

**REX HEALTHCARE, INC. AND SUBSIDIARIES
(A COMPONENT UNIT OF THE UNIVERSITY OF NORTH
CAROLINA HEALTH CARE SYSTEM)**

**COMBINED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED JUNE 30, 2014 AND 2013

REX HEALTHCARE, INC. AND SUBSIDIARIES
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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Rex Healthcare, Inc. and Subsidiaries
Raleigh, North Carolina

Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of Rex Healthcare, Inc. and Subsidiaries ("Rex"), (a component unit of the University of North Carolina Health Care System), which comprise the combined statements of net position as of June 30, 2014 and 2013, and the related combined statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Rex's preparation and fair presentation of the combined 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 Rex'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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Rex as of June 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Pronouncement

As discussed in Note 14 to the combined financial statements, Rex adopted Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, during the year ended June 30, 2013. In accordance with the provisions of that standard, Rex applied the provisions retroactively to all years presented in the combined financial statements.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 7 and the Schedule of Plan Funding Progress on page 38 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplemental combining schedules on pages 36 and 37 are presented for purposes of additional analysis and are not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.



CliftonLarsonAllen LLP

Charlotte, North Carolina
September 3, 2014

REX HEALTHCARE, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014 AND 2013
(IN \$000'S)

Overview

The Management's Discussion and Analysis section of the Rex Healthcare, Inc. and Subsidiaries ("Rex") annual financial report is designed to provide a general overview of the financial position and operating results as of and for the fiscal years ended June 30, 2014 and 2013. This discussion and analysis should be read in conjunction with the combined financial statements and related notes which follow this discussion and analysis.

Rex Healthcare, Inc. is a private, not-for-profit health care organization located in Raleigh, North Carolina, and a component unit of the University of North Carolina Health Care System. The flagship facility is Rex Hospital, Inc., a 433-bed community hospital. Rex Hospital, Inc. provides comprehensive care, including emergency, general surgery, orthopedics, oncology, vascular, cardiac, gynecology, and obstetric services on its main campus. Rex Hospital, Inc. reaches beyond the hospital setting to provide long-term care and sub-acute rehabilitation in two skilled nursing centers – a 120-bed center in Raleigh and a 107-bed facility in Apex. In Cary, Rex offers wellness and diagnostic services. At its Wakefield campus, Rex provides outpatient surgery, a full cancer center with medical and radiation oncology services, urgent care, diagnostics, family medicine and a wellness center. At its Knightdale campus, Rex provides urgent care, diagnostics, family medicine, wound care and a sleep disorders center. In addition, Rex has a fourth medically supervised wellness center in Garner. Rex Healthcare of Holly Springs provides urgent care, diagnostics and physician practices to residents in southern Wake County. Rex has additional oncology or cardiology practices in Wake, Johnston, Sampson, Harnett, Franklin, Wayne, Nash, and Wilson Counties.

Rex operates a home health service, outpatient rehab in three locations, and a senior health center in an underserved area in downtown Raleigh.

Current Year Events

Rex implemented a new electronic health record system in fiscal 2014. Rex is able to better serve our patients across numerous locations by accessing patient care records that are now consolidated on the same platform in all UNC Health Care Triangle locations.

Rex began construction of the North Carolina Heart & Vascular Hospital at Rex's main campus. That project includes the relocation of acute care beds from Rex's aging patient tower, relocation of existing operating rooms, and consolidation of all existing heart and vascular services into a more convenient and accessible location.

Rex's overall credit rating was upgraded by rating agencies Standard & Poor and Fitch to AA- and reaffirmed by Moody's at A+.

Rex added 3D mammography screening technology at the Rex Breast Care Center in Raleigh. They also purchased a Femtosecond Laser for ophthalmic cataract extractions to enable image-guided control for lens fragmentation and corneal incisions. Rex is the only hospital in Wake County to offer this technology.

REX HEALTHCARE, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014 AND 2013
(IN \$000'S)

Rex ranked #8 in the nation in the Axial Becker's National Patient Engagement Ranking. Rex also continued to earn "A" ratings in Leapfrog Group's fall and spring national hospital safety assessment. Rex Rehabilitation and Nursing Care Center of Apex was named to U.S. News & World Report's list of the top nursing facilities. Rex also launched its new mobile mammography unit to screen underserved women. Finally and with great pride, Rex celebrated its 120th anniversary.

Using this Financial Report

Rex's financial statements report information of Rex using accounting methods similar to those used by private-sector health organizations. These statements offer short and long-term financial information about its activities.

Statement of Net Position

The statement of net position shows the financial position of Rex and includes all of Rex's assets (resources), deferred outflows of resources, liabilities (claims to resources), deferred inflows of resources, and net position (equity). The statement of net position also provides the basis for evaluating the capital structure, liquidity and financial flexibility of Rex.

Statement of Revenues, Expenses and Changes in Net Position

Revenues and expenses are accounted for in the statement of revenues, expenses and changes in net position. This statement measures the success of Rex's operations and can be used to determine whether Rex has successfully recovered all of its costs through its fees and other sources of revenue, profitability and credit worthiness.

Statement of Cash Flows

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operating, investing and capital and related financing activities, and noncapital related financing activities. It also provides answers to such questions as where cash comes from, what cash was used for and what the change in the cash balance was during the reporting period.

Notes to the Combined Financial Statements

Notes to the combined financial statements are designed to give the reader additional information concerning Rex and further supports the combined financial statements noted above.

Financial Analysis

The statement of revenues, expenses and changes in net position reports the net assets of Rex and the changes affecting them. Rex's net position, the difference between assets and liabilities, is a way to measure financial health or financial position. Over time, increases or decreases in Rex's net position is one indicator of whether its financial health is improving or deteriorating. However, one will also need to consider other non-financial factors such as changes in economic conditions, population growth and new or changed governmental legislation and regulations.

REX HEALTHCARE, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014 AND 2013
(IN \$000'S)

Condensed Combined Statements of Net Position

The following condensed combined statements of net position show the combined financial position at June 30, 2014, and 2013:

	<u>2014</u>	<u>2013</u>
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Current Assets	\$ 188,504	\$ 182,790
Capital Assets, Net	286,586	283,235
Noncurrent Assets	329,954	257,575
Deferred Outflows of Resources	1,068	1,291
Total Assets and Deferred Outflows of Resources	<u>\$ 806,112</u>	<u>\$ 724,891</u>
LIABILITIES		
Long-Term Debt, Including Current Portion	\$ 140,414	\$ 147,323
Other Liabilities	186,108	121,651
Total Liabilities	<u>326,522</u>	<u>268,974</u>
NET POSITION		
Net Investment in Capital Assets	146,172	137,203
Restricted	5,672	5,227
Unrestricted	327,746	313,487
Total Net Position	<u>479,590</u>	<u>455,917</u>
Total Liabilities, Deferred Inflows of Resources, and Net Position	<u>\$ 806,112</u>	<u>\$ 724,891</u>

Current assets increased \$5,714 (3.1%) and \$4,824 (2.8%) in 2014 and 2013, respectively. The 2014 increase is due to an increase in patient accounts receivable mainly due to volume increases. The 2013 increase is due to higher cash balances in the operating accounts. The increases result from growth in outpatient volumes, disciplined expense control, and improved reimbursement associated with renegotiated payor contracts.

Noncurrent assets increased \$72,379 (28.1%) and \$14,012 (5.7%) in 2014 and 2013, respectively, as the result of investment earnings consistent with overall market performance as well as additional investment.

During 2014 and 2013, long-term debt decreased \$6,909 (4.7%) and \$9,534 (6.1%), respectively. The decrease in 2014 and 2013 is the result of making scheduled principal payments.

Net position increased \$23,673 (5.2%) and \$9,009 (2.2%) in 2014 and 2013, respectively. The 2014 increase was primarily due to income from operations and investment returns, both realized and unrealized. Rex also experienced a loss in 2013 due to the write-off of certain abandoned construction in progress projects. For further information on this change, see the following combined statements of revenues, expenses and changes in net position.

REX HEALTHCARE, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014 AND 2013
(IN \$000'S)

Capital Assets

Rex's investment in capital assets consisted of the following at June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Land and Land Improvements	\$ 51,044	\$ 51,050
Buildings and Improvements	297,605	257,682
Equipment	<u>349,866</u>	<u>347,401</u>
Total Capital Assets	698,515	656,133
Accumulated Depreciation and Amortization	<u>(444,039)</u>	<u>(411,688)</u>
Total Capital Assets, Net	254,476	244,445
Construction in Progress	<u>32,110</u>	<u>38,790</u>
Total Capital Assets	<u><u>\$ 286,586</u></u>	<u><u>\$ 283,235</u></u>

Investments in capital assets in 2014 consisted primarily of the Heart and Vascular Hospital, cancer center renovation, west operating room and surgeon lounge, and ICU bed replacement projects. Capital investments in 2013 consisted primarily of costs incurred in connection with ongoing replacement of the central energy plant for the main campus, a new bed tower, and technology and imaging assets.

