accumulated unrestricted net assets is charged to excess of revenues over expenses based on the proportion of the projected benefit obligation settled to the total projected benefit obligation. The settlement has been recognized and measured as of both April 30, 2014 (settlement date) and June 30, 2014. As of June 30, 2014, the Group determined that a settlement had occurred and recognized a loss of $3,853 that was recorded within Employee Benefits expense line item in the consolidated statements of operations and changes in net assets.

Net amount recognized in unrestricted net assets that have not been recognized in net periodic benefit cost are as follows:

	2015	**2014**
Net actuarial loss	**$ 29,420**	$ 26,828
Prior service credit	**(189)**	(315)
Total recognized in unrestricted net assets	**$ 29,231**	$ 26,513

The estimated net actuarial loss and prior service credit for the Plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $2,314 and ($126), respectively.

(In Thousands)

11. Pension Plan (continued)

Weighted average assumptions used to determine projected benefit obligations and net periodic benefit costs at June 30 were as follows:

	2015	2014
Projected benefit obligation		
Discount rate	**3.50%**	3.50%
Rates of increase in compensation levels:		
Age:		
<30	**5.00**	5.00
30<44	**4.00**	4.00
45=<	**3.00**	3.00
Net periodic benefit cost		
Discount rate	**3.50**	3.60
Expected long-term return on plan assets	**7.00**	7.00
Rate of increase in compensation levels:		
Age:		
<30	**5.00**	5.00
30<44	**4.00**	4.00
45=<	**3.00**	3.00

The defined benefit pension plan asset allocation as of the measurement date and the target asset allocation, presented as a percentage of total plan assets, were as follows:

	2015	2014	Target Allocation
Debt securities	**27%**	27%	25%–40%
Equity securities	**70**	71	45%–75%
Cash and cash equivalents	**3**	2	1%–10%
Total	**100%**	100%	

(In Thousands)

11. Pension Plan (continued)

The Health System's defined benefit plan invests in a diversified mix of traditional asset classes. Investments in U.S. equity securities and fixed income securities are made to maximize long-term results while recognizing the need for adequate liquidity to meet ongoing benefit and administrative obligations. Risk tolerance of unexpected investment and actuarial outcomes is continually evaluated by understanding the pension plan's liability characteristics. This is performed through forecasting and assessing ranges of investment outcomes over short-term and long-term horizons, and by assessing the Health System's financial condition and its future potential obligations from both the pension and general operational requirements. Complementary investment styles, such as growth and value equity investing techniques, are utilized by the Health System's investment advisors to further improve portfolio and operational risk characteristics. Equity investments, both active and passively managed, are used primarily to increase overall plan returns. Fixed income investments provide diversification benefits and liability hedging attributes that are desirable, especially in falling interest rate environments.

Asset allocations and investment performance are formally reviewed at regularly scheduled meetings of the Health System's Financial Resources Committee.

The overall rate of expected return on assets assumption was based on historical returns, with adjustments made to reflect expectations of future returns. The extent to which the future expectations were recognized included the target rates of return for the future which have not historically changed.

The fair value of the Health System's pension plan assets as of June 30, 2015 and 2014, by asset category (see Note 10, *Fair Value Measurements* for a description of the asset categories) are as follows:

	June 30, 2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments at fair value:				
Cash and cash equivalents	**$ 4,057**	**$ –**	**$ –**	**$ 4,057**
U.S. Treasuries	**6,746**	**–**	**–**	**6,746**
Government sponsored mortgage-backed securities	**–**	**9,253**	**–**	**9,253**
Corporate debt securities	**–**	**15,523**	**–**	**15,523**
Publically traded equity securities	**83,491**	**–**	**–**	**83,491**
Other	**341**	**–**	**–**	**341**
Total investments	**$ 94,635**	**$ 24,776**	**$ –**	**$ 119,411**

(In Thousands)

11. Pension Plan (continued)

	June 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments at fair value:				
Cash and cash equivalents	$ 2,771	$ –	$ –	$ 2,771
U.S. Treasuries	6,281	–	–	6,281
Government sponsored mortgage-backed securities	–	7,887	–	7,887
Corporate debt securities	–	15,865	–	15,865
Publically traded equity securities	79,848	–	–	79,848
Other	350	–	–	350
Total investments	$ 89,250	$ 23,752	$ –	$ 113,002

The following methods and assumptions were used to estimate fair value of each class of financial instrument:

U.S. Treasuries: the fair value is determined by an active price for an identical security in an observable market.

