CONSOLIDATED FINANCIAL STATEMENTS, SUPPLEMENTARY INFORMATION, AND OMB CIRCULAR A-133 REPORTS AND SCHEDULES

Sacred Heart Health System, Inc. and Subsidiaries –
Member of Ascension Health, a subsidiary of
Ascension Health Alliance
Years Ended June 30, 2013 and 2012
With Reports of Independent Auditors

Ernst & Young LLP

Building a better
working world

Sacred Heart Health System, Inc. and Subsidiaries

Consolidated Financial Statements, Supplementary Information, and
OMB Circular A-133 Reports and Schedules

Years Ended June 30, 2013 and 2012

Contents

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Report of Independent Auditors

The Board of Directors
Sacred Heart Health System, Inc. and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sacred Heart Health System, Inc. and Subsidiaries (Sacred Heart Health System), which comprise the Consolidated Balance Sheets as of June 30, 2013 and 2012, 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 consolidated 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 consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain 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 consolidated financial position of Sacred Heart Health System as of June 30, 2013 and 2012, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

***Adoption of ASU No. 2011-07,* Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowances for Doubtful Accounts for Certain Health Care Entities**

As discussed in Note 2 to the consolidated financial statements, Sacred Heart Health System changed the presentation of the provision for bad debts as a result of adopting the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowances for Doubtful Accounts for Certain Health Care Entities*, effective July 1, 2012. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying Schedule of Net Cost of Providing Care of Persons Living in Poverty and Community Benefit Programs, Schedule of Expenditures of Federal Awards, and Schedule of Expenditures of State Financial Assistance Projects as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and Section 215.97, *Florida Statues*, and Chapter 10.650, *Rules of the Auditor General* are presented for purposes of additional analysis and are 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated September 18, 2013, on our consideration of Sacred Heart Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Sacred Heart Health System's internal control over financial reporting and compliance.

Ernst & Young LLP

September 18, 2013, except for the
Schedule of Expenditures of Federal
Awards and Schedule of State Financial
Assistance Programs for which the
date is March 28, 2014

Sacred Heart Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands)

	June 30, 2013	2012
Assets		
Current assets:		
Cash and cash equivalents	**$ 19,380**	$ 13,275
Interest in investments held by Ascension Health Alliance	**–**	16,165
Accounts receivable, less allowances for doubtful accounts ($88,678 and $71,995 in 2013 and 2012, respectively)	**98,225**	103,179
Current portion of assets limited as to use	**4,302**	2,641
Estimated third-party payor settlements	**17,729**	21,618
Inventories	**17,650**	15,777
Assets held for sale	**2,859**	2,050
Other	**15,509**	12,996
Total current assets	**175,654**	187,701
Assets limited as to use and other long-term investments	**13,697**	10,963
Interest in investments held by Ascension Health Alliance	**186,990**	170,047
Property and equipment, net	**286,878**	284,446
Other assets:		
Land held for expansion	**4,702**	4,702
Investment in unconsolidated entities	**33,546**	38,637
Other	**23,394**	19,524
Total other assets	**61,642**	62,863
Total assets	**$ 724,861**	$ 716,020

	June 30,	
	2013	**2012**
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	**$ 1,807**	$ 1,158
Accounts payable and accrued liabilities	**57,028**	55,019
Estimated third-party payor settlements	**6,619**	7,299
Current portion of self-insurance liabilities	**1,149**	1,003
Intercompany accounts payable	**10,899**	6,502
Total current liabilities	**77,502**	70,981
Noncurrent liabilities:		
Long-term debt	**123,157**	125,734
Self-insurance liabilities	**2,850**	2,686
Pension and other postretirement liabilities	**13,453**	16,704
Other liabilities:		
Deferred compensation	**12,519**	11,106
Other	**27,273**	19,170
Total noncurrent liabilities	**179,252**	175,400
Total liabilities	**256,754**	246,381
Net assets:		
Unrestricted:		
Controlling interest	**457,393**	457,514
Noncontrolling interests	**1,802**	2,033
Unrestricted net assets	**459,195**	459,547
Temporarily restricted – controlling interest	**8,912**	10,092
Total net assets	**468,107**	469,639
Total liabilities and net assets	**$ 724,861**	$ 716,020

See accompanying notes.

Sacred Heart Health System, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

(Dollars in Thousands)

	June 30, 2013	2012
Operating revenue:		
Net patient service revenue	**$ 730,851**	$ 737,983
Less provision for doubtful accounts	**80,351**	84,118
Net patient service revenue, less provision for doubtful accounts	**650,500**	653,865
Other revenue	**22,772**	19,588
Loss from unconsolidated entities	**(3,980)**	(978)
Net assets released from restrictions for operations	**1,921**	697
Gain on sale of assets	**503**	–
Total operating revenue	**671,716**	673,172
Operating expenses:		
Salaries and wages	**272,615**	263,074
Employee benefits	**58,459**	59,521
Purchased services	**53,871**	48,745
Professional fees	**39,736**	33,248
Supplies	**132,546**	130,985
Insurance	**2,619**	3,098
Interest	**5,319**	6,048
Depreciation and amortization	**29,458**	29,096
Other	**74,602**	72,503
Total operating expenses before impairment, restructuring, and nonrecurring gains (losses), net	**669,225**	646,318
Income (loss) from operations before impairment, restructuring, and nonrecurring gains (losses), net	**2,491**	26,854
Impairment, restructuring, and nonrecurring gains (losses), net	**(5,479)**	19,558
(Loss) income from operations	**(2,988)**	46,412
Nonoperating gains (losses):		
Investment return	**14,999**	(2,107)
Other	**(3,967)**	(701)
Total nonoperating gains (losses), net	**11,032**	(2,808)
Excess of revenues and gains over expenses and losses	**8,044**	43,604
Less excess of revenues and gains over expenses and losses attributable to noncontrolling interest	**(2,051)**	(2,834)
Excess of revenues and gains over expenses and losses attributable to controlling interest	**5,993**	40,770

Sacred Heart Health System, Inc. and Subsidiaries

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

(Dollars in Thousands)

	June 30, 2013	June 30, 2012
Unrestricted net assets, controlling interest:		
Excess of revenues and gains over expenses and losses	**$ 5,993**	$ 40,770
Pension and other postretirement liability adjustments	**1,278**	(18,779)
Transfers to sponsor and other affiliates, net	**(10,645)**	(8,378)
Net assets released from restrictions for property acquisitions	**3,215**	1,499
Other	**38**	(90)
(Decrease) increase in unrestricted net assets, controlling interest	**(121)**	15,022
Unrestricted net assets, noncontrolling interests:		
(Deficit) excess of revenues and gains over expenses and losses	**(231)**	24
(Decrease) increase in unrestricted net assets, noncontrolling	**(231)**	24
Temporarily restricted net assets, controlling interest:		
Contributions and grants	**3,985**	3,258
Net change in unrealized gains/losses on investments	**10**	–
Net assets released from restrictions	**(5,137)**	(2,195)
Other	**(38)**	–
(Decrease) increase in temporarily restricted net assets, controlling interest	**(1,180)**	1,063
(Decrease) increase in net assets	**(1,532)**	16,109
Net assets, beginning of year	**469,639**	453,530
Net assets, end of year	**$ 468,107**	$ 469,639

See accompanying notes.

Sacred Heart Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	June 30, 2013	June 30, 2012
Operating activities		
(Decrease) increase in net assets	**$ (1,532)**	$ 16,109
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	**29,458**	29,096
Provision for bad debts	**80,351**	84,457
Loss from unconsolidated entitites	**3,980**	978
Interest, dividends, and net (gains) losses on investments	**(14,999)**	2,107
Loss (gain) on sale of assets, net	**(503)**	–
Impairment and nonrecurring expenses	**5,479**	(19,558)
Transfers to sponsor and other affiliates, net	**10,645**	8,378
Restricted contributions, investment return, and other restricted activity	**(3,215)**	(1,499)
(Increase) decrease in:		
Accounts receivable	**(75,397)**	(98,944)
Estimated third-party payor settlements	**3,209**	(7,632)
Inventories and other current assets	**(3,483)**	(6,772)
Investments classified as trading, including interest in investments held by Ascension Health Alliance	**12,439**	12,753
Other assets	**(3,297)**	4,307
Increase (decrease) in:		
Accounts payable and accrued liabilities	**(3,470)**	(5,543)
Intercompany accounts payable	**4,396**	6,502
Self-insurance liabilities	**310**	(538)
Other noncurrent liabilities	**6,267**	21,283
Net cash provided by operating activities	**50,638**	45,484

Sacred Heart Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)
(Dollars in Thousands)

	June 30, 2013	June 30, 2012
Investing activities		
Property and equipment additions, net	**$ (36,934)**	$ (33,943)
Proceeds from sale of property and equipment	**1,170**	–
Distributions received from unconsolidated entities	**589**	–
Investment in unconsolidated entities	**–**	(32,322)
Net cash used in investing activities	**(35,175)**	(66,265)
Financing activities		
Repayment of long-term debt	**(1,979)**	(1,103)
Transfers to sponsors and other affiliates, net	**(10,594)**	(8,378)
Restricted contributions, investment income, and other	**3,215**	1,499
Net cash used in financing activities	**(9,358)**	(7,982)
Net increase (decrease) in cash and cash equivalents	**6,105**	(28,763)
Cash and cash equivalents at beginning of year	**13,275**	42,038
Cash and cash equivalents at end of year	**$ 19,380**	$ 13,275

See accompanying notes.