Condensed Combined Statements of Revenues, Expenses and Changes in Net Position

While the combined statements of net position show the financial position of Rex at June 30, 2014 and 2013, the following combined statements of revenues, expenses and changes in net position provides answers to the nature and source of changes in net position for the years ended June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Operating Revenues	\$ 749,798	\$ 731,381
Operating Expenses	<u>735,312</u>	<u>686,028</u>
Operating Income	14,486	45,353
Nonoperating Income	44,163	817
Contributions and Other	<u>(34,976)</u>	<u>(37,161)</u>
Change in Net Position	23,673	9,009
Net Position, Beginning of Period	455,917	446,908
Net Position, End of Period	<u><u>\$ 479,590</u></u>	<u><u>\$ 455,917</u></u>

Operating Income

The increase in operating revenues in 2014 and 2013 is primarily the result of volume growth and increased reimbursement resulting from renegotiated payor contracts. The increases in operating expenses in each year are the result of changes in patient volumes, inflation, and expansion of services offered, and the impact of implementation of the new electronic health record system. Operating expenses for the year ended June 30, 2014 include \$15.3 million specific to the implementation.

REX HEALTHCARE, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2014 AND 2013
(IN \$000'S)

Nonoperating Income

Nonoperating income consisted of the following for the years ended June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Interest Income	\$ 461	\$ 695
Dividend Income	8,402	3,991
Realized Gains, Net	4,159	8,324
Net Change in Unrealized Gains	32,064	9,052
Brokerage Fees	<u>(986)</u>	<u>(1,086)</u>
Total Investment Income	44,100	20,976
Loss from Abandonment of Construction in Progress	-	(16,783)
Other	63	<u>(3,376)</u>
Total Nonoperating Income	<u>\$ 44,163</u>	<u>\$ 817</u>

Finance Contact

Rex's combined financial statements are designed to present users with a general overview of Rex's finances and to demonstrate Rex's financial accountability. If you have any questions about this report or need additional financial information, inquiries may be sent to:

Chief Financial Officer
Rex Healthcare, Inc.
4420 Lake Boone Trail
Raleigh, North Carolina 27607

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF NET POSITION
JUNE 30, 2014 AND 2013
(IN \$000's)

	2014	2013
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 59,174	\$ 73,998
Patient Accounts Receivable, Net of Allowance for Uncollectible		
Accounts of Approximately \$19,427 in 2014 and \$20,987 in 2013	86,591	78,678
Other Receivables	23,713	13,440
Inventories	13,398	11,249
Prepaid Expenses and Other Current Assets	5,628	5,425
Total Current Assets	188,504	182,790
ASSETS LIMITED AS TO USE	294,750	246,629
CAPITAL ASSETS, NET	286,586	283,235
OTHER ASSETS		
Investments in Affiliates	11,545	10,189
Other Assets	23,659	757
Total Other Assets	35,204	10,946
Total Assets	805,044	723,600
DEFERRED OUTFLOWS OF RESOURCES		
Loss on Refunding of Long-Term Debt	1,068	1,291
Total Assets and Deferred Outflows of Resources	\$ 806,112	\$ 724,891
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION		
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 7,698	\$ 7,399
Vendor Accounts Payable	50,966	41,834
Accrued Expenses and Other Liabilities	109,281	66,188
Estimated Third-Party Payor Settlements	24,340	13,000
Total Current Liabilities	192,285	128,421
LONG-TERM DEBT, NET	132,716	139,924
OTHER NONCURRENT LIABILITIES	1,521	629
Total Liabilities	326,522	268,974
NET POSITION		
Net Investment in Capital Assets	146,172	137,203
Restricted	5,672	5,227
Unrestricted	327,746	313,487
Total Net Position	479,590	455,917
Total Liabilities, Deferred Inflows of Resources, and Net Position	\$ 806,112	\$ 724,891

See accompanying Notes to Combined Financial Statements.

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30, 2014 AND 2013
(IN \$000's)

	2014	2013
OPERATING REVENUES		
Net Patient Service Revenue (Net of Provision for Uncollectible Accounts of Approximately \$21,431 in 2014 and \$26,594 in 2013)	\$ 712,454	\$ 701,745
Other Operating Revenues	37,344	29,636
Total Operating Revenues	749,798	731,381
OPERATING EXPENSES		
Salaries	332,846	295,944
Employee Benefits	74,360	90,703
Medical Supplies and Other Expenses	292,087	263,525
Depreciation and Amortization	31,062	30,813
Interest	4,957	5,043
Total Operating Expenses	735,312	686,028
OPERATING INCOME	14,486	45,353
NONOPERATING INCOME (LOSS)		
Investment Income, Net	44,100	20,976
Other, Net	63	(20,159)
Nonoperating Income, Net	44,163	817
EXCESS OF REVENUES AND GAINS OVER EXPENSES AND LOSSES	58,649	46,170
CONTRIBUTIONS TO RELATED PARTY	(34,965)	(38,017)
OTHER	(11)	856
CHANGE IN NET POSITION	23,673	9,009
Net Position - Beginning of Year	455,917	446,908
NET POSITION - END OF YEAR	\$ 479,590	\$ 455,917

See accompanying Notes to Combined Financial Statements.

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2014 AND 2013
(IN \$000's)

	2014	2013
OPERATING ACTIVITIES		
Receipts from Third-Party Payors and Patients	\$ 705,608	\$ 710,922
Payments to and on Behalf of Employees	(400,868)	(380,309)
Payments to Suppliers	(262,091)	(264,846)
Other Receipts	35,086	30,893
Net Cash Provided by Operating Activities	77,735	96,660
INVESTING ACTIVITIES		
Purchases and Sales of Investments, Net	(16,193)	(17,105)
Contributions to Related Party	(34,965)	(38,017)
Investment Income	12,036	11,924
Other Nonoperating Income, Net	63	(3,376)
Net Cash Used in Investing Activities	(39,059)	(46,574)
CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of Capital Assets	(25,070)	(43,246)
Related Party Receivable for Capital Assets	(16,000)	-
Proceeds from Issuance of Long-Term Debt, Net of Premium	-	1,899
Principal Repayments of Long-Term Debt	(7,609)	(11,301)
Cash Paid for Interest on Long-Term Debt	(4,957)	(2,754)
Net Cash Used in Capital and Related Financing Activities	(53,636)	(55,402)
DECREASE IN CASH AND CASH EQUIVALENTS	(14,960)	(5,316)
Cash and Cash Equivalents - Beginning of Year	74,158	79,474
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 59,198	\$ 74,158
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO COMBINED STATEMENTS OF NET POSITION:		
Cash and Cash Equivalents in Current Assets	\$ 59,174	\$ 73,998
Cash and Cash Equivalents in Assets Limited as to Use	24	160
Total Cash and Cash Equivalents	\$ 59,198	\$ 74,158

See accompanying Notes to Combined Financial Statements.

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED JUNE 30, 2014 AND 2013
(IN \$000's)

	2014	2013
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 14,486	\$ 45,353
Interest Expense Considered Capital Financing Activity	4,957	5,043
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Provision for Uncollectible Accounts	21,431	26,594
Depreciation and Amortization	31,692	30,873
Gain on Disposal of Capital Assets	(827)	(179)
Changes in Assets and Liabilities:		
Patient and Other Receivables, Net	(39,617)	(26,000)
Accounts Payable and Accrued Expenses	36,334	5,017
Estimated Third-Party Payor Settlements	11,340	8,583
Other Assets and Liabilities, Net	(2,061)	1,376
Net Cash Provided by Operating Activities	\$ 77,735	\$ 96,660
SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION		
Net Change in Unrealized Gains on Investments	\$ 32,064	\$ 9,052
Additions to Capital Assets Included in Current Liabilities	8,223	-
Capital Assets Acquired through Capital Lease Obligations	1,056	-
Loss on Abandonment of Construction in Progress	-	(16,783)

See accompanying Notes to Combined Financial Statements.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 1 ORGANIZATION

Rex Healthcare, Inc. ("Rex") is a North Carolina not-for-profit corporation organized to provide a broad range of health care services to residents of the Triangle area of North Carolina. Acting through its network of operating affiliates, Rex provides health care to patients from several locations through continued development of acute care and non-hospital programs.

Rex's sole member is the University of North Carolina Health Care System ("UNCHCS"). UNCHCS appoints eight of the thirteen seats on Rex's Board of Trustees. Additionally, UNCHCS reviews and approves Rex's annual operating and capital budgets. Rex is a component unit of UNCHCS and its financial data is incorporated into the comprehensive annual financial report of UNCHCS.