Corporate debt securities and government sponsored mortgage-backed securities: the fair value is estimated using quoted prices for similar assets in active markets or quoted prices for identical or similar assets in non-active markets (few transactions, limited information, non-current prices, and high variability over time).

Money market funds: the carrying value of these money market funds approximates fair value as the maturities are less than three months.

Publically traded equity securities: the fair value is determined by market quotes for an identical security in an observable market.

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

(In Thousands)

11. Pension Plan (continued)

Cash Flows

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows for the years ending June 30:

2016	$ 5,536
2017	5,955
2018	6,932
2019	7,197
2020	7,616
2021–2025	44,348

The Health System intends to make voluntary contributions to the defined benefit pension plan of $3 million for the year ending June 30, 2016. This funding level exceeds any regulatory requirements for 2016.

12. Commitments and Contingencies

Agreement with the Office of Inspector General

The Health System received several subpoenas from the Office of Inspector General of the U.S. Department of Health and Human Services (OIG), requiring the production of certain documents related to claims for physician health care services provided by a former Medical Staff Member. These subpoenas were issued in connection with a civil investigation being conducted by the U.S. Attorney's Office for the District of Maryland. In January 2011, the Health System reached a tentative "Agreement in Principle", which was ultimately approved by the U.S. Department of Justice, the OIG, the Office of Personnel Management (OPM), and the state of Maryland in August 2011, to resolve all remaining potential civil claims arising out of the Health System's medical services to patients of the physician. The Health System reached this agreement without admitting liability in order to avoid the expense and uncertainty of litigation and to allow the Health System to move forward. In this regard and consistent with the settlement, an amount of $1.8 million was paid in June 2011. The settlement also includes a five year Corporate Integrity Agreement that will require the Health System to establish and/or enhance various compliance processes and also have several independent peer review reports completed on an annual basis.

12. Commitments and Contingencies (continued)

Other

The Health System has been named as a defendant in various lawsuits arising from the performance of its normal activities. In the opinion of the Health System's management, after discussion with legal counsel, the amount, if any, of the Health System's ultimate liability under these lawsuits will not have a material adverse effect on the financial position of the Health System.

A portion of the Health System's revenues is received from health maintenance organizations and other managed care payors. Managed care payors generally use case management activities to control utilization. These payors also have the ability to select providers offering the most cost-effective care. Management does not believe that the organization has undue exposure to any one managed care payor.

The Health System's revenues may be subject to adjustment as a result of examination by government agencies or contractors based upon differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered. Section 302 of the Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare overpayments and underpayments made to providers. We have established protocols to respond to RAC requests and payment denials. Payment recoveries resulting from RAC reviews are appealable through administrative and judicial processes, and we intend to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, we will incur additional costs to respond to requests for records and pursue the reversal of payment denials. As of June 30, 2015 and 2014, the Health System has recorded an estimated reserve regarding the Medicare overpayments. In the opinion of the Health System's management, the ultimate settlement of this matter will not have a material adverse effect on the financial position of the Health System.

As part of a national investigation, the Health System has been working with the Department of Justice (DOJ) regarding the Medicare programs coverage guidelines for the implantation of implantable cardioverter defibrillators (ICD's). On June 15, 2015, the Health System executed a settlement agreement with the DOJ for $2,910. Upon settlement, the Health System accrued the settlement balance as accrued liabilities. Payment was made in July 2015.

(In Thousands)

12. Commitments and Contingencies (continued)

On June 22, 2012, the Health System filed a self-disclosure to CMS, reporting technical violations of the self-referral regulations (referred to as Stark). As of June 30, 2015, the Health System does not believe the settlement of this issue will have a material adverse effect on the entity's financial statements.