1. Organization and Mission

Organizational Structure

Sacred Heart Health System, Inc. and Subsidiaries (the Health Ministry) is a member of Ascension Health. In December 2011, Ascension Health Alliance became the sole corporate member and parent organization of Ascension Health, a Catholic, national health system consisting primarily of nonprofit corporations that own and operate local health care facilities, or Health Ministries, located in 23 of the United States and the District of Columbia. In addition to serving as the sole corporate member of Ascension Health, Ascension Health Alliance serves as the member or shareholder of various other subsidiaries. Ascension Health Alliance, its subsidiaries, and the Health Ministries are referred to collectively from time to time hereafter as the System.

Ascension Health Alliance is sponsored by Ascension Health Ministries, a Public Juridic Person. The Participating Entities of Ascension Health Ministries are the Daughters of Charity of St. Vincent de Paul in the United States, St. Louise Province, the Congregation of St. Joseph, the Congregation of the Sisters of St. Joseph of Carondelet, the Congregation of Alexian Brothers of the Immaculate Conception Province – American Province, and the Sisters of the Sorrowful Mother of the Third Order of St. Francis of Assisi – US/Caribbean Province.

The Health Ministry's principal operations consist of three nonprofit acute care hospitals: Sacred Heart Hospital located in Pensacola, Florida; Sacred Heart Hospital on the Emerald Coast, located in Destin, Florida; and Sacred Heart Hospital on the Gulf, located in Port St. Joe, Florida. The Health Ministry also owns and operates other health care related entities, including a nursing facility and physicians' medical group. The Health Ministry provides inpatient, outpatient, and emergency care services for residents of northwest Florida. Admitting physicians are primarily practitioners in the local area. The Health Ministry is related to Ascension Health's other sponsored organizations through common control. Substantially all expenses of Ascension Health are related to providing health care services.

1. Organization and Mission (continued)

Mission

The System directs its governance and management activities toward strong, vibrant, Catholic Health Ministries united in service and healing and dedicates its resources to spiritually centered care that sustains and improves the health of the individuals and communities it serves. In accordance with the System's mission of service to those persons living in poverty and other vulnerable persons, each Health Ministry accepts patients regardless of their ability to pay. The System uses four categories to identify the resources utilized for the care of persons living in poverty and community benefit programs:

- Traditional charity care includes the cost of services provided to persons who cannot afford health care because of inadequate resources and/or who are uninsured or underinsured.

- Unpaid cost of public programs, excluding Medicare, represents the unpaid cost of services provided to persons covered by public programs for persons living in poverty and other vulnerable persons.

- Cost of other programs for persons living in poverty and other vulnerable persons includes unreimbursed costs of programs intentionally designed to serve the persons living in poverty and other vulnerable persons of the community, including substance abusers, the homeless, victims of child abuse, and persons with acquired immune deficiency syndrome.

- Community benefit consists of the unreimbursed costs of community benefit programs and services for the general community, not solely for the persons living in poverty, including health promotion and education, health clinics and screenings, and medical research.

Discounts are provided to all uninsured patients, including those with the means to pay. Discounts provided to those patients who did not qualify for assistance under charity care guidelines are not included in the cost of providing care of persons living in poverty and community benefit programs. The cost of providing care to persons living in poverty and

(Dollars in Thousands)

1. Organization and Mission (continued)

community benefit programs is estimated by reducing charges foregone by a factor derived from the ratio of each entity's total operating expenses to the entity's billed charges for patient care.

The amount of traditional charity care provided, determined on the basis of cost, was approximately $14,087 and $17,414 for the years ended June 30, 2013 and 2012, respectively. The amount of unpaid cost of public programs, cost of other programs for persons living in poverty and other vulnerable persons, and community benefit cost are reported in the accompanying supplementary information.

2. Significant Accounting Policies

Principles of Consolidation

All corporations and other entities for which operating control is exercised by the Health Ministry or one of its member corporations are consolidated, and all significant inter-entity transactions have been eliminated in consolidation.

Investments in entities where the Health Ministry does not have operating control are recorded under the equity or cost method of accounting. For entities recorded under the equity method of accounting, the following reflects the Health Ministry's interest in unconsolidated entities in the Consolidated Balance Sheets, as well as income or loss for such entities included in the consolidated excess of revenues and gains over expenses and losses in the accompanying Consolidated Statements of Operations and Changes in Net Assets:

	Investment Recorded in Consolidated Balance Sheets as of June 30,		Effect on Consolidated Excess of Revenues and Gains Over Expenses and Losses for the Year Ended June 30,	
	2013	**2012**	**2013**	**2012**
Destin Ambulatory Surgical Center, LLC	**$ 347**	$ 361	**$ 575**	$ 156
Escambia Clinics Holdings, Inc.	**475**	475	**–**	(2)
Gulf Region Radiation Oncology, LLC	**6,339**	6,214	**125**	(401)
Bay County Health System, LLC	**26,385**	31,587	**(4,680)**	(735)
	$ 33,546	$ 38,637	**$ (3,980)**	$ (982)

2. Significant Accounting Policies (continued)

The Health Ministry's equity in the net income (loss) of unconsolidated entities is recorded in other operating revenue if the investment relates to providing health care services. The Health Ministry recorded $3,980 and $980 in other operating loss for the years ended June 30, 2013 and 2012, respectively.

The Health Ministry's equity investment in Gulf Region Radiation Oncology MSO, LLC (GRROC) does not equate to the Health Ministry's 51% ownership of GRROC's equity balance due to a difference in the cost basis and the fair market value of assets contributed. In accordance with Accounting Standards Codification (ASC) Topic 323, *Investments – Equity Method and Joint Ventures*, which codified in Accounting Principles Board (APB) Statement 18, this basis difference is being amortized over the weighted-average life of the assets contributed, net of the Health Ministry's earnings in the investment.

Use of Estimates

Management has made estimates and assumptions that affect the reported amounts of certain assets, liabilities, revenues, and expenses. Actual results could differ from those estimates.

Fair Value of Financial Instruments

Carrying values of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of financial instruments classified as other than current assets and current liabilities are disclosed in the Fair Value Measurements note.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and interest-bearing deposits with maturities of three months or less.

2. Significant Accounting Policies (continued)

Interest in Investments Held by Ascension Health Alliance, Investments, and Investment Return

Prior to April 2012, the Health Ministry held a significant portion of its investments through the Ascension Legacy Portfolio (formerly the Health System Depository, or HSD), an investment pool of funds in which the System and a limited number of nonprofit health care providers participated. The Ascension Legacy Portfolio investments were managed primarily by external investment managers within established investment guidelines. The value of the Health Ministry's investment in the Ascension Legacy Portfolio represented the Health Ministry's pro rata share of the Ascension Legacy Portfolio's funds held for participants.

During the year ended June 30, 2012, the CHIMCO Alpha Fund, LLC (the Alpha Fund) was created to hold primarily all investments previously held through the Ascension Legacy Portfolio. Catholic Healthcare Investment Management Company (CHIMCO), a wholly owned subsidiary of Ascension Health Alliance, acts as manager and serves as the principal investment advisor for the Alpha Fund, overseeing the investment strategies offered to the Alpha Fund's members. In April 2012, a significant portion of the assets in the Ascension Legacy Portfolio was transferred to the Alpha Fund, in which Ascension Health Alliance has an investment interest, as a member of the Alpha Fund. Ascension Health Alliance invests funds in the Alpha Fund on behalf of the Health Ministry. As of June 30, 2013 and 2012, the Health Ministry has an interest in investments held by Ascension Health Alliance, which is reflected in the Consolidated Balance Sheets, and represents the Health Ministry's pro rata share of Ascension Health Alliance's investment interest in the Alpha Fund.

The Health Ministry also invests primarily in equity securities that are locally managed. Primarily all of these funds are held in the Sacred Heart Foundation, where the Health Ministry has significant beneficial interest in foundation assets.