As required by accounting principles generally accepted in the United States of America, the combined financial statements of Rex present the financial position and results of operations of the primary enterprise, Rex Healthcare, Inc., and its blended component units. The combined component units discussed below are included in Rex's reporting entity because of their operational or financial relationships with Rex, including sharing the same governance, of Rex being the sole member of the component unit.

Rex Hospital, Inc. – Rex Hospital, Inc. (the "Hospital"), located in Raleigh, North Carolina, is a 433-bed hospital. The Hospital provides inpatient, outpatient and emergency services primarily to the residents of Wake County, North Carolina. The Hospital operates on its main campus Rex Cancer Center, Rex Women's Center and Rex Rehabilitation and Nursing Care Center of Raleigh, a 120-bed nursing facility. The Hospital provides wellness and diagnostic services at its Cary, North Carolina campus, and outpatient surgery, oncology and wellness services, urgent care, family medicine and diagnostics at its Wakefield campus. Rex's Knightdale campus provides urgent care, diagnostics, family medicine, wound care and a sleep disorders center. Rex also operates Rex Rehabilitation and Nursing Care Center of Apex, a 107-bed nursing facility located in Apex, North Carolina. Rex's Holly Springs campus provides urgent care, diagnostics and physician practice services.

- *Rex Physicians, LLC* – Holdings formed and became the sole member of Rex Physicians LLC ("Physicians"), a single member limited liability company which has elected to be treated as a taxable corporation. Physicians was formed to operate specialty physician practices serving the residents of Wake County and surrounding areas. Physicians currently operates physician practices in the areas of general surgery, heart and vascular services, and thoracic surgery. On January 1 2014, all of Physicians assets and services were transferred to the Hospital.
- *Rex Health Ventures* – Rex created Rex Health Ventures GP I, LLC and Rex Health Ventures I, LLP (collectively "Rex Health Ventures" or "RHV"). RHV was formed as a venture capital fund to invest in and partner with health care startup companies and entrepreneurs. RHV invests in organizations that support the

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 1 ORGANIZATION (CONTINUED)

discovery and development of new treatments, tools, products and services that foster innovation and positively impact the provision of health care. Rex has committed to investing up to \$10,000 in RHV. Following is the organizational structure of the RHV entities:

Rex Health Ventures GP I, LLC – The Hospital is the sole member of Rex Health Ventures GP I, LLC (“RHV GP”).

Rex Health Ventures I, LLP – The Hospital is the sole limited partner in Rex Health Ventures I, LLP (“RHVI”) and RHV GP is the sole general partner. RHVI is the venture capital fund and invests in startup companies. At June 30, 2014 and 2013, RHVI had invested \$2,072 and \$1,498, respectively, in unrelated health care startup companies. RHVI accounts for these investments utilizing the fair value method of accounting. During the year ended June 30, 2014 RHVI realized a distribution gain on investment of approximately \$5,048. Management has determined there is no impairment of these investments at June 30, 2014 and 2013.

- *Rex Orthopedic Ventures, LLC* – The Hospital formed and became the sole member of Rex Orthopedic Ventures, LLC (“ROV”), a single member, manager-managed limited liability company. ROV was formed to hold a membership interest in Orthopedic Surgery Center of Raleigh, LLC (see Investments in Affiliates below).
- *Rex Surgery Center of Wakefield, LLC* – In 2014, the Hospital formed and became the sole member of Rex Surgery Center of Wakefield, LLC (“RSCW”), a single member, manager-managed limited liability company. There was no financial activity related to this entity as of and for the year ended June 30, 2014.

Rex Holdings, LLC – Rex formed and became the sole member of Rex Holdings, LLC (“Holdings”), a single member limited liability company. Holdings was formed to hold membership interest in various limited liability companies. During fiscal years 2014 and 2013, there were no activities related to this entity.

Rex Enterprises Company, Inc. – Rex Enterprises Company, Inc. (“Enterprises”) is a North Carolina for-profit corporation organized to hold investments in various affiliates and to promote the development of real property in support of the mission of Rex.

- *Rex Health Ventures, LLC* – Enterprises is the sole member of Rex Health Ventures, LLC (“RHVLLC”), which provides management services to RHVI.
- *Rex Wakefield Enterprises, LLC* – Rex Wakefield Enterprises, LLC (formerly known as Rex CDP Ventures, LLC) (“RWE”), is a limited liability company organized to own and develop real estate in the Wakefield community of northern Wake County. At June 30, 2013, RWE was the sole member of the following limited liability companies:

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 1 ORGANIZATION (CONTINUED)

Rex Wakefield Wellness, LLC – RWE is the sole member of Rex Wakefield Wellness, LLC ("Wellness"), a single member limited liability company. Wellness was created to develop a wellness center building on the Wakefield campus of the Hospital. The Hospital leases the building from Wellness.

Rex Wakefield MOB, LLC – RWE is the sole member of Rex Wakefield MOB (formerly known as Wakefield Rex Investors MOB, LLC) ("MOB"), a single member limited liability company. MOB was formed to develop a medical office building on the Wakefield campus of the Hospital. The Hospital leases space from MOB.

Rex Healthcare Foundation, Inc. – Rex Healthcare Foundation, Inc. (the "Foundation") is a North Carolina not-for-profit corporation organized to promote the health and welfare of the people of the Triangle area by promoting philanthropic contributions and public support of Rex.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

As a result of the transfer of the membership interest to UNCHCS, an agency of the State of North Carolina, Rex is subject to the application of accounting pronouncements issued by the Governmental Accounting Standards Board (GASB). Rex follows GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board Statements and other pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

The accompanying basic combined financial statements are presented in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") in accordance with the American Institute of Certified Public Accountants' Audit and Accounting Guide *Health Care Entities*, and other pronouncements applicable to health care organizations and guidance from the GASB, where applicable. The basic combined financial statements include all of the accounts of Rex. Intercompany accounts and transactions have been eliminated in combination.

Use of Estimates

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

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less when purchased, and which are not designated as assets limited as to use, and are recorded at cost which approximates market value.

Inventory

Inventory consists primarily of medical supplies, surgical supplies, and pharmaceuticals and is stated at the lower of cost (first-in, first-out method) or market.

Investments

Investments in marketable debt and equity securities with readily determinable fair values, including assets whose use is limited, are measured at fair value in the accompanying statements of net position. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in nonoperating income (loss) in the accompanying combined financial statements. The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments.

Investments in Affiliates

Quality Textile Services, Inc. - Enterprises own a 50% interest in Quality Textile Services, Inc. ("QTS"), a Raleigh, North Carolina company that provides laundry services to local hospitals. Enterprises exercises significant influence over QTS; however, it does not control it through a majority voting interest. This investment is accounted for using the equity method of accounting; accordingly, Enterprises' investment has been adjusted for its share of QTS' operations. Enterprises' equity in the net loss of this affiliate totaled approximately \$152 and \$34 for the years ended June 30, 2014 and 2013, respectively, and is included in net nonoperating income. Enterprises received no cash distributions from QTS during 2014 or 2013. Enterprises' investment in QTS totaled approximately \$2,171 and \$2,323 as of June 30, 2014 and 2013, respectively. Separate financial statements for QTS are not publicly available.

Rex Cary MOB, LLC - Enterprises owns a 32.5% interest in Rex Cary MOB, LLC, a company that in July 2003, built and began leasing a medical office building in Cary, North Carolina. Enterprises' investment has been adjusted for its share of Rex Cary MOB, LLC's operations. Enterprises accounts for its investment in the affiliate under the equity method of accounting since it exercises significant influence over the affiliate, but does not have financial accountability. Enterprises' equity in the net income of this affiliate totaled approximately \$216 and \$294 for the years ended June 30, 2014 and 2013, respectively, and is included in net nonoperating income. Additionally, Enterprises received cash distributions from Rex Cary MOB, LLC totaling approximately \$257 and \$311 during 2014 and 2013, respectively. Enterprises' investment in Rex Cary MOB, LLC totaled approximately \$737 and \$778 as of June 30, 2014 and 2013, respectively. Separate financial statements for Rex Cary MOB, LLC are not publicly available.

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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in Affiliates (Continued)

JRH Ventures, LLC – On February 1, 2012, the Hospital assigned 100% of its membership interest in Smithfield Radiation Oncology to JRH Ventures, LLC (“JRH”), a limited liability company organized to own and operate linear accelerators, in exchange for a 50% member interest in JRH. The Hospital accounts for its investment in JRH under the equity method of accounting since it exercises significant influence over JRH, but does not have financial accountability. The Hospital’s equity in the net income (loss) of this affiliate totaled approximately \$74 and \$(213) for the years ended June 30, 2014 and 2013, respectively, and is included in net nonoperating income. The Hospital’s investment in JRH totaled approximately \$2,664 and \$2,590 as of June 30, 2014 and 2013, respectively. Separate financial statements for JRH are not publicly available.