Operating Leases

The Company leases certain of its operating facilities and equipment. These leases, which expire through 2028, generally require the Company to pay all maintenance, property tax and insurance costs.

At June 30, 2015, aggregate amounts of future minimum payments under operating leases were as follows:

2016	$ 1,725
2017	1,492
2018	1,480
2019	1,314
2020	981
2021 – Beyond	6,046

Rent expense is recognized on a straight-line basis over the terms of the leases. Rent expense was $2,400 and $2,161 for the years ended June 30, 2015 and 2014, respectively.

13. Maryland Health Services Cost Review Commission

Certain Hospital charges are subject to review and approval by the Maryland Health Services Cost Review Commission (the Commission). Hospital management has filed the required forms with the Commission and believes the Hospital to be in compliance with Commission requirements.

13. Maryland Health Services Cost Review Commission (continued)

The current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted to the State of Maryland under Section 1814(b) of the Social Security Act. As of January 2014, the Centers for Medicare and Medicaid Services approved a modernized waiver that will be in place as long as Maryland hospitals commit to achieving significant quality improvements, limits on all-payer capita hospital growth and limits on annual Medicare per capita hospital cost growth to a rate lower than the national annual per capita growth rate. This model is projected to save Medicare at least $330 million over the next five years.

Beginning in fiscal year 2014, the Hospital entered into an agreement with the HSCRC to participate in the Global Budgeted Revenue program. GBR methodology encourages hospitals to focus on population health strategies by establishing a fixed annual revenue cap for each GBR hospital. The agreement is evergreen in nature and covers both regulated inpatient and outpatient revenues.

Under GBR, hospital revenue is known at the beginning of each fiscal year. Annual revenue is calculated from a base year and is adjusted annually for inflation, infrastructure requirements, population changes, performance in quality-based programs and changes in levels of uncompensated care. Revenue may also be adjusted annually for market levels and shifts of services to unregulated services.

The Commission's rate-setting methodology for hospital service centers that provide both inpatient and outpatient services or only outpatient services consists of establishing an acceptable unit rate for defined inpatient and outpatient service centers within the hospital. The actual average unit charge for each service center is compared to the approved rate monthly and annually. Overcharges and undercharges due to either patient volume or price variances, adjusted for penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis. The Hospital overcharged by $354, as of June 30, 2015, which is within the allowable corridor as specified in the GBR Agreement.

13. Maryland Health Services Cost Review Commission (continued)

The timing of the Commission’s rate adjustments for the Hospital could result in an increase or reduction in rates due to the variances and penalties described above in a year subsequent to the year in which such items occur, and there is at least a possibility that the amounts may be material. The Hospital’s policy is to record revenue based on actual charges for services to patients in the year in which the services are performed. The Hospital recognizes unbilled revenue for in-house patient

14. Subsequent Events

The Health System has evaluated subsequent events through September 18, 2015, the date the financial statements were issued.

Supplementary Information

Peninsula Regional Health System, Inc.

Consolidating Balance Sheet
(In Thousands)

June 30, 2015

	Peninsula Regional Medical Center	Peninsula Regional Medical Center Foundation, Inc.	Peninsula Health Ventures, Inc.	Peninsula Regional Health System, Inc.	Eliminations	Consolidated
Assets						
Current assets:						
Cash and cash equivalents	$ 46,173	$ 1,167	$ 5,621	$ 15	$ –	$ 52,976
Short-term investments	6,477	–	–	–	–	6,477
Intercompany receivables	195	–	–	–	(195)	–
Accounts receivable, less allowance for uncollectible accounts	38,694	–	612	–	–	39,306
Inventories and other	10,189	–	372	–	–	10,561
Prepaids	4,922	–	–	–	–	4,922
Total current assets	106,650	1,167	6,605	15	(195)	114,242
Long-term investments	226,306	–	–	–	–	226,306
Investment in subsidiaries	–	–	–	450,924	(450,924)	–
Board-designated investments	23,963	–	–	–	–	23,963
Assets limited as to use:						
Construction fund	18,863	–	–	–	–	18,863
Donor-restricted fund	31,922	5,840	–	–	(5,840)	31,922
Self-insurance fund	19,293	–	–	–	–	19,293
Total assets limited as to use	70,078	5,840	–	–	(5,840)	70,078
Property and equipment, net	202,333	–	3,838	–	–	206,171
Unamortized financing costs, net of accumulated amortization	1,356	–	46	–	–	1,402
Other assets	10,888	–	8,329	188	–	19,405
Total assets	$ 641,574	$ 7,007	$ 18,818	$ 451,127	$ (456,959)	$ 661,567

Peninsula Regional Health System, Inc.