The Health Ministry reports its interest in investments held by Ascension Health Alliance in the accompanying Consolidated Balance Sheets as short or long term, based on liquidity needs, which, prior to June 30, 2013, were directed by the Health Ministry and as of June 30, 2013, are directed by Ascension Health Alliance. The Health Ministry reports its other investments, including foundation investments in the accompanying Consolidated Balance Sheets based upon the long- or short-term nature of the investments and whether such investments are restricted by law or donors or designated for specific purposes by a governing body of the Health Ministry.

2. Significant Accounting Policies (continued)

The Health Ministry's investments, excluding its interest in investments held by Ascension Health Alliance, are measured at fair value and are classified as trading securities. The Alpha Fund's and the Ascension Legacy Portfolio's investments, which are required to be recorded at fair value, are classified as trading securities and include pooled short-term investment funds; U.S. government, state, municipal, and agency obligations; corporate and foreign fixed income securities; asset backed securities; and equity securities. The Alpha Fund's and the Ascension Legacy Portfolio's investments also include alternative investments and other investments, which are valued based on the net asset value of the investments. In addition, the Alpha Fund participates, and the Ascension Legacy Portfolio participated, in securities lending transactions whereby a portion of its investments are loaned to selected established brokerage firms in return for cash and securities from the brokers as collateral for the investments loaned.

Purchases and sales of investments are accounted for on a trade-date basis. Investment returns are comprised of dividends, interest, and gains and losses on the Health Ministry's investments, as well as the Health Ministry's return on its interest in investments held by Ascension Health Alliance, and are reported as nonoperating gains (losses) in the Consolidated Statements of Operations and Changes in Net Assets, unless the return is restricted by donor or law.

Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost or market value utilizing first-in, first-out (FIFO) or a methodology that closely approximates FIFO.

Deferred Compensation

Certain executives of the Health Ministry participate in a deferred compensation plan. Total cost for the plan in 2013 and 2012 was $453 and $1,158, respectively. The plan assets are recorded at fair value with an offsetting noncurrent liability, included in other noncurrent liabilities on the Consolidated Balance Sheets equal to the assets.

(Dollars in Thousands)

2. Significant Accounting Policies (continued)

Intangible Assets

Intangible assets primarily consist of capitalized computer software costs, including software internally developed. Costs incurred in the development and installation of internal use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage. Intangible assets are included in other noncurrent assets on the Consolidated Balance Sheets and are comprised of the following:

	June 30, 2013	June 30, 2012
Capitalized computer software costs	**$ 29,412**	$ 25,855
Less accumulated amortization	**(22,287)**	(20,135)
Total intangible assets, net	**$ 7,125**	$ 5,720

Intangible assets whose lives are definite lives, primarily capitalized computer software costs, are amortized over their expected useful lives.

Property and Equipment

Property and equipment are stated at cost or, if donated, at fair market value at the date of the gift. A summary of property and equipment at June 30, 2013 and 2012 is as follows:

	June 30, 2013	June 30, 2012
Land and improvements	**$ 50,380**	$ 49,815
Buildings and equipment	**561,501**	545,759
	611,881	595,574
Less accumulated depreciation	**(355,261)**	(329,439)
	256,620	266,135
Construction in progress	**30,258**	18,311
Total property and equipment, net	**$ 286,878**	$ 284,446

2. Significant Accounting Policies (continued)

Depreciation is determined on a straight-line basis over the estimated useful lives of the related assets. Depreciation expense in 2013 and 2012 was $27,231 and $27,218, respectively.

Estimated useful lives by asset category are as follows: land improvements – 5 to 15 years; buildings – 5 to 40 years; and equipment – 5 to 15 years.

Several capital projects have remaining construction and related equipment purchase commitments of approximately $34,271 as of June 30, 2013.

Noncontrolling Interest

The consolidated financial statements include all assets, liabilities, revenue, and expenses of less than 100% owned or controlled entities the Health Ministry controls in accordance with applicable accounting guidance. Accordingly, the Health Ministry has reflected a noncontrolling interest for the portion of net assets not owned or controlled by the Health Ministry separately on the Consolidated Balance Sheets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those assets whose use by the Health Ministry has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity, which include endowment funds. Temporarily restricted net assets and earnings on permanently restricted net assets, including earnings on endowment funds, are used in accordance with the donor's wishes, primarily to purchase equipment and to provide charity care and other health and educational services. Contributions with donor-imposed restrictions that are met in the same reporting period are reported as unrestricted.

Performance Indicator

The performance indicator is excess of revenues and gains over expenses and losses. Changes in unrestricted net assets that are excluded from the performance indicator primarily include pension and other postretirement liability adjustments, transfers to or from sponsors and other affiliates, net assets released from restrictions for property acquisitions, and contributions of property and equipment.

(Dollars in Thousands)

2. Significant Accounting Policies (continued)

Operating and Nonoperating Activities

The Health Ministry's primary mission is to meet the health care needs in its market area through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, long-term care, and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to the Health Ministry's primary mission are considered to be nonoperating, consisting primarily of investment income.

Net Patient Service Revenue, Accounts Receivable, and Allowance for Doubtful Accounts

Net patient service revenue is reported at the estimated realizable amounts from patients, third-party payors, and others for services provided and includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Revenue under certain third-party payor agreements is subject to audit, retroactive adjustments, and significant regulatory actions. Provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and as final settlements are determined. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. Adjustments to revenue related to prior periods (decreased) increased net patient service revenue by approximately ($3,514) and $9,036 for the years ended June 30, 2013 and 2012, respectively.

The percentage of net patient service revenue earned by payor for the years ended June 30, 2013 and 2012 is as follows:

	Year Ended June 30,	
	2013	**2012**
Medicare	**35%**	37%
Medicaid	**12**	13
Blue Cross	**27**	24
Third party	**21**	22
Self-pay	**5**	4
	100%	100%

(Dollars in Thousands)

2. Significant Accounting Policies (continued)

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Significant concentrations of accounts receivable, less allowance for doubtful accounts, at June 30, 2013 and 2012 are as follows:

	Year Ended June 30,	
	2013	**2012**
Medicare	**14%**	18%
Medicaid	**15**	19
Blue Cross	**8**	8
Third party	**39**	43
Self-pay	**24**	12
	100%	100%

The provision for doubtful accounts is based upon management's assessment of expected net collections considering economic conditions, historical experience, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience by payor category, including those amounts not covered by insurance. The results of this review are then used to make any modifications to the provision for doubtful accounts to establish an appropriate allowance for doubtful accounts. After satisfaction of amounts due from insurance and reasonable efforts to collect from the patient have been exhausted, the Health Ministry follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by Ascension Health. Accounts receivable are written off after collection efforts have been followed in accordance with the Health Ministry's policies. See the Adoption of New Accounting Standards section for change in accounting presentation of allowance for doubtful accounts in the accompanying Consolidated Statements of Operations and Changes in Net Assets.

The methodology for determining the allowance for doubtful accounts and related write-offs on uninsured patient accounts has remained consistent with the prior year. The Health Ministry has not experienced material changes in write-off trends and has not materially changed its charity care policy since June 30, 2012.

2. Significant Accounting Policies (continued)

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Health Ministry accounts for HITECH incentive payments as a gain contingency. Income from Medicare incentive payments is recognized as revenue after the Health Ministry has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. The Health Ministry deferred revenue from Medicare incentive payments totaling $3,783 for the year ended June 30, 2013, which is included in other noncurrent liabilities in the accompanying Consolidated Balance Sheets. The Health Ministry recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling $3,340 and $3,020 for the years ended June 30, 2013 and 2012, respectively, are included in total operating revenue in the accompanying Consolidated Statements of Operations and Changes in Net Assets. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost report data that is subject to audit. Additionally, the Health Ministry's compliance with the meaningful use criteria is subject to audit by the federal government.

Impairment, Restructuring, and Nonrecurring Expenses

Long-lived assets are reviewed for impairment whenever events or business conditions indicate the carrying amount of such assets may not be fully recoverable. Initial assessments of recoverability are based on estimates of undiscounted future net cash flows associated with an asset or group of assets. Where impairment is indicated, the carrying amount of these long-lived assets is reduced to fair value based on discounted net cash flows or other estimates of fair value.

2. Significant Accounting Policies (continued)

During the years ended June 30, 2013 and 2012, the Health Ministry recorded total impairment, restructuring, and nonrecurring expenses of $5,479 and income of $19,558, respectively. For the year ended June 30, 2013, this amount was related to changes in business operations, including reorganization and severance charges. For the year ended June 30, 2012, the impairment, restructuring, and nonrecurring gain of $20,098 was related to a pension curtailment discussed further in Note 6. The restructuring and nonrecurring expenses of $540 related to the termination of an information technology service contract.

Hospital or Health Ministry Income Taxes

The member health care entities of the Health Ministry are primarily tax-exempt organizations under Internal Revenue Code Section 501(c)(3) or 501(c)(2), and their related income is exempt from federal income tax under Section 501(a).