Rex Surgery Center of Cary, LLC – Rex Surgery Center of Cary, LLC (“CSC”) is a limited liability company organized to own and operate an ambulatory surgery center. CSC was formed and began operations on February 28, 2011. The Hospital owned 55% of the membership interests at June 30, 2014 and 2013. Per the membership agreement, both the Hospital and the unrelated party now maintain 50/50 voting rights, regardless of the ownership structure. The Hospital’s equity in the net income of this affiliate totaled approximately \$4,922 and \$5,367 for the years ended June 30, 2014 and 2013, respectively, and is included in other operating revenues. The Hospital’s investment in CSC totaled approximately \$2,011 and \$1,448 as of June 30, 2014 and 2013, respectively. Separate financial statements for CSC are not publicly available.

Orthopaedic Surgery Center of Raleigh, LLC – Orthopaedic Surgery Center of Raleigh, LLC (“OSCR”) is a limited liability company organized to own and operate an ambulatory surgery center. OSCR was formed and began operations in April 2013. The Hospital owned 51% of the membership interests at June 30, 2014 and 2013. Per the membership agreement, both the Hospital and the unrelated party now maintain 50/50 voting rights, regardless of the ownership structure. The Hospital’s equity in the net income (loss) of this affiliate totaled approximately \$3,693 and \$(929) for the years ended June 30, 2014 and 2013, respectively, and is included in other operating revenues. The Hospital’s investment in OSCR totaled approximately \$2,448 and \$410 as of June 30, 2014 and 2013, respectively. Separate financial statements for OSCR are not publicly available.

Rex MOB Partners, LLC - Enterprises owns less than a 5% interest in Rex MOB Partners, LLC, a company that operates a multi-tenant medical office building in Raleigh, North Carolina on land leased from the Hospital. Enterprises does not exercise significant influence over the affiliate, and accounts for the investment using the cost method of accounting. Enterprises’ investment in Rex MOB Partners, LLC totaled approximately \$300 as of June 30, 2014 and 2013. Management has determined there is no impairment of this investment at June 30, 2014 and 2013. Separate financial statements for Rex MOB Partners, LLC are not publicly available.

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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in Affiliates (Continued)

The following table summarizes unaudited aggregated financial information for the investees in which Rex has an equity method investment as of and for the year ended June 30, 2014:

Current Assets	\$	10,790
Noncurrent Assets		21,292
		\$ 32,082
Current Liabilities	\$	2,965
Noncurrent Liabilities		9,440
Net Position		19,677
		\$ 32,082
Revenues	\$	46,285
Expenses		30,003
Operating Income		16,282
Nonoperating Income		72
		\$ 16,354
Excess Revenues Over Expenses	\$	16,354

Capital Assets

Capital asset acquisitions are recorded at cost and include interest on funds used to finance the acquisition or construction of major capital projects. Assets under capital lease are stated at the present value of the minimum lease payments at the inception of the lease. Depreciation is provided on both straight-line and accelerated methods over the estimated useful lives of the depreciable assets which is generally 5 to 15 years for equipment, 5 to 15 years for building improvements, and 30 to 40 years for buildings.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs for major renewals and betterments are capitalized and depreciated over the estimated useful lives. Upon disposition, the asset and related accumulated depreciation accounts are relieved and any gain or loss is credited or charged to non-operating revenues and expenses.

Assets under capital leases and leasehold improvements are depreciated over the estimated useful life or the related lease term, whichever is shorter; generally periods ranging from 5 to 7 years. Depreciation of assets under capital leases and leasehold improvements is included in depreciation and amortization expense in the accompanying statements of revenues, expenses and changes in net assets.

Other Assets

Other assets consisted primarily of long-term notes receivable and deferred lease assets at June 30, 2014 and 2013.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Proprietary Fund Accounting

Rex utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Net Position

In accordance with GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, net position is categorized as net investment in capital assets, restricted and unrestricted. Net investment in capital assets is intended to reflect the portion of net position that is associated with nonliquid capital assets less outstanding capital-related debt. Restricted net position is assets generated from revenues that have third-party limitations as to their use. Unrestricted net position has no third-party restrictions as to use.

Restricted net position included the following at June 30, 2014 and 2013:

	2014	2013
Expendable:		
Various Scholarships, Lectureships and Buildings	\$ 1,248	\$ 1,157
Various Supplies, Equipment and Patient Charity Care	4,020	3,691
Total Expendable	5,268	4,848
Nonexpendable:		
Endowments	404	379
Total Restricted Net Position	\$ 5,672	\$ 5,227

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Charity Care

Rex provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because Rex does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue or accounts receivable in the accompanying financial statements. Rex maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The amount of charity care provided, based on charges foregone, was approximately \$88,000 and \$89,000 for the years ended June 30, 2014 and 2013, respectively. Rex has estimated costs associated with amounts foregone, utilizing the most recent Medicare cost report cost-to-charge ratio, to be approximately \$24,226 and \$24,502 for the years ended June 30, 2014 and 2013, respectively.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Income

Rex classifies all revenues and expenses earned or incurred in the course of providing health care to patients as operating activities.

Nonoperating Income

Nonoperating income consists primarily of investment income and other miscellaneous income and expense items. Income related to Rex's equity investments in affiliates, excluding CSC and OSCAR, are included in other nonoperating income. Earnings related to CSC and OSCAR are reported in other operating income.

Capitalized Interest

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Electronic Health Record ("EHR") Incentive Payments

The Hospital recognizes revenue at the completion of the EHR reporting period and all meaningful use objectives and any other specific grant requirements that are applicable (such as electronic transmission of quality measures in the second and subsequent payment years) are met.

Tax-Exempt Status

Rex, the Hospital, and the Foundation are exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code. Enterprises is a taxable corporation that previously had net operating loss carryforwards which expired in 2012.

The Hospital is the sole member of ROV and RSCW, and Enterprises is the sole member of RWE, and RWE is the sole member of Wellness, MOB and RHVLLC. As such, these entities are considered disregarded entities for tax purposes.

Significant Future Accounting Pronouncements

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The objective of this statement is to establish new accounting and financial reporting requirements for governments that provide their employees with pensions. The requirements in this statement will change how governments calculate and report the costs and obligations associated with pensions and improve the decision-usefulness of reported pension information and increase the transparency, consistency, and comparability of pension information across governments. This statement will be effective for Rex's fiscal year ending June 30, 2015. Management is currently evaluating the impact of adopting this statement, but believes the impact of the unfunded liability could reduce net position in excess of \$100,000, and increase annual pension expense in excess of \$1,000.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications

Certain amounts in the 2013 combined financial statements have been reclassified to conform to the 2014 presentation. These reclassifications had no effect on previously reported changes in net position.

NOTE 3 NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services, and defined capital and medical education costs related to Medicare beneficiaries, are paid based on a cost reimbursement methodology. Outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates based on the Ambulatory Payment Classification System ("APC"). The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been settled by the Medicare fiscal intermediary through June 30, 2010. An allowance is provided for retroactive adjustments under the contractual agreements for unsettled years through 2014.

Medicaid - Inpatient acute care services are paid at prospectively determined rates per discharge. Amounts received for Medicaid outpatient services are generally cost-based at standard per encounter rates established by state regulations. The Hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary. The Hospital's Medicaid cost reports have been settled by the Medicaid fiscal intermediary through June 30, 2010. An allowance is provided for retroactive adjustments under the contractual agreements for unsettled years through 2014.

Managed Care Agreements - Net patient service revenues include amounts determined to be reimbursable under contractual agreements with managed care organizations, area businesses and insurance companies. The agreements provide for various discounts, per diem rates, and/or per case rates. Allowances are provided for adjustments under these agreements.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 3 NET PATIENT SERVICE REVENUE (CONTINUED)

Revenues from the Medicare and Medicaid programs accounted for approximately 25% and 2%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2014. Revenues from the Medicare and Medicaid programs accounted for approximately 25% and 3%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2013. 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 could change by a material amount in the near term. The 2014 and 2013 net patient service revenue increased approximately \$4,783 and \$8,613, respectively, as a result of changes in estimates related to various third-party accruals and reserves.

Contractual adjustments totaled approximately \$1,296,000 and \$1,209,000 for the years ended June 30, 2014 and 2013, respectively.

The Hospital has historically participated in the voluntary North Carolina Medicaid Reimbursement Initiative Program (the "MRI Program"). The MRI Program allowed the Hospital to receive additional annual Medicaid funding for its disproportionate share costs. In March 2012, the Center for Medicare and Medicaid Services ("CMS") approved two new disproportionate share plans for North Carolina.

The first plan covers the UNCHCS hospitals (The UNC Upper Payment Limit or "UPL Plan"), including Rex. The second plan covers all other non-state government hospitals and private hospitals in North Carolina (the "GAP Plan") and is essentially a supplemental upper payment limit plan to the existing MRI Program. Under the UNC UPL Plan, Rex does not participate in the GAP Plan and no longer participates in the MRI Program.