Consolidating Balance Sheet (continued)

(In Thousands)

	Peninsula Regional Medical Center	Peninsula Regional Medical Center Foundation, Inc.	Peninsula Health Ventures, Inc.	Peninsula Regional Health System, Inc.	Eliminations	Consolidated
Liabilities and net assets						
Current liabilities:						
Current portion of long-term debt	$ 1,930	$ –	$ 75	$ –	$ –	$ 2,005
Current portion of accrued self-insured liabilities	2,495	–	–	–	–	2,495
Intercompany payables	–	–	–	195	(195)	–
Accounts payable	17,578	–	363	–	–	17,941
Accrued liabilities	18,765	–	–	–	–	18,765
Advances from third-party payors	9,846	–	–	–	–	9,846
Total current liabilities	50,614	–	438	195	(195)	51,052
Long-term debt, net	144,721	–	1,773	–	–	146,494
Other liabilities	17,141	–	–	–	–	17,141
Total liabilities	212,476	–	2,211	195	(195)	214,687
Net assets:						
Unrestricted	397,332	1,167	14,820	413,327	(413,319)	413,327
Temporarily restricted	23,520	5,840	–	29,359	(35,199)	23,520
Permanently restricted	8,246	–	–	8,246	(8,246)	8,246
Peninsula Regional Health System, Inc net assets	429,098	7,007	14,820	450,932	(456,764)	445,093
Minority interest	–	–	1,787	–	–	1,787
Total net assets	429,098	7,007	16,607	450,932	(456,764)	446,880
Total liabilities and net assets	$ 641,574	$ 7,007	$ 18,818	$ 451,127	$ (456,959)	$ 661,567

Peninsula Regional Health System, Inc.

Consolidating Statement of Operations

(In Thousands)

Year Ended June 30, 2015

	Peninsula Regional Medical Center	Peninsula Regional Medical Center Foundation, Inc.	Peninsula Health Ventures, Inc.	Peninsula Regional Health System, Inc.	Eliminations	Consolidated
Unrestricted revenue and other support:						
Net patient service revenue	$ 400,804	$ –	$ 4,205	$ –	$ –	$ 405,009
Provision for bad debts	(10,729)	–	(56)	–	–	(10,785)
Net patient service revenue less provision for bad debts	390,075	–	4,149	–	–	394,224
Other operating revenue	3,697	–	14	–	–	3,711
Net assets released from restrictions	–	335	–	–	(335)	–
Total unrestricted revenue and other support	393,772	335	4,163	–	(335)	397,935
Operating expenses:						
Salaries and wages	155,405	–	–	–	–	155,405
Supplies and other expenses	162,316	3	5,330	6	–	167,655
Employee benefits	32,187	–	–	–	–	32,187
Depreciation	22,325	–	246	–	–	22,571
Interest	6,095	–	91	–	–	6,186
Contributions to Hospital	–	335	–	–	(335)	–
Total operating expenses	378,328	338	5,667	6	(335)	384,004
Income (loss) from operations	15,444	(3)	(1,504)	(6)	–	13,931
Nonoperating income (expense):						
Nonoperating income	15,933	1	3,011	–	–	18,945
Nonoperating expense	(7,309)	–	–	–	–	(7,309)
	8,624	1	3,011	–	–	11,636
Excess of unrestricted revenue and other support over expenses	24,068	(2)	1,507	(6)	–	25,567
Minority interest in earnings of controlled subsidiaries	–	–	279	–	–	279
Excess of unrestricted revenue and other support over expenses attributable to PRHS	$ 24,068	$ (2)	$ 1,786	$ (6)	$ –	$ 25,846