Reclassifications

Certain reclassifications were made to the 2012 consolidated financial statements to conform to the 2013 presentation.

Subsequent Events

The Health Ministry evaluates the impact of subsequent events, which are events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date. For the year ended June 30, 2013, the Health Ministry evaluated subsequent events through September 18, 2013, representing the date on which the consolidated financial statements were available to be issued. During this period, there were no subsequent events that required recognition or disclosure in the consolidated financial statements. Additionally, there were no non-recognized subsequent events that required disclosure.

2. Significant Accounting Policies (continued)

Adoption of New Accounting Standards

In July 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowances for Doubtful Accounts for Certain Health Care Entities*. This ASU requires health care entities that recognize significant amounts of patient service revenue at the time services are rendered to present the provision for doubtful accounts related to patient service revenue adjacent to patient service revenue in the Statement of Operations and Changes in Net Assets rather than as an operating expense. Additional disclosures relating to sources of patient service revenue and the allowance for doubtful accounts are also required. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011.

The Health Ministry recognizes a significant amount of patient service revenue at the time services are rendered in certain settings, such as the emergency room, even though the patient's ability to pay is not initially assessed. The Health Ministry assessed the significance of adopting this ASU at the consolidated level. The Health Ministry adopted this guidance as of July 1, 2012 and retrospectively applied the presentation requirements to all periods presented. The adoption of this guidance resulted in the reclassification of the Health Ministry's provision for doubtful accounts for the year ended June 30, 2012, decreasing total operating revenue and total operating expenses before impairment, restructuring, and nonrecurring losses, net, by $84,118.

(Dollars in Thousands)

3. Cash and Cash Equivalents, Interest in Investments Held by Ascension Health Alliance, and Assets Limited as to Use and Other Long-Term Investments

At June 30, 2013 and 2012, the Health Ministry's investments are comprised of its interest in investments held by Ascension Health Alliance and certain other investments, including investments held and managed by the Sacred Heart Foundation. Board-designated investments represent investments designated by resolution of the Sacred Heart Foundation to put amounts aside primarily for future capital expansion and improvements. Assets limited as to use primarily include investments restricted by donors. The Health Ministry's cash, cash equivalents, interest in investments held by Ascension Health Alliance, and assets limited as to use and other long-term investments are reported in the accompanying Consolidated Balance Sheets as presented in the following table:

	June 30, 2013	June 30, 2012
Cash and cash equivalents	**$ 19,380**	$ 13,275
Current portion of assets limited as to use	**4,302**	2,641
Assets limited as to use and other long-term investments:		
Assets limited as to use	**6,003**	3,514
Other long-term investments	**7,694**	7,449
Total assets limited as to use and other long-term investments	**13,697**	10,963
Other noncurrent assets	**12,519**	11,106
Interest in investments held by Ascension Health Alliance	**186,990**	186,212
Total	**$ 236,888**	$ 224,197

(Dollars in Thousands)

3. Cash and Cash Equivalents, Interest in Investments Held by Ascension Health Alliance, and Assets Limited as to Use and Other Long-Term Investments (continued)

The composition of cash and investments classified as cash and cash equivalents, short-term investments, board-designated investments, assets limited as to use, and other investments is summarized as follows:

	June 30, 2013	June 30, 2012
Cash and cash equivalents	**$ 19,380**	$ 13,275
Assets limited as to use:		
Cash and current portion of pledges receivable	**4,302**	2,641
Noncurrent portion of pledges receivable, net	**258**	2,088
Long-term investments at fair value	**10,392**	8,875
Real property	**3,047**	–
Current portion of assets limited as to use, noncurrent portion of assets limited as to use, and other long-term investments	**17,999**	13,604
Interest in investments held by Ascension Health Alliance	**186,990**	186,212
Other noncurrent assets (deferred compensation assets)	**12,519**	11,106
Cash and cash equivalents, short-term investments, interest in investments held by Ascension Health Alliance, assets limited as to use, and other long-term investments	**$ 236,888**	$ 224,197

(Dollars in Thousands)

3. Cash and Cash Equivalents, Interest in Investments Held by Ascension Health Alliance, and Assets Limited as to Use and Other Long-Term Investments (continued)

As of June 30, 2013 and 2012, the composition of total Alpha Fund investments is as follows:

	June 30, 2013	June 30, 2012
Cash, cash equivalents, and short-term investments	**3.3%**	4.7 %
U.S. government	**24.7**	32.1
Asset-backed securities	**8.6**	10.3
Corporate and foreign fixed income	**12.0**	9.0
Equity securities	**17.4**	13.1
Alternative investments and other investments:		
Private equity and real estate funds	**5.8**	5.7
Hedge funds	**21.9**	18.7
Commodities funds and other investments	**6.3**	6.4
	100.0%	100.0%

Investment return recognized by the Health Ministry is summarized as follows:

	Year Ended June 30, 2013	Year Ended June 30, 2012
Return on interest in investments held by Ascension Health Alliance and investment return in HSD	**$ 8,474**	$ 9,839
Net gains (losses) on investments reported at fair value	**6,525**	(11,946)
Total investment return included in nonoperating gains (losses)	**$ 14,999**	$ (2,107)

4. Fair Value Measurements

The Health Ministry categorizes, for disclosure purposes, assets and liabilities measured at fair value in the consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs that are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available in the circumstances.

4. Fair Value Measurements (continued)

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement of the asset or liability. The Health Ministry's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The Health Ministry follows the three-level fair value hierarchy to categorize these assets and liabilities recognized at fair value at each reporting period, which prioritizes the inputs used to measure such fair values. Level inputs are defined as follows:

> Level 1 **–** Quoted prices (unadjusted) that are readily available in active markets or exchanges for identical assets or liabilities on the reporting date.
>
> Level 2 **–** Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 pricing inputs include prices quoted for similar investments in active markets or exchanges or prices quoted for identical or similar investments in markets that are not active. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.
>
> Level 3 **–** Significant pricing inputs that are unobservable for the asset or liability, including assets or liabilities for which there is little, if any, market activity for such asset or liability. Inputs to the determination of fair value for Level 3 assets and liabilities require management judgment and estimation.

There were no significant transfers between Levels 1 and 2 during the years ended June 30, 2013 and 2012, respectively.

4. Fair Value Measurements (continued)

As of June 30, 2013 and 2012, assets and liabilities listed in the fair value hierarchy tables below utilize the following valuation techniques and inputs:

Corporate and Foreign Fixed Income Maturities

The fair value of investments in U.S. and international corporate bonds, including commingled funds that invest primarily in such bonds, and foreign government bonds is primarily determined using techniques that are consistent with the market approach. Significant observable inputs include benchmark yields, reported trades, observable broker/dealer quotes, issuer spreads, and security specific characteristics, such as early redemption options.

Equity Securities

The fair value of investments in U.S. and international equity securities is primarily determined using the calculated net asset value. The values for underlying investments are fair value estimates determined by external fund managers based on operating results, balance sheet stability, growth, and other business and market sector fundamentals.

Guaranteed Pooled Fund

The fair value of guaranteed pooled fund investments is based on cost plus guaranteed, annuity, contract-based interest rates. Significant unobservable inputs to the guaranteed rate include the fair value and average duration of the portfolio of investments underlying the annuity contract, the contract value, and the annualized weighted-average yield to maturity of the underlying investment portfolio.

As discussed in Notes 2 and 3, the Health Ministry has an interest in investments held by Ascension Health Alliance. As of June 30, 2013, 20%, 42%, and 37% of total Alpha Fund assets that are measured at fair value on a recurring basis were measured based on Level 1, Level 2, and Level 3 inputs, respectively, while 0%, 100%, and 0% of total Alpha Fund liabilities that are measured at fair value on a recurring basis were measured at such fair values based on Level 1, Level 2, and Level 3 inputs, respectively. As of June 30, 2012, 17%, 52%, and 31% of total Alpha Fund assets that were measured at fair value on a recurring basis were measured based on Level 1, Level 2, and Level 3 inputs, respectively, while 0%, 100%, and 0% of total Alpha Fund liabilities that were measured at fair value on a recurring basis were measured based on Level 1, Level 2, and Level 3 inputs, respectively.