Under the provisions of the UPL Plan, Rex is assessed an inter-governmental transfer ("IGT Payment") by the North Carolina Medicaid program ("Medicaid"), in return Medicaid makes an upper payment limit payment to Rex. When both amounts are reasonably estimable and probable of payment, Rex recognizes the revenues related to the UPL Plan as net patient service revenue.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 3 NET PATIENT SERVICE REVENUE (CONTINUED)

Both the UPL Plan and the GAP Plan were approved in March 2012; however, the provisions were retroactively effective to October 1, 2010 and January 1, 2011. The following table summarizes the revenue recognized by Rex related to these plans for the years ended June 30, 2014 and 2013:

	2014	2013
UPL Plan Year - 2013:		
IGT Payment	\$ -	\$ (19,772)
UPL Revenue	-	27,816
	-	8,044
Reserve for Future Settlements	-	(430)
	-	7,614
UPL Plan Year - 2014:		
IGT Payment	(15,073)	-
UPL Revenue	23,013	-
	7,940	-
Reserve for Future Settlements	(475)	-
	7,465	-
	\$ 7,465	\$ 7,614

Other Payors

Rex has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Rex under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

NOTE 4 ACCOUNTS RECEIVABLE AND ACCRUED EXPENSES

Patient accounts receivable consists of the following at June 30, 2014 and 2013:

	2014	2013
Gross Receivables:		
Medicare	\$ 39,732	\$ 46,323
Medicaid	4,415	5,559
Managed Care	37,524	37,058
Self Pay	79,464	40,764
Other	59,597	55,586
	220,732	185,290
Less:		
Contractual Allowances	(114,714)	(85,626)
Allowance for Uncollectible Accounts	(19,427)	(20,986)
	\$ 86,591	\$ 78,678

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 4 ACCOUNTS RECEIVABLE AND ACCRUED EXPENSES (CONTINUED)

Other receivables consist of the following at June 30, 2014 and 2013:

	2014	2013
Sales Tax Receivable	\$ 3,888	\$ 3,745
Pledges Receivable	114	214
Due from Related Party	17,499	8,727
Other	2,212	754
	<u>\$ 23,713</u>	<u>\$ 13,440</u>

Accrued expenses and other liabilities consist of the following at June 30, 2014 and 2013:

	2014	2013
Accrued Salaries, Wages and Withholdings	\$ 32,257	\$ 30,695
Accrued Paid Time Off	17,080	14,790
Reserve for Workers' Compensation Claims	1,984	2,373
Reserve for Employee Health Benefit Claims	4,372	2,456
Reserve for Medical Malpractice Claims	1,043	624
Due to Related Party	39,018	6,507
Other	13,527	8,743
	<u>\$ 109,281</u>	<u>\$ 66,188</u>

NOTE 5 CASH, CASH EQUIVALENTS, AND INVESTMENTS

The fair value of cash, cash equivalents, and investments consist of the following at June 30, 2014 and 2013:

	2014	2013
Cash and Cash Equivalents	\$ 59,198	\$ 74,158
Certificates of Deposit	350	450
Mutual Funds	72,954	58,810
Equities	136,780	114,249
Alternative Investments	84,642	72,960
	<u>\$ 353,924</u>	<u>\$ 320,627</u>
	2014	2013
Included in the Following Balance Sheet Captions:		
Cash and Cash Equivalents	\$ 59,174	\$ 73,998
Assets Limited as to Use:		
Restricted by Contributors and Grantors	5,672	5,227
Designated for Long Term Investment	289,078	241,402
	<u>294,750</u>	<u>246,629</u>
	<u>\$ 353,924</u>	<u>\$ 320,627</u>

Certificates of deposits for the years ended June 30, 2014 and 2013 have maturities of less than one year.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 5 CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

Rex's general investment policy is to apply the prudent-person rule: Funds shall be invested with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the investment of a fund of like character and with like aims, taking into consideration the long-term and short-term needs of the institution, and current and expected returns, price level trends, and economic conditions. Investments shall be so diversified as to minimize the risk of large losses.

The Board requires a minimum of 75% of investments be invested in liquid securities, defined as securities that can be transacted quickly and efficiently with minimal impact on market price. Up to 30% of the total portfolio may be invested in alternative assets, but must be specifically approved by the Board. Rex's investment policy prohibits short selling, margin transactions and interest rate futures and swaps.

Interest Rate Risk. Rex has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The policy requires that the duration of the portfolio shall not exceed six years and its average maturity shall range between two and six years.

Credit Risk. Rex's investment policy allows it to invest in (i) direct obligations or obligations on which the principal and interest are unconditionally guaranteed by the United States government; (ii) obligations issued by an approved agency or corporation wholly-owned by the United States government; (iii) interest-bearing time deposits, certificates of deposit or other approved forms of deposits in any bank or trust company in North Carolina which satisfies insurance and, if necessary, collateral requirements for holding Company money; and (iv) corporate notes and bonds.

Fixed income investments should be limited to investment grade securities, i.e., securities with ratings of BBB- (Standard & Poor's) or Baa3 (Moody's) or higher. Unrated securities of the U.S. Treasury, government agencies and government sponsored entities are permissible investments. The average portfolio quality should be "A."

Alternative investments are investments in the common stock of limited investment companies that offer a pattern of returns different from that of the overall market and occasionally have lesser levels of liquidity. Examples of alternative investments allowed by Rex's investment policy include hedge funds, hedge fund-of-funds, private equity funds, managed futures and structured alternatives.

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 5 CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

Concentration of Credit Risk. Rex limits the amount it may invest in any single issuer. Fixed income holdings in a single issuer (excluding obligations of the United States Government, its agencies and government sponsored entities) shall be limited to 5 percent of the portfolio measured at market value at the time of purchase. Treasuries, agencies and government-sponsored entities have no issuer limits. Securities rated under "A-" are limited to 3% per issuer. Rex's investment policy at June 30, 2014 includes the following allocation structure and benchmarks:

	Min.	Target	Max.	Benchmark
Global Equities	40%	45%	60%	
U.S. Equity	10%	23%	40%	Russell 3000
Non-U.S. Equity	10%	22%	40%	ACWI ex. - US
Real Assets	5%	10%	15%	CPI-U + 5%
Hedge Funds	10%	15%	20%	T-Bills + 5%
Fixed Income	20%	30%	40%	BC Aggregate Index
Cash and Equivalents	0%	0%	10%	N/A

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, Rex will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Fixed income and equity securities may be exposed to custodial credit risk if they are uninsured, are not registered in the name of Rex and are held by either the counterparty or the counterparty's trust department or agent, but not in Rex's name. At June 30, 2014 and 2013, all investments in securities are on deposit with Rex's fiduciary agent, which holds these securities by book entry in its fiduciary Federal Reserve accounts. Rex's ownership of these securities is identified through the internal records of the fiduciary agent. Certain of these securities are optionally callable at par by the issuer on specified dates.

Rex does not have a deposit policy for custodial credit risk, but does require cash to be employed productively at all times, by investment in short-term cash equivalents to provide safety, liquidity, and return. At June 30, 2014, Rex had approximately \$59,000 on deposit with financial institutions that exceeded the \$250,000 FDIC insurance limit.

Nonoperating income (loss) consisted of the following for the years ended June 30, 2014 and 2013:

	2014	2013
Interest Income	\$ 461	\$ 695
Dividend Income	8,402	3,991
Realized Gains	4,159	8,324
Net Change in Unrealized Gains on Investments	32,064	9,052
Brokerage Fees	(986)	(1,086)
Total Investment Income	44,100	20,976
Loss from Abandonment of Construction in Progress	-	(16,783)
Other	63	(3,376)
Total Nonoperating Income, Net	\$ 44,163	\$ 817

REX HEALTHCARE, INC. AND SUBSIDIARIES
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NOTE 6 CAPITAL ASSETS AND ACCUMULATED DEPRECIATION

A summary of changes in the historical cost of capital assets and accumulated depreciation and amortization related to capital assets for the year ended June 30, 2014 is as follows:

	June 30, 2013	Transfers/ Additions	Transfers/ Retirements	June 30, 2014
CAPITAL ASSETS AT COST				
Land	\$ 29,912	\$ 3,081	\$ -	\$ 32,993
Land Improvements	21,138	-	(3,087)	18,051
Buildings and Improvements	257,682	40,714	(791)	297,605
Equipment	347,401	10,211	(7,746)	349,866
Construction in Progress	38,790	35,963	(42,643)	32,110
Total	<u>694,923</u>	<u>89,969</u>	<u>(54,267)</u>	<u>730,625</u>
ACCUMULATED DEPRECIATION AND AMORTIZATION				
Land Improvements	8,170	675	(234)	8,611
Buildings and Improvements	137,748	20,962	(791)	157,919
Equipment	265,770	18,030	(6,291)	277,509
Total	<u>411,688</u>	<u>39,667</u>	<u>(7,316)</u>	<u>444,039</u>
Capital Assets, Net	<u>\$ 283,235</u>	<u>\$ 50,302</u>	<u>\$ (46,951)</u>	<u>\$ 286,586</u>