(Dollars in Thousands)

4. Fair Value Measurements (continued)

The following table summarizes fair value measurements, by level, at June 30, 2013, for all other financial assets and liabilities that are measured at fair value on a recurring basis in the consolidated financial statements:

	Level 1	Level 2	Level 3	Total
June 30, 2013				
Assets limited as to use and other long-term investments:				
Equity securities	**$ 9,334**	**$ –**	**$ –**	**$ 9,334**
Corporate bonds	**–**	**1,058**	**–**	**1,058**
Deferred compensation assets, included in other noncurrent assets:				
Equity securities	**8,325**	**–**	**–**	**8,325**
Guaranteed pooled fund	**–**	**–**	**4,194**	**4,194**
Total	**$ 17,659**	**$ 1,058**	**$ 4,194**	**$ 22,911**

The following table summarizes fair value measurements, by level, at June 30, 2012, for all other financial assets and liabilities that are measured at fair value on a recurring basis in the consolidated financial statements:

	Level 1	Level 2	Level 3	Total
June 30, 2012				
Assets limited as to use and other long-term investments:				
Equity securities	$ 7,461	$ –	$ –	$ 7,461
Corporate bonds	–	1,413	–	1,413
Deferred compensation assets, included in other noncurrent assets:				
Equity securities	7,046	–	–	7,046
Guaranteed pooled fund	–	–	4,060	4,060
Total	$ 14,507	$ 1,413	$ 4,060	$ 19,980

(Dollars in Thousands)

4. Fair Value Measurements (continued)

During the years ended June 30, 2013 and 2012, the changes in the fair value of the foregoing assets measured using significant unobservable inputs (Level 3) were comprised of the following:

	Deferred Compensation Assets
July 1, 2011	$ 4,445
Purchases	360
Sales	(601)
Transfers into Level 3	37
Transfers out of Level 3	(181)
June 30, 2012	4,060
July 1, 2012	**4,060**
Purchases	**1,640**
Sales	**(1,402)**
Transfers into Level 3	**419**
Transfers out of Level 3	**(523)**
June 30, 2013	**$ 4,194**

(Dollars in Thousands)

5. Long-Term Debt

Long-term debt consists of the following:

	June 30, 2013	June 30, 2012
Intercompany debt with Ascension Health Alliance, payable in installments through 2054; interest (3.5% and 3.8% at June 30, 2013 and 2012, respectively) adjusted based on prevailing blended market interest rate of underlying debt obligations	**$ 124,946**	$ 125,879
Other	**18**	1,013
	124,964	126,892
Less current portion	**(1,807)**	(1,158)
Long-term debt, less current portion	**$ 123,157**	$ 125,734

Scheduled principal repayments of long-term debt are as follows:

Year ending June 30:	
2014	$ 1,807
2015	1,764
2016	1,486
2017	1,802
2018	1,820
Thereafter	116,285
Total	$ 124,964

Certain members of Ascension Health Alliance formed the Ascension Health Credit Group (Senior Credit Group). Each Senior Credit Group member is identified as either a senior obligated group member, senior designated affiliate, or senior limited designated affiliate. Senior obligated group members are jointly and severally liable under a Senior Master Trust Indenture (Senior MTI) to make all payments required with respect to obligations under the Senior MTI and may be entities not controlled directly or indirectly by Ascension Health Alliance. Though

5. Long-Term Debt (continued)

senior designated affiliates and senior limited designated affiliates are not obligated to make debt service payments on the obligations under the Senior MTI, Ascension Health Alliance may cause each senior designated affiliate to transfer such amounts as are necessary to enable the obligated group to comply with the terms of the Senior MTI, including repayment of the outstanding obligations. Additionally, each senior limited designated affiliate has an independent limited designated affiliate agreement and promissory note with Ascension Health Alliance with stipulated repayment terms and conditions, each subject to the governing law of the senior limited designated affiliate's state of incorporation. The Health Ministry is a senior obligated group member under the terms of the Senior MTI.

Pursuant to a Supplemental Master Indenture dated February 1, 2005, senior obligated group members, which are operating entities, have pledged and assigned to the Master Trustee a security interest in all of their rights, titles, and interest in their pledged revenues and proceeds thereof.

A Subordinate Credit Group, which is comprised of subordinate obligated group members, subordinate designated affiliates, and subordinate limited designated affiliates, was created under the Subordinate Master Trust Indenture (Subordinate MTI). The subordinate obligated group members are jointly and severally liable under the Subordinate MTI to make all payments required with respect to obligations under the Subordinate MTI and may be entities not controlled directly or indirectly by Ascension Health Alliance. Though subordinate designated affiliates and subordinate limited designated affiliates are not obligated to make debt service payments on the obligations under the Subordinate MTI, Ascension Health Alliance may cause each subordinate designated affiliate to transfer such amounts as are necessary to enable the obligated group members to comply with the terms of the Subordinate MTI, including payment of the outstanding obligations. Additionally, each subordinate limited designated affiliate has an independent subordinate limited designated affiliate agreement and promissory note with Ascension Health Alliance, with stipulated repayment terms and conditions, each subject to the governing law of the subordinate limited designated affiliate's state of incorporation. The Health Ministry is a subordinate obligated group member under the terms of the Subordinate MTI.

The borrowing portfolio of the Senior and Subordinate Credit Group includes a combination of fixed and variable rate hospital revenue bonds, commercial paper, and other obligations, the proceeds of which are in turn loaned to the Senior and Subordinate Credit Group members subject to a long-term amortization schedule of 1 to 39 years.

5. Long-Term Debt (continued)

Certain portions of Senior and Subordinate Credit Group borrowings may be periodically subject to interest rate swap arrangements to effectively convert borrowing rates on such obligations from a floating to a fixed interest rate or vice versa based on market conditions. Additionally, Senior and Subordinate Credit Group borrowings may, from time to time, be refinanced or restructured in order to take advantage of favorable market interest rates or other financial opportunities. Any gain or loss on refinancing, as well as any bond premiums or discounts, is allocated to the Senior and Subordinate Credit Group members based on their pro rata share of the Senior and Subordinate Credit Group's obligations. Senior and Subordinate Credit Group refinancing transactions rarely have a significant impact on the outstanding borrowings or intercompany debt amortization schedule of any individual Senior and Subordinate Credit Group member.

The carrying amounts of intercompany debt with Ascension Health Alliance and other debt approximate fair value based on a portfolio market valuation provided by a third party.

The Senior and Subordinate Credit Group financing documents contain certain restrictive covenants, including a debt service coverage ratio.

As of June 30, 2013, the Senior Credit Group has a line of credit of $1,000,000, which may be used as a source of funding for unremarketed variable rate debt (including commercial paper) or for general corporate purposes, toward which bank commitments totaling $1,000,000 extend to November 9, 2014. As of June 30, 2013 and 2012, there were no borrowings under the line of credit.

As of June 30, 2013, the Subordinate Credit Group has a $75,000 revolving line of credit related to its letters-of-credit program toward which a bank commitment of $75,000 extends to November 27, 2013. As of June 30, 2013, $49,990 of letters of credit had been extended under the revolving line of credit, although there were no borrowings under any of the letters of credit.

The outstanding principal amount of all hospital revenue bonds is $5,196,235, which represents 40% of the combined unrestricted net assets of the Senior and Subordinate Credit Group members at June 30, 2013.

5. Long-Term Debt (continued)

Guarantees are contingent commitments issued by the Senior and Subordinate Credit Groups, generally to guarantee the performance of a sponsored organization or an affiliate to a third party in borrowing arrangements, such as commercial paper issuances, bond financing, and similar transactions. The term of the guarantee is equal to the term of the related debt, which can be as short as 30 days or as long as 27 years. The maximum potential amount of future payments the Senior and Subordinate Credit Groups could be required to make under their guarantees and other commitments at June 30, 2013 is approximately $377,000.

During the years ended June 30, 2013 and 2012, interest paid was approximately $5,648 and $6,048, respectively. Capitalized interest was approximately $329 and $0 for the years ended June 30, 2013 and 2012, respectively.

6. Pension Plans

The Health Ministry participates in the Ascension Health Pension Plan and the Ascension Health Defined Contribution Plan. Details of these plans follow.

Ascension Health Pension Plan

The Health Ministry participates in the Ascension Health Pension Plan (the Ascension Plan), a noncontributory, defined benefit pension plan that covers substantially all eligible employees of certain System entities. Benefits are based on each participant's years of service and compensation. The Ascension Plan's assets are invested in the Ascension Health Master Pension Trust (the Trust), a master trust consisting of cash and cash equivalents, equity, fixed income funds, and alternative investments. The Trust also invests in derivative instruments, the purpose of which is to economically hedge the change in the net funded status of the Ascension Plan for a significant portion of the total pension liability that can occur due to changes in interest rates. Contributions to the Ascension Plan are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants. Net periodic pension income of $1,973 in 2013 was recognized by the Health Ministry. Net periodic pension cost of $1,437 in 2012 was charged to the Health Ministry. The service cost component of net periodic pension cost charged to the Health Ministry is actuarially determined while all other components are allocated based on the Health Ministry's pro rata share of Ascension Health's overall projected benefit obligation.

6. Pension Plans (continued)

During the year ended June 30, 2012, the System approved and communicated to employees a redesign of associate retirement benefits, which affects the Ascension Plan, as well as provides an enhanced comprehensive defined contribution plan. These changes became effective January 1, 2013. These changes resulted in the Health Ministry's recognition of a nonrecurring curtailment gain of $20,098 during the year ended June 30, 2012. These changes also resulted in one-time decreases to the projected benefit obligation of $19,395. The projected benefit obligation is included in pension and other postretirement liabilities in the accompanying Consolidated Balance Sheets.

The assets of the Ascension Plan are available to pay the benefits of eligible employees of all participating entities. In the event participating entities are unable to fulfill their financial obligations under the Ascension Plan, the other participating entities are obligated to do so. As of June 30, 2013, the Ascension Plan had a net unfunded liability of $187,362. The Health Ministry's allocated share of the Ascension Plan's net unfunded liability reflected in the accompanying Consolidated Balance Sheets at June 30, 2013 and 2012 was $13,453 and $16,704, respectively. As a result of updating the funded status of the Ascension Plan, Ascension Health transferred an additional pension liability of $235 and reduction of pension liability of $1,319 to the Health Ministry during 2013 and 2012, respectively. These transfers are included in pension and other postretirement liability adjustments in the accompanying Consolidated Statements of Operations and Changes in Net Assets.

As of June 30, 2013 and 2012, the fair value of the Ascension Plan's assets available for benefits was $3,849,706 and $3,948,293, respectively. As discussed in Note 4, the Health Ministry, as well as the System, follows a three-level hierarchy to categorize assets and liabilities measured at fair value. In accordance with this hierarchy, as of June 30, 2013, 21%, 39%, and 40% of the Ascension Plan's assets that are measured at fair value on a recurring basis were categorized as Level 1, Level 2, and Level 3, respectively. With respect to the Ascension Plan's liabilities measured at fair value on a recurring basis, 0%, 0%, and 100% were categorized as Level 1, Level 2, and Level 3, respectively, as of June 30, 2013. Additionally, as of June 30, 2012, 16%, 51%, and 33% of the Ascension Plan's assets that are measured at fair value on a recurring basis were categorized as Level 1, Level 2, and Level 3, respectively. With respect to the Ascension Plan's liabilities measured at fair value on a recurring basis, 6%, 87%, and 7% were categorized as Level 1, Level 2, and Level 3, respectively, as of June 30, 2012.

6. Pension Plans (continued)

Ascension Health Defined Contribution Plan

The Health Ministry participates in the Ascension Health Defined Contribution Plan (the Defined Contribution Plan), a contributory and noncontributory, defined contribution plan sponsored by Ascension Health that covers all eligible associates. There are three primary types of contributions to the Defined Contribution Plan: employer automatic contributions, employee contributions, and employer matching contributions. Benefits for employer automatic contributions are determined as a percentage of a participant's salary and increase over specified periods of employee service. These benefits are funded annually, and participants become fully vested over a period of time. Benefits for employer matching contributions are determined as a percentage of an eligible participant's contributions each payroll period. These benefits are funded each payroll period, and participants become fully vested in all employer contributions immediately. Defined contribution expense, representing both employer automatic contributions and employer matching contributions, was $7,104 and $5,025 for the years ended June 30, 2013 and 2012, respectively.

7. Self-Insurance Programs

The Health Ministry participates in pooled risk programs to insure professional and general liability risks and workers' compensation risks to the extent of certain self-insured limits. In addition, various umbrella insurance policies have been purchased to provide coverage in excess of the self-insured limits. Actuarially determined amounts, discounted at 6%, are contributed to the trusts and the captive insurance company to provide for the estimated cost of claims. The loss reserves recorded for estimated self-insured professional, general liability, and workers' compensation claims include estimates of the ultimate costs for both reported claims and claims incurred but not reported and are discounted at 6% in 2013 and 2012. In the event that sufficient funds are not available from the self-insurance programs, each participating entity may be assessed its pro rata share of the deficiency. If contributions exceed the losses paid, the excess may be returned to participating entities.

7. Self-Insurance Programs (continued)

Professional and General Liability Programs

The Health Ministry participates in Ascension Health's professional and general liability self-insured program, which provides claims-made coverage through a wholly owned onshore trust and offshore captive insurance company, Ascension Health Insurance, Ltd. (AHIL), with a self-insured retention of $10,000 per occurrence with no aggregate. The Health Ministry has a deductible of $100 per claim. Excess coverage is provided through AHIL with limits up to $185,000. AHIL retains $5,000 per occurrence and $5,000 annual aggregate for professional liability. AHIL also retains a 20% quota share of the first $25,000 of umbrella excess. The remaining excess coverage is reinsured by commercial carriers.

Included in operating expenses in the accompanying Consolidated Statements of Operations and Changes in Net Assets is professional and general liability expense of $1,333 and $2,137 for the years ended June 30, 2013 and 2012, respectively. For the year ended June 30, 2013, the expense has been reduced by $5,659 of excess premiums previously retained by Ascension Health's professional and general liability self-insured program, which has been returned to the Health Ministry. Included in current and long-term self-insurance liabilities on the accompanying Consolidated Balance Sheets are liabilities for deductibles and reserves for claims incurred but not yet reported of approximately $3,999 and $3,689 at June 30, 2013 and 2012, respectively.

Workers' Compensation

The Health Ministry participates in Ascension Health's workers' compensation program, which provides occurrence coverage through a grantor trust. The trust provides coverage up to $1,000 per occurrence with no aggregate. The trust provides a mechanism for funding the workers' compensation obligations of its members. Excess insurance against catastrophic loss is obtained through commercial insurers. Premium payments made to the trust are expensed and reflect both claims reported and claims incurred but not reported.

Included in operating expenses in the accompanying Consolidated Statements of Operations and Changes in Net Assets is workers' compensation expense of $1,369 and $1,428 for the years ended June 30, 2013 and 2012, respectively.

(Dollars in Thousands)

8. Lease Commitments

Future minimum payments under noncancelable operating leases with terms of one year or more are as follows:

Year ending June 30:		
2014	$	9,871
2015		9,203
2016		7,194
2017		6,250
2018		5,415
Thereafter		22,700
Total	$	60,633

The Health Ministry has subleased certain of its space under the operating leases reported above. Total future minimum rents to be received under noncancellable subleases with terms of one year or more are $1,456.

In prior years, the Health Ministry entered into agreements to lease four parcels of land to an unrelated third party to construct and operate medical office buildings on the premises. Under the first lease, annual payments of $51 are due from the lessee, beginning on February 1, 1999, and continuing for a 51½-year period. Beginning with the second lease year through the term of the lease, rental payments increase by an amount equal to 2.00% of the rent of the previous year. The lessee has the option to extend the term of the lease for an additional ten-year period. Under the second lease, quarterly payments of $14 are due from the lessee, beginning on July 26, 2004, and continuing for a 76½-year period. Beginning with the 2007 lease year through and including the 2016 lease year, rental payments increase by an amount equal to 2.75% of the rent of the previous year. After the 2016 lease year, rent will increase by the lesser of 2.75% of the immediately preceding lease year or the Consumer Price Index, as defined by the lease agreement. The lessee has the option to extend the term of the lease for an additional ten-year period. Under the third lease, quarterly payments of $15 are due from the lessee, beginning on May 1, 2002, and continuing for a 76½-year period. Beginning with the 2005 lease year through and including the 2014 lease year, rental payments increase by an amount equal to 2.75% of the

(Dollars in Thousands)

8. Lease Commitments (continued)

rent of the previous year. After the 2015 lease year, rent will increase by the lesser of 2.75% of the immediately preceding lease year or the Consumer Price Index, as defined by the lease agreement. The lessee has the option to extend the term of the lease for an additional ten-year period. Under the fourth lease, quarterly payments of $46 are due from the lessee, beginning on October 1, 2003, and continuing for a 76½-year period. Beginning with the 2005 lease year through and including the 2014 lease year, rental payments increase by an amount equal to 2.75% of the rent of the previous year. After the 2015 lease year, rent will increase by the lesser of 2.75% of the immediately preceding lease year or the Consumer Price Index, as defined by the lease agreement. The lessee has the option to extend the term of the lease for an additional ten-year period.

In addition, the Health Ministry is a lessor under certain operating lease agreements, primarily ground leases related to third-party owned medical office buildings on land owned by the Health Ministry. Future minimum rental receipts under all noncancellable operating leases with terms of one year or more are as follows:

Year ending June 30:	
2014	$ 1,997
2015	1,565
2016	1,493
2017	1,290
2018	1,299
Thereafter	50,408
Total	$ 58,052

Rental expense under operating leases amounted to $13,591 and $13,421 in 2013 and 2012, respectively.