A summary of changes in the historical cost of capital assets and accumulated depreciation and amortization related to capital assets for the year ended June 30, 2013 is as follows:

	June 30, 2012	Transfers/ Additions	Transfers/ Retirements	June 30, 2013
CAPITAL ASSETS AT COST				
Land	\$ 29,912	\$ -	\$ -	\$ 29,912
Land Improvements	19,540	1,598	-	21,138
Buildings and Improvements	252,777	6,551	(1,646)	257,682
Equipment	321,861	37,537	(11,997)	347,401
Construction in Progress	47,715	42,156	(51,081)	38,790
Total	<u>671,805</u>	<u>87,842</u>	<u>(64,724)</u>	<u>694,923</u>
ACCUMULATED DEPRECIATION AND AMORTIZATION				
Land Improvements	7,506	634	30	8,170
Buildings and Improvements	127,297	10,467	(16)	137,748
Equipment	249,703	17,653	(1,586)	265,770
Total	<u>384,506</u>	<u>28,754</u>	<u>(1,572)</u>	<u>411,688</u>
Capital Assets, Net	<u>\$ 287,299</u>	<u>\$ 59,088</u>	<u>\$ (63,152)</u>	<u>\$ 283,235</u>

The capital acquisitions' figures above are presented net of transfers from construction in progress to operating asset categories and sales and other dispositions. Depreciation expense related to RWE and its related entities is included in other nonoperating income. Depreciation and amortization expense totaled approximately \$31,825 and \$31,891 for the years ended June 30, 2014 and 2013, respectively. The expense shown in the table above is net of decreases in accumulated depreciation for sales and other dispositions of capital assets. During the year ended June 30, 2013, Rex abandoned certain CIP projects resulting in losses of approximately \$16,783. These losses are reported as non-operating loss in the accompanying combined financial statements.

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(IN \$000's)

NOTE 6 CAPITAL ASSETS AND ACCUMULATED DEPRECIATION (CONTINUED)

At June 30, 2014 and 2013, equipment under capital obligations had a cost of approximately \$7,394 and accumulated amortization of approximately \$4,942 and \$2,494, respectively.

NOTE 7 LONG-TERM DEBT

A summary of long-term debt and changes in long-term debt for the years ended June 30, 2014 and 2013 is as follows:

	June 30, 2012	Borrowings	Payments and Amortization	June 30, 2013	Borrowings	Payments and Amortization	June 30, 2014
Series 2010A Bonds	\$ 119,847	\$ -	\$ (4,647)	\$ 115,200	\$ -	\$ (4,835)	\$ 110,365
Notes Payable	29,810	1,899	(4,898)	26,811	-	(1,838)	24,973
Obligations Under Capital Lease	3,583	-	(1,756)	1,827	1,056	(936)	1,947
	153,240	1,899	(11,301)	143,838	1,056	(7,609)	137,285
Bond Premium, Net	3,851	-	(366)	3,485	-	(356)	3,129
	<u>\$ 157,091</u>	<u>\$ 1,899</u>	<u>\$ (11,667)</u>	<u>\$ 147,323</u>	<u>\$ 1,056</u>	<u>\$ (7,965)</u>	<u>\$ 140,414</u>

Bonds Payable

In October 2010, Rex issued \$122,965 Series 2010A Health Care Facilities Revenue and Revenue Refunding Bonds (2010A Bonds) through the North Carolina Medical Care Commission ("Commission"). The proceeds were used to refund the previously outstanding 1998 Bonds, fund costs of construction and equipment related to the relocation of Rex's power plant, pay construction period interest, and pay for issuance costs for the 2010A Bonds.

The 2010A Bonds mature annually in amounts ranging from \$1,000 to \$8,130 and bear interest at rates between 2.00% and 5.00% for amounts maturing between 2011 and 2030. Under the agreements, the Obligated Group must also maintain a defined level of income available for debt service.

The 2010A Bonds are secured by a pledge of and a lien on the accounts receivable and the proceeds thereof derived from the ownership and operation of the Obligated Group. In the Master Indenture agreements for the 2010A Bonds, the Obligated Group includes Rex and the Hospital. Under the terms of the Master Indenture agreement for the 2010A Bonds, the Obligated Group is subject to certain financial covenants including but not limited to limitations on the transfer or sale of the Obligated Group's assets, limitations on the incurrence of additional indebtedness, maintenance of adequate insurance coverage on property, and maintenance of its tax-exempt status. Under the agreements, the Obligated Group must also maintain a defined level of income available for debt service. Rex believes the Obligated Group is in compliance with all debt covenants at June 30, 2014.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 7 LONG-TERM DEBT (CONTINUED)

Bonds Payable (Continued)

As a result of the early extinguishment of the 1998 Bonds, Rex incurred a loss of approximately \$1,947 during 2011. The loss has been deferred and is being amortized over the remaining life of the 1998 Bonds. At June 30, 2014 and 2013, accumulated amortization of the deferred loss was approximately \$879 and \$656, respectively.

Lines of Credit

The Hospital entered into a note agreement for a short-term revolving line of credit with a financial institution for an amount up to \$50,000 to support short-term normal operating expenses and to enhance liquidity. The line of credit is collateralized by the Hospital's accounts receivable. Interest is due and payable monthly at the monthly London Inter-Bank Offered Rate ("LIBOR") plus 1.25%. The outstanding principal amount along with any accrued interest will be due upon the maturity date of March 31, 2015. The Hospital has not drawn any proceeds on this line of credit, thus, at June 30, 2014 and 2013, there was no outstanding balance.

Notes Payable

During the year ended June 30, 2012, RWE entered into a note agreement with a financial institution for \$30,000 to pay off the remaining balance of a construction loan. The note is payable in monthly principal and interest payments of \$153 from April 5, 2012 through March 5, 2022. The note is collateralized by certain property of RWE.

Rex Physicians entered into a note agreement with a financial institution for \$72. The outstanding principal amount along with any accrued interest will be due in November 2014. This note payable was transferred to the Hospital as of December 31, 2013. The outstanding balance of the loan was \$11 and \$37 at June 30, 2014 and 2013, respectively.

Obligations Under Capital Lease

Rex has entered into non-cancellable capital lease obligations for several pieces of equipment as of June 30, 2014 which expire at various dates through 2018.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 7 LONG-TERM DEBT (CONTINUED)

Total future debt service requirements subsequent to June 30, 2014 are as follows:

	Bonds	Notes Payable	Obligations Under Capital Lease	Interest	Total
Year Ending June 30:					
2015	\$ 4,980	\$ 1,861	\$ 857	\$ 5,938	\$ 13,636
2016	5,175	1,154	795	5,691	12,815
2017	5,435	1,047	255	5,381	12,118
2018	5,645	1,086	40	5,129	11,900
2019	5,925	1,127	-	4,806	11,858
2020-2024	33,870	18,698	-	17,977	70,545
2025-2029	33,470	-	-	8,991	42,461
2030-2032	15,865	-	-	1,200	17,065
	<u>110,365</u>	<u>24,973</u>	<u>1,947</u>	<u>55,113</u>	<u>192,398</u>
Unamortized Bond Premium, Net	3,129	-	-	-	3,129
	<u>\$ 113,494</u>	<u>\$ 24,973</u>	<u>\$ 1,947</u>	<u>\$ 55,113</u>	<u>\$ 195,527</u>

NOTE 8 EMPLOYEE BENEFITS

Rex Employees' Retirement Plan

The Hospital sponsors the Rex Employees' Retirement Plan (the "Plan"), a single-employer defined benefit retirement plan available to eligible employees. The benefit formula is based on the highest five consecutive years of an employee's compensation during the 10 plan years preceding retirement.

During the year ended June 30, 2009, the Hospital amended the Plan to (1) reduce early retirement benefits by increasing the retirement age from 62 to 65, and (2) freeze access to the Plan for eligible employees hired after February 1, 2009. In addition, the Hospital revised certain actuarial assumptions to (1) change the amortization period for gains and losses from 10 to 30 years and (2) change the asset valuation method from 20% to 30% above and below market value.

Funding amounts for the Plan are based upon actuarial calculations. The Plan utilized the projected unit-credit method to determine the annual contributions. The Hospital contributed approximately \$12,911 and \$10,040 to the Plan in 2014 and 2013, respectively. There are no employee contributions to the Plan.