8. Lease Commitments (continued)

The Health Ministry entered into agreements to lease space in medical office buildings (MOBs) under construction by external development companies. The Health Ministry was considered the owner of the MOBs during construction. In addition, because these transactions (and the sales of other existing MOBs) did not qualify for sale-leaseback accounting, they were treated as financing transactions. Accordingly, the associated financing obligations of $11,911 and $12,040 at June 30, 2013 and 2012, respectively, are included in other noncurrent liabilities in the accompanying Consolidated Balance Sheets. These financing obligations will not result in cash payments. All future cash obligations related to leased space within these MOBs are included as future minimum lease payments in the amounts reported above.

9. Related-Party Transactions

The Health Ministry utilized various centralized programs and overhead services of the System or its other sponsored organizations, including risk management, retirement services, treasury, debt management, executive management support, administrative services, and information technology services. The charges allocated to the Health Ministry for these services represent both allocations of common costs and specifically identified expenses that are incurred by the System on behalf of the Health Ministry. Allocations are based on relevant metrics, such as the Health Ministry's pro rata share of revenues, certain costs, debt, or investments, to the consolidated totals of the System. The amounts charged to the Health Ministry for these services may not necessarily result in the net costs that would be incurred by the Health Ministry on a stand-alone basis. The charges allocated to the Health Ministry were approximately $35,186 and $34,260 for the years ended June 30, 2013 and 2012, respectively.

In addition to the charges discussed above, the Health Ministry made payments to the System of $7,039 and $7,196 for the years ended June 30, 2013 and 2012, respectively, representing the Health Ministry's share of costs to fund a System-wide information technology and process standardization project that is expected to continue through December 2015. These payments are included in transfers to sponsor and other affiliates, net, in the accompanying Consolidated Statements of Operations and Changes in Net Assets.

During the year ended June 30, 2013, the Health Ministry transferred cash and investments of $2,119 in support of the System's strategic initiatives.

9. Related-Party Transactions (continued)

Included on the accompanying Consolidated Balance Sheet in other current assets at June 30, 2013 is $875 due from Bay County Health System, LLC related to contracted managed care services that the Health Ministry provides to Bay County. Included in other noncurrent assets is $522 due from Bay County Health System, LLC related to the acquisition paid by the Health Ministry.

10. Contingencies and Commitments

In March 2013, Ascension Health Alliance and some of its subsidiaries were named as defendants to litigation surrounding the Church Plan status of the Ascension Plan. The Health Ministry does not believe that this matter would have a material adverse effect on the Health Ministry's consolidated financial position or results of operations.

In September 2010, Ascension Health received a letter from the U.S. Department of Justice (the DOJ) in connection with its nationwide review to determine whether, in certain cases, implantable cardioverter defibrillators (ICDs) were provided to certain Medicare beneficiaries in accordance with national coverage criteria. In connection with this nationwide review, the Health Ministry will be reviewing applicable medical records for response to the DOJ. The DOJ's investigation spans a time frame beginning in 2004 and extending through the present time. Through September 18, 2013, the DOJ has not asserted any claims against the Health Ministry. Ascension Health and the Health Ministry continue to fully cooperate with the DOJ in its investigation.

Sacred Heart Health System, Inc., Emerald Coast Radiation Oncology Center, a wholly owned subsidiary, and Gulf Region Radiation Oncology Centers, a partially owned subsidiary, are defendants in a civil lawsuit brought by the Florida Attorney General (Medicaid Fraud Control Unit), DOJ, OIG, and DOD in connection with alleged improper payments for radiation therapy services provided at Gulf Region Radiation Oncology Centers from December 2007 to present. The claim alleges violation of the False Claims Act. Tentative settlement has been reached on all claims with the exception of a whistle-blower's wrongful termination/retaliation claim. The parties are now negotiating a settlement agreement with the DOJ and the Corporate Integrity Agreement (Gulf Region Radiation Oncology Centers only) with OIG. Settlement will require the Health Ministry to pay $2,300, $300 of which will be structured as a loan from the Health Ministry to GRROC.

Supplementary Information

Sacred Heart Health System, Inc. and Subsidiaries

Schedule of Net Cost of Providing Care of Persons
Living in Poverty and Community Benefit Programs
(Dollars in Thousands)

The net cost excluding the provision for bad debt expense of providing care of persons living in poverty and community benefit programs is as follows:

	Year Ended June 30, 2013	2012
Traditional charity care provided	**$ 14,087**	$ 17,414
Unpaid cost of public programs for persons living in poverty	**39,540**	19,199
Other programs for persons living in poverty and other vulnerable persons	**806**	772
Community benefit programs	**4,422**	4,470
Care of persons living in poverty and community benefit programs	**$ 58,855**	$ 41,855

OMB Circular A-133 Reports and Schedules

Sacred Heart Health Systems, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Agency or Pass-Through Contract Number	Expenditures
U.S. Department of Education passed through the Florida Department of Health			
Special Education - Grants for Infants and Families	84.181	COQ-UC	$ 739,941
U.S. Department of Health and Human Services passed through the Florida Department of Health			
Temporary Assistance for Needy Families	93.558	COQ-UC	247,943
National Bioterrorism Hospital Preparedness Program	93.889	COP 1F	30,000
National Bioterrorism Hospital Preparedness Program	93.889	COP S1	8,133
National Bioterrorism Hospital Preparedness Program	93.889	COP 1E	108,892
Total Program 93.889			147,025
U.S. Department of Health and Human Services			
Children's Health Insurance Program	93.767	1Z0330873A	358,760
U.S. Department of Health and Human Services passed through Lutheran Services Florida, Inc. Northwest			
HIV Care Formula Grants	93.917	HV003	98,000
Total U.S. Department of Health and Human Services			851,728
U.S. Department of Homeland Security (FEMA) passed through the Florida Division of Emergency Management			
Hazard Mitigation Grant	97.039	1545-111-F	305,328
Hazard Mitigation Grant	97.039	1609-02-Fj	126,532
Total Program 97.039 and U.S. Department of Homeland Security			431,860
Total Federal Expenditures			$ 2,023,529

See accompanying notes.

Sacred Heart Health Systems, Inc. and Subsidiaries

Schedule of Expenditures of State Financial Assistance Projects

Year Ended June 30, 2013

State Agency and Project Title	State CSFA Number	State Contract/ Grant Number	State Expenditures
Florida Department of Health			
Rural Primary Care	64.123	COTEN	$ 3,000,000
Total State Expenditures			$ 3,000,000

See accompanying notes.

Notes to Schedule of Expenditures of Federal Awards and Schedule of Expenditures of State Financial Assistance Projects

Year Ended June 30, 2013

1. Summary of Significant Accounting Policies

The accounting policies and presentation of the Schedule of Expenditures of Federal Awards and Schedule of Expenditures of State Financial Assistance Projects of Sacred Heart Health Systems, Inc. and subsidiaries (the Health Ministry) have been designed to conform to accounting principles generally accepted in the United States, including the reporting and compliance requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*.

Reporting Entity

OMB Circular A-133 sets forth the audit and reporting requirements for federal financial assistance. Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*, set forth the audit and reporting requirements for state of Florida financial assistance. The Schedule of Expenditures of Federal Awards and Schedule of Expenditures of State Financial Assistance Projects include all federal and state financial assistance expended by the Health Ministry.

Basis of Accounting

The Schedule of Expenditures of Federal Awards and Schedule of Expenditures of State Financial Assistance Projects have been prepared using the accrual basis of accounting. The accrual basis of accounting recognizes revenues when they are earned and expenditures when the related liability is incurred.

2. Contingencies

Grant monies received and disbursed by the Health Ministry are for specific purposes and are subject to audit by the grantor agencies. Such audits may result in requests for reimbursement due to disallowed expenditures. Based on prior experience, the Health Ministry does not believe that such disallowances, if any, would have a material effect on the consolidated financial position of the Health Ministry.

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Directors
Sacred Heart Health System, Inc. and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Sacred Heart Health System, Inc. and Subsidiaries (the Health Ministry), which comprise the Consolidated Balance Sheets as of June 30, 2013 and 2012, 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, and have issued our report thereon dated September 18, 2013.

Internal Control Over Financial Reporting

In planning and performing our audits of the consolidated financial statements, we considered the Health Ministry's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health Ministry's internal control. Accordingly, we do not express an opinion on the effectiveness of the Health Ministry's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Health Ministry's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

September 18, 2013

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Report of Independent Auditors on Compliance With Requirements for Each Major Federal Program and State Financial Assistance Project; Report on Internal Control Over Compliance Required by OMB Circular A-133, Section 215.97, *Florida Statutes,* and Chapter 10.650, *Rules of the Auditor General*

The Board of Directors
Sacred Heart Health System, Inc. and Subsidiaries

Report on Compliance for Each Major Federal Program

We have audited Sacred Heart Health System, Inc. and Subsidiaries' (the Health Ministry) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*, and the *Department of Financial Services State Project Compliance Supplement*, that could have a direct and material effect on each of the Health Ministry's major federal programs and state financial assistance projects for the year ended June 30, 2013. The Health Ministry's major federal programs and state financial assistance projects are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs and state financial assistance projects.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Health Ministry's major federal programs and state financial assistance projects based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*. Those standards, OMB Circular A-133, Section 215.97 and Chapter 10.650 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federalprogram or state financial assistance project occurred. An audit includes examining, on a test basis, evidence about the Health Ministry's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program and state financial assistance project. However, our audit does not provide a legal determination of the Health Ministry's compliance.

Opinion on Each Major Federal Program

In our opinion, the Health Ministry complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs and state financial assistance project for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133, Section 215.97, *Florida Statutes,* and Chapter 10.650, *Rules of the Auditor General*, and that are described in the accompanying Schedule of Findings and Questioned Costs as follows:

Finding No	CFDA No.	Program Name	Compliance Requirement
2013-01	93.889	National Bioterrorism Hospital Preparedness	Reporting
2013-01	97.039	Hazard Mitigation Grant	Reporting
2013-02	93.889	National Bioterrorism Hospital Preparedness	Procurement, Suspension, & Debarment

Our opinion on each major federal program is not modified with respect to these matters.

The Health Ministry's responses to the noncompliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. The Health Ministry's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the Health Ministry is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Health Ministry's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program and state financial assistance project to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and state financial assistance project and to test and report on internal control over compliance in accordance with OMB Circular A-133, Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Health Ministry's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program or state financial assistance project on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program or state financial assistance project will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program or state financial assistance project that is less severe than a material weakness in internal control over compliance yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying Schedule of Findings and Questioned Costs as items 2013-001 and 2013-002, that we consider to be significant deficiencies.

The Health Ministry's responses to the internal control over compliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. The Health Ministry's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133, Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*. Accordingly, this report is not suitable for any other purpose.

Ernst + Young LLP

March 28, 2014

Sacred Heart Health Systems, Inc. and Subsidiaries

Schedule of Findings and Questioned Costs

Year Ended June 30, 2013

Part I – Summary of Auditor's Results

Financial Statements Section

Type of auditor's report issued (unmodified, qualified, adverse, or disclaimer):	Unmodified
Internal control over financial reporting:	
Material weakness(es) identified?	___ Yes X No
Significant deficiency(ies) identified?	___ Yes X None reported
Noncompliance material to financial statements noted?	___ Yes X No

Federal Awards and State Financial Assistance Projects Section

Internal control over major programs:	
Material weakness(es) identified?	___ Yes X No
Significant deficiency(ies) identified?	X Yes ___ None reported
Type of auditor's report issued on compliance for major programs (unmodified, qualified, adverse, or disclaimer):	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133 and with Section 215.97, *Florida Statutes*, and Chapter 10.650, *Rules of the Auditor General*, State of Florida?	X Yes ___ No

Part I – Summary of Auditor's Results (continued)

Identification of major programs:

CFDA Numbers	Name of Federal Program or Cluster
CFDA 97.039	Hazard Mitigation Grant
CFDA 93.889	National Bioterrorism Hospital Preparedness Program

CSFA Number(s)	Name of State Financial Assistance Project
CSFA 64.123	Rural Primary Care

Dollar threshold used to distinguish between Type A and Type B programs for federal programs:	$300,000
Dollar threshold used to distinguish between Type A and Type B programs for state financial assistance projects	$300,000
Auditee qualified as a low-risk auditee for federal purposes?	X Yes ______ No

Part II – Financial Statement Findings Section

This section identifies the significant deficiencies, material weaknesses, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse related to the consolidated financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

No matters were identified or were reported.

Part III – Federal Award and State Financial Assistance Project Findings and Questioned Costs Section

This section identifies the audit findings required to be reported by Circular A-133 Section .510(a) and Section 215.97, *Florida Statutes* and Chapter 10.650 *Rules of the Auditor General* (for example, material weaknesses, significant deficiencies, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving federal awards that are material to a major program. Where practical, findings should be organized by federal agency or pass-through entity.

Finding: 2013-01

Federal program information:

CFDA No.: 97.039
Title: Hazard Mitigation Grant
Federal Grantor: U.S. Department of Homeland Security FEMA
Pass-through Grantor's Identifying Number or Award Number: 1545-111-F and 1609-02-Fj

CFDA No.: 93.889
Title: National Bioterrorism Hospital Preparedness Program
Federal Grantor: U.S. Department of Health and Human Services passed through the Florida Department of Health
Pass-through Grantor's Identifying Number or Award Number: COP 1F, COP S1, and COP 1E

Part III – Federal Award Findings and Questioned Costs Section (continued)

Criteria or Specific Requirement (Including Statutory, Regulatory, or Other Citation):

Reporting:

Recipients of federal awards are to maintain adequate controls over their books and records in order to prepare appropriate financial statements, including the Schedule of Expenditures of Federal Awards (Office of Management and Budget (OMB) Circular A-133, Section .300(d)).

Condition:

The Schedule of Expenditures of Federal Awards (SEFA) is to provide total federal awards expended for each individual federal program. Errors were identified in the preparation of the June 30, 2013, SEFA as Sacred Heart Health System, Inc. and Subsidiaries (the Health Ministry) misstated expenditures.

Questioned Costs:

Not applicable.

Context:

As a result of Allowability & Period of Availability compliance and internal control testing, certain expenditures were incorrectly identified as relating to the federal program and were not subject to reimbursement. As these balances were included on the SEFA, the Health Ministry performed an analysis to determine that the SEFA was complete and accurate. This analysis resulted in a combined adjustment to the SEFA of ($388,877) or a 19% total reduction of federal award expenditures.

Effect:

Identified errors were corrected upon discovery during the audit; the SEFA was subsequently adjusted. This could result in incorrect selection of major programs for audit.

Cause:

Lack of enforcement of internal controls combined with personnel changes caused the internal controls over the process to not operate effectively.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Recommendation:

The Health Ministry should implement additional procedures and improved internal controls to ensure its SEFA is prepared properly and accurately to only include federal expenditures applicable to the reporting period. The Health Ministry should ensure proper reconciliation between its accounting system and the federal expenditures at the program level and that this reconciliation is performed timely, with discrepancies investigated.

Views of Responsible Officials and Planned Corrective Actions:

Management at the Health Ministries agrees with this finding and will strength their existing controls and procedures over the preparation and review of the SEFA.

The process of reconciling the SEFA will be centralized to one accountant within the accounting department. This centralized accountant will be responsible for all federally awarded funds of the Health System and will also ensure that all entities with awarded federal funding are reviewed with assigned operation managers related to each of the awards. Non-allowable expenses will be identified and documented each month to prevent errors in reporting on the SEFA.

Finding: 2013-02

Federal program information:

CFDA No.: 93.889
Title: National Bioterrorism Hospital Preparedness Program
Federal Grantor: U.S. Department of Health and Human Services passed through the Florida Department of Health
Pass-through Grantor's Identifying Number or Award Number: COP 1F, COP S1, and COP 1E

Criteria or Specific Requirement (Including Statutory, Regulatory, or Other Citation):

Procurement, Suspension, and Debarment:

Section .43 of 2 CFR Part 215, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations (OMB Circular A-110), states that:

Part III – Federal Award Findings and Questioned Costs Section (continued)

> "All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so."

Section .45 of 2 CFR Part 215, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations (OMB Circular A-110), states that:

> "Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the re-view and evaluation of each element of cost to determine reasonableness, allocability, and allowability."

Condition:

Five procurement vendors with expenditures totaling $7,982 were selected for compliance and internal control testing out of a total of 17 vendors or $40,391 expenditures, none of which exceeded the small purchase threshold individually or in the aggregateThe Health Ministry did not formally document the cost and price analysis process nor that the transactions were conducted in a manner to provide open and free competition as defined by OMB Circular A-110.

Questioned Costs:

Not applicable.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Context:

The finding was a result of our Procurement, Suspension & Debarment compliance and control tests. Total procurement-related expenditures were $40,391 for the year ended June 30, 2013, representing approximately 27% of the major program's federal expenditures of $147,025.

Effect:

The entity is not in compliance with OMB Circular A-10, Sections .43 and .45. This could result in payments to suspended or debarred parties or payments in excess of reasonable or market amounts.

Cause:

Lack of enforcement of internal controls combined with personnel changes caused the internal controls over the process to not operate effectively.

Recommendation:

The Health Ministry should implement additional procedures and improve internal controls to ensure the required documentation is in place at the time of each procurement for all federal procurements in accordance with OMB Circular A-110, Sections .43 and .45.

Views of Responsible Officials and Planned Corrective Actions:

Operation managers of each award will ensure compliance with the procurement requirements.. Additionally, operation managers will be required to maintain files of each purchase, including printouts of pricing from the Ascension vendor procurement system, and e-mails related to proposals from the vendor. The bids will be provided to Purchasing upon request.

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