Plan assets held in trust on behalf of the Plan participants consisted primarily of equity securities, U.S. Treasury securities and corporate bonds at June 30, 2014 and 2013. The actuarial value of Plan assets was determined by using a five-year moving average method.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
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NOTE 8 EMPLOYEE BENEFITS (CONTINUED)

Rex Employees' Retirement Plan (Continued)

The following table shows the trend in Rex's annual pension cost (APC), percentage of APC contributed, and net pension asset:

	Trend Information		
	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Asset
<u>Fiscal Year Ending:</u>			
June 30, 2014	\$ (12,901)	100.00 %	\$ -
June 30, 2013	(10,040)	100.00	-
June 30, 2012	(8,020)	100.00	-

As of January 1, 2014, the most recent actuarial valuation date, the Plan was 73.5% funded. The actuarial accrued liability for benefits was approximately \$273,714 and the actuarial value of assets was approximately \$201,077 resulting in an unfunded actuarial accrued liability of approximately \$72,637. The covered payroll was approximately \$181,915 and the ratio of the unfunded actuarial accrued liability to the covered payroll was 39.9%.

The Schedule of Funding Progress, presented as Required Supplementary Information following the Notes to the Combined Financial Statements, presents multi-year trend information about whether the actuarial value of Plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The following assumptions were used in the January 1, 2014 and 2013 actuarial variations:

	2014	2013
Inflation Rate	3.00%	3.00%
Investment Rate of Return	7.50%	7.50%
Projected Salary Increases	3.00%	3.00%

Tax Deferred Annuity Retirement Plan

The Hospital sponsors a defined contribution retirement plan covering substantially all employees. The Hospital matches one-half of each participant's voluntary contributions on a graduated scale based on length of service not to exceed 5% of the participant's annual salary. Employer contributions totaled approximately \$9,194 and \$10,415 for the years ended June 30, 2014 and 2013, respectively.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 9 RELATED PARTY TRANSACTIONS

UNCHCS provides and receives certain shared services (primarily information technology, revenue cycle, and administration) to Rex and other affiliated entities. Rex provided approximately \$27,692 of shared services to UNCHCS and Rex received shared services of approximately \$49,286 for the year ended June 30, 2014.

UNCHCS provides and receives certain services with Rex. Rex paid UNCHCS approximately \$4,995 for such services during the year ended June 30, 2013. UNCHCS paid Rex approximately \$839 for such services during the year ended June 30, 2013.

Under a management agreement effective January 1, 2000, UNCHCS assumed responsibility for the management and day-to-day operations of Rex Home Services, Inc., which became a division of the Hospital during 2013. During the years ended June 30, 2014 and 2013, this agreement resulted in approximately \$0 paid to UNCHCS.

Rex contributed approximately \$28,911 and \$34,273 to UNCHCS during 2014 and 2013, respectively, to help fund working capital needs at UNCHCS which includes new hospital affiliates and UNC Physicians Network, LLC ("UNCPN"), of which UNCHCS is the sole member. UNCPN provides health care to patients throughout the Triangle and surrounding counties in North Carolina. Rex also contributed \$6,054 and \$3,744 during the years ended June 30, 2014 and 2013, respectively, to the UNCHCS Enterprise Fund to support the ongoing health care mission of UNCHCS.

Net payables due to UNCHCS were approximately \$36,812 and \$6,438 as of June 30, 2014 and 2013, respectively, and are included in accrued expenses and other liabilities in the accompanying combined statements of net position.

In 2014 Rex entered into a note receivable with UNCHCS for funding the electronic health record system. UNCHCS can draw up to approximately \$43,000 on this note. Unpaid principal shall bear interest at 2.5% until paid in full. Principal and any accrued interest shall be repaid in equal monthly installments with final payment in July 2024. As of June 30, 2014 the outstanding note receivable balance was approximately \$23,668.

The Hospital paid QTS approximately \$1,379 and \$1,508 for laundry services during the years ended June 30, 2014 and 2013, respectively.

The Hospital paid Rex Cary MOB, LLC approximately \$402 and \$296 in rent expenditures for the use of surgical and office suites during the years ended June 30, 2014 and 2013, respectively.

Rex MOB Partners, LLC paid the Hospital approximately \$289 and \$282 for rent during the years ended June 30, 2014 and 2013, respectively.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 10 COMMITMENTS, CONTINGENCIES, AND RISK MANAGEMENT

Commitments

The Hospital has entered into a lease with Wellness to lease the wellness center. In addition, the Hospital entered into a lease with MOB for part of the medical office building. Rex has certain other noncancellable operating leases for the rental of office space and equipment. Future rent payments under these leases subsequent to June 30, 2014 are as follows:

Year Ending June 30:	Wellness Center	Medical Office Building	Office Space and Equipment	Total
2015	\$ 862	\$ 2,253	\$ 7,986	\$ 11,101
2016	862	2,286	6,944	10,092
2017	862	2,300	6,252	9,414
2018	862	1,865	5,798	8,525
2019	902	1,900	5,463	8,265
2020-2024	4,697	9,329	20,027	34,053
2025-2029	4,439	8,964	2,425	15,828
	<u>\$ 13,486</u>	<u>\$ 28,897</u>	<u>\$ 54,895</u>	<u>\$ 97,278</u>

Total rental expense, including rental expense under noncancellable leases, was approximately \$16,275 and \$15,852 for the years ended June 30, 2014 and 2013, respectively.

Contingencies

The Hospital self-insures a portion of its workers' compensation exposure up to \$350 per claim. An accrual for the self-insurance program is established to provide for estimated claims and losses and applicable legal expenses for claims incurred through June 30, 2014 but not reported. This accrual was determined by an actuary and totaled approximately \$1,984 and \$2,373 at June 30, 2014 and 2013, respectively. The accrual is included in accrued expenses and other liabilities in the accompanying combined statements of net position. Commercial insurance has been obtained for coverage in excess of the self-insured amounts.

The Hospital self-insures a portion of its employee health benefits exposure up to \$200 per incident. An accrual for the self-insurance program is established to provide for estimated claims and losses and applicable legal expenses for claims incurred through June 30, 2014 but not reported. This accrual was determined by an actuary and totaled approximately \$4,372 and \$2,456 at June 30, 2014 and 2013, respectively. The accrual is included in accrued expenses and other liabilities in the accompanying combined statements of net position. Commercial insurance has been obtained for coverage in excess of the self-insured amounts.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 10 COMMITMENTS, CONTINGENCIES, AND RISK MANAGEMENT (CONTINUED)

Contingencies (Continued)

The health care industry is subject to numerous laws and regulations of Federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers.

Management believes Rex is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayment for patient services previously billed.

Risk Management

Rex is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; employee health, dental, and accident benefits; and medical malpractice. Commercial insurance and stop loss coverage is purchased for claims arising from such matters, subject to various deductibles.

Rex maintains professional and general liability insurance coverage in excess self-insured retention limits in 2014 was on a claims-made basis (i.e., \$1,000,000 for any one claim and \$3,000,000 for aggregate annual claims). To the extent that any claims-made coverage is not renewed or replaced with equivalent insurance, claims based on occurrences during the term of such coverage, but reported subsequently, would be uninsured. Management believes, based on incidents identified through the Hospital's incident reporting system, that any such claims would not have a material effect on Rex's operations or financial position. In any event, management anticipates that the claims-made coverage currently in place will be renewed or replaced with equivalent insurance as the term of such coverage expires.

Rex is involved in litigation arising in the normal course of business. After consultation with legal counsel, management estimates these matters will be resolved without a material adverse effect on Rex's financial position or results of operations.

NOTE 11 CONCENTRATIONS OF CREDIT RISK

Rex provides services primarily to residents of Wake and surrounding counties without collateral or other proof of ability to pay. Concentrations of credit risk with respect to patient accounts receivable are limited due to large numbers of patients served and formalized agreements with third-party payors. Rex has significant accounts receivable whose collectability is dependent upon the performance of certain governmental programs, primarily Medicare. Management does not believe there are significant credit risks associated with these governmental programs.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 11 CONCENTRATIONS OF CREDIT RISK (CONTINUED)

The aggregate mix of accounts receivable from patients and third-party payors was as follows at June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Medicare	18 %	25 %
Medicaid	2	3
Managed Care	17	20
Self Pay	36	22
Other	27	30
Total	<u>100 %</u>	<u>100 %</u>

NOTE 12 ELECTRONIC HEALTH RECORD INCENTIVE PROGRAM

The Electronic Health Record (EHR) incentive program was enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA) and the Health Information Technology for Economic and Clinical Health (HITECH) Act. These Acts provided for incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified EHR technology. The incentive payments are made based on a statutory formula and are contingent on Rex's continuing to meet the escalating meaningful use criteria. For the first payment year, Rex must attest, subject to an audit, that it met the meaningful use criteria for a continuous 90-day period. For the subsequent payment year, Rex must demonstrate meaningful use for the entire year. The incentive payments are generally made over a 4-year period.

Rex demonstrated meaningful use to the 90-day period ended September 30, 2011, and received the first tentative incentive payments of approximately \$2,512 in March 2012. Of the \$2,512 received, \$2,012 was recognized as other operating revenue in the statement of revenues, expenses, and changes in net assets. Rex received an additional \$3,756 during the year ended June 30, 2014. The final amount of these payments will be determined based on audit of the information from Rex's Medicare cost report for the year ended June 30, 2011. Events could occur that would cause the final payment to differ materially upon final settlement.

NOTE 13 COMMUNITY BENEFITS

In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, Rex also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced rates. Rex sponsors many community health initiatives, including breast and prostate cancer screenings, cardiovascular and pulmonary awareness and diabetes education programs that ultimately result in the overall improved health of our community. The Rex Healthcare Emergency Response Team provides emergency aid and medical treatment at special events in the Wake County area. Rex also provides contributions, cash and in-kind, to various charitable and community organizations. The costs of these programs are included in operating expenses in the accompanying statements of revenues, expenses and changes in net assets.

REX HEALTHCARE, INC. AND SUBSIDIARIES
NOTES TO COMBINED FINANCIAL STATEMENTS
JUNE 30, 2014 AND 2013
(IN \$000's)

NOTE 14 ADOPTION OF NEW ACCOUNTING STANDARD

In March 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. Prior to the adoption of this standard, Rex amortized deferred financing costs over the life of the related debt. Rex also presented the deferred loss on refunding as a component of debt in the liabilities section of the combined statement of net position.

The below table summarizes the impact of the standard on the combined financial statements as of and for the year ended June 30, 2013:

	Pre-Adoption Balance	Change	Post-Adoption Balance
OTHER ASSETS			
Deferred Bond Issuance Costs, Net	\$ 1,163	\$ (1,163)	\$ -
TOTAL OTHER ASSETS	13,607	(1,163)	12,444
TOTAL ASSETS	718,256	(1,163)	717,093
DEFERRED OUTFLOWS OF RESOURCES			
Loss on Refunding of Debt	-	1,291	1,291
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	718,256	128	718,384
LONG-TERM DEBT, NET OF CURRENT MATURITIES	138,633	1,291	139,924
TOTAL LIABILITIES	261,176	1,291	262,467
NET POSITION			
Unrestricted	314,650	(1,163)	313,487
TOTAL NET POSITION	457,080	(1,163)	455,917
TOTAL NET POSITION, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	718,256	128	718,384
OTHER OPERATING EXPENSES			
Interest Expense	5,165	(122)	5,043
TOTAL OPERATING EXPENSES	686,150	(122)	686,028
OPERATING INCOME	45,231	122	45,353
EXCESS OF REVENUES AND GAINS OVER EXPENSES AND LOSSES	46,048	122	46,170
CHANGE IN NET POSITION	8,887	122	9,009
NET POSITION - BEGINNING OF YEAR	448,193	(1,285)	446,908
NET POSITION - END OF YEAR	457,080	(1,163)	455,917

SUPPLEMENTARY INFORMATION

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINING STATEMENT OF NET POSITION
JUNE 30, 2014
(IN \$000's)

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	<u>Obligated Group</u>	<u>Nonobligated Group</u>	<u>Eliminations</u>	<u>Combined Rex Healthcare, Inc. and Subsidiaries</u>
CURRENT ASSETS				
Cash and Cash Equivalents	\$ 55,810	\$ 3,364	\$ -	\$ 59,174
Patient Accounts Receivable, Net	86,591	-	-	86,591
Other Receivables	10,259	9,648	3,806	23,713
Inventories	13,398	-	-	13,398
Prepaid Expenses and Other Current Assets	5,068	560	-	5,628
Total Current Assets	<u>171,126</u>	<u>13,572</u>	<u>3,806</u>	<u>188,504</u>
ASSETS LIMITED AS TO USE	287,048	7,702	-	294,750
CAPITAL ASSETS, NET	261,765	24,821	-	286,586
OTHER ASSETS				
Investment in Affiliates	10,574	4,985	(4,014)	11,545
Other Assets	23,040	2,606	(1,987)	23,659
Total Other Assets	<u>33,614</u>	<u>7,591</u>	<u>(6,001)</u>	<u>35,204</u>
Total Assets	753,553	53,686	(2,195)	805,044
DEFERRED OUTFLOWS OF RESOURCES				
Loss on Refunding of Long-Term Debt	1,068	-	-	1,068
Total Assets and Deferred Outflows of Resources	<u>\$ 754,621</u>	<u>\$ 53,686</u>	<u>\$ (2,195)</u>	<u>\$ 806,112</u>
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION				
CURRENT LIABILITIES				
Current Maturities of Long-Term Debt	\$ 6,725	\$ 973	\$ -	\$ 7,698
Vendor Accounts Payable	50,490	476	-	50,966
Accrued Expenses and Other Liabilities	99,726	5,749	3,806	109,281
Estimated Third-Party Settlements	24,340	-	-	24,340
Total Current Liabilities	<u>181,281</u>	<u>7,198</u>	<u>3,806</u>	<u>192,285</u>
LONG-TERM DEBT, NET	109,750	22,966	-	132,716
OTHER NONCURRENT LIABILITIES	3,508	-	(1,987)	1,521
Total Liabilities	<u>294,539</u>	<u>30,164</u>	<u>1,819</u>	<u>326,522</u>
NET POSITION				
Net Investment in Capital Assets	145,290	882	-	146,172
Restricted	954	4,718	-	5,672
Unrestricted	313,838	17,922	(4,014)	327,746
Total Net Position	<u>460,082</u>	<u>23,522</u>	<u>(4,014)</u>	<u>479,590</u>
Total Liabilities, Deferred Inflows of Resources, and Net Position	<u>\$ 754,621</u>	<u>\$ 53,686</u>	<u>\$ (2,195)</u>	<u>\$ 806,112</u>

REX HEALTHCARE, INC. AND SUBSIDIARIES
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2014
(IN \$000's)

	Obligated Group	Nonobligated Group	Eliminations	Rex Healthcare, Inc. and Subsidiaries
OPERATING REVENUES				
Net Patient Service Revenue	\$ 681,719	\$ 30,735	\$ -	\$ 712,454
Other Operating Revenues	34,370	2,974	-	37,344
Total Operating Revenues	<u>716,089</u>	<u>33,709</u>	-	<u>749,798</u>
OPERATING EXPENSES				
Salaries	303,890	28,956	-	332,846
Employee Benefits	70,629	3,731	-	74,360
Medical Supplies and Other Expenses	287,733	7,069	(2,715)	292,087
Depreciation and Amortization	30,594	468	-	31,062
Interest	4,951	6	-	4,957
Total Operating Expenses	<u>697,797</u>	<u>40,230</u>	<u>(2,715)</u>	<u>735,312</u>
OPERATING INCOME (LOSS)	18,292	(6,521)	2,715	14,486
NONOPERATING INCOME (LOSS)				
Investment Income (Loss), Net	38,171	5,929	-	44,100
Other, Net	1,638	1,140	(2,715)	63
Nonoperating Income (Loss), Net	<u>39,809</u>	<u>7,069</u>	<u>(2,715)</u>	<u>44,163</u>
EXCESS OF REVENUES AND GAINS OVER EXPENSES AND LOSSES	58,101	548	-	58,649
CONTRIBUTIONS TO RELATED PARTY	(34,965)	-	-	(34,965)
OTHER	<u>(37,652)</u>	<u>40,157</u>	<u>(2,516)</u>	<u>(11)</u>
CHANGE IN NET POSITION	(14,516)	40,705	(2,516)	23,673
Net Position - Beginning of Year	<u>474,598</u>	<u>(17,183)</u>	<u>(1,498)</u>	<u>455,917</u>
NET POSITION - END OF YEAR	<u>\$ 460,082</u>	<u>\$ 23,522</u>	<u>\$ (4,014)</u>	<u>\$ 479,590</u>

REX HEALTHCARE, INC. AND SUBSIDIARIES
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF FUNDING PROGRESS FOR REX EMPLOYEES' RETIREMENT PLAN
(UNAUDITED)
JUNE 30, 2014
(IN \$000's)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
January 1, 2014	\$ 201,077	\$ 273,714	\$ 72,637	73.46 %	\$ 181,915	39.93 %
January 1, 2013	177,497	250,134	72,637	70.96	184,796	39.31
January 1, 2012	166,265	215,516	49,251	77.15	185,343	26.57
January 1, 2011	158,693	188,633	29,940	84.13	190,434	15.72
January 1, 2010	149,019	171,627	22,608	86.83	199,427	11.34
January 1, 2009	140,562	155,914	15,352	90.15	173,000	8.87

The actuarial accrued liability is being amortized over a ten-year period on an open basis using the level-dollar method.