

THE JOHNS HOPKINS HEALTH SYSTEM CORPORATION AND AFFILIATES

**Combined Financial Statements
June 30, 2014 and 2013**

The Johns Hopkins Health System Corporation and Affiliates

Index

June 30, 2014 and 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
The Johns Hopkins Health System Corporation and Affiliates:

We have audited the accompanying combined financial statements of The Johns Hopkins Health System Corporation and Affiliates ("JHHS"), which comprise the combined balance sheets as of June 30, 2014 and 2013, and the related combined statements of operations and changes in net assets, and cash flows for the years then ended.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditor's Responsibility

Our responsibility is to express an opinion on the 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 audit 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 our 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, we consider internal control relevant to the JHHS' 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 the JHHS' 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 JHHS at June 30, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Tricewaterhouse LLP

September 25, 2014

The Johns Hopkins Health System Corporation and Affiliates
Combined Balance Sheets
June 30, 2014 and 2013
(in thousands)

ASSETS	2014	2013
Current assets:		
Cash and cash equivalents	\$ 569,702	\$ 510,493
Short-term investments	117,905	77,962
Assets whose use is limited - used for current liabilities	16,282	18,876
Patient accounts receivables, net of estimated uncollectibles of \$158,664 and \$162,384 as of June 30, 2014 and 2013, respectively	522,942	518,792
Due from others, current portion	35,964	41,046
Due from affiliates, current portion	20,764	26,861
Inventories of supplies	87,868	87,958
Estimated malpractice recoveries, current portion	224,902	28,590
Prepaid expenses and other current assets	53,978	59,811
Total current assets	<u>1,650,307</u>	<u>1,370,389</u>
Assets whose use is limited		
By long-term debt agreement for:		
Debt service reserve funds	4,955	4,955
Construction fund	150,811	-
By donors or grantors for:		
Future campus development	1,113	984
Pledges receivable	28,077	28,540
Other	95,910	87,554
By Board of Trustees	841,216	746,170
Interest in net assets of Howard Hospital Foundation	13,644	13,903
Other	20,896	18,243
Total assets whose use is limited	<u>1,156,622</u>	<u>900,349</u>
Investments	<u>1,576,615</u>	<u>1,318,855</u>
Property, plant and equipment	4,386,047	4,188,895
Less: allowance for depreciation and amortization	<u>(1,621,180)</u>	<u>(1,422,685)</u>
Total property, plant and equipment, net	<u>2,764,867</u>	<u>2,766,210</u>
Due from affiliates, net of current portion	<u>90,888</u>	<u>63,606</u>
Due from others, net of current portion	<u>2,796</u>	<u>3,796</u>
Estimated malpractice recoveries, net of current portion	<u>42,260</u>	<u>56,177</u>
Swap counterparty deposit	<u>80,330</u>	<u>72,840</u>
Other assets	<u>49,376</u>	<u>44,938</u>
Total assets	<u><u>\$7,414,061</u></u>	<u><u>\$6,597,160</u></u>

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

The Johns Hopkins Health System Corporation and Affiliates
Combined Balance Sheets, continued
June 30, 2014 and 2013
(in thousands)

LIABILITIES AND NET ASSETS	2014	2013
Current liabilities:		
Current portion of long-term debt and obligations under capital leases	\$ 98,705	\$ 43,496
Accounts payable and accrued liabilities	511,398	463,864
Medical claims reserve	74,627	76,987
Deferred revenue	88,561	67,942
Due to affiliates, current portion	10,110	7,220
Accrued vacation	65,385	65,225
Advances from third-party payors	140,112	128,360
Current portion of estimated malpractice costs	234,885	41,218
Total current liabilities	<u>1,223,783</u>	<u>894,312</u>
Long-term debt and obligations under capital leases, net of current portion	1,633,116	1,488,320
Estimated malpractice costs, net of current portion	126,747	129,841
Net pension liability	448,835	408,124
Interest rate swap liabilities	190,621	184,417
Other long-term liabilities	63,433	62,539
Total liabilities	<u>3,686,535</u>	<u>3,167,553</u>
Net assets:		
Unrestricted	3,501,484	3,215,011
Temporarily restricted	167,451	157,874
Permanently restricted	58,591	56,722
Total net assets	<u>3,727,526</u>	<u>3,429,607</u>
Total liabilities and net assets	<u>\$7,414,061</u>	<u>\$6,597,160</u>

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

The Johns Hopkins Health System Corporation and Affiliates
Combined Statements of Operations and Changes in Net Assets
for the years ended June 30, 2014 and 2013
(in thousands)

	2014	2013
Operating revenues:		
Net patient service revenue before provision for bad debts	\$ 4,726,648	\$ 4,577,945
Provision for bad debts	141,364	144,051
Net patient service revenue	4,585,284	4,433,894
Other revenue	479,225	470,674
Investment income	53,210	48,609
Net assets released from restrictions used for operations	7,806	6,615
Total operating revenues	5,125,525	4,959,792
Operating expenses:		
Salaries, wages and benefits	2,035,990	2,017,016
Purchased services	1,813,942	1,748,391
Supplies and other	783,493	715,538
Interest	39,038	40,037
Depreciation and amortization	266,226	263,011
Total operating expenses	4,938,689	4,783,993
Income from operations	186,836	175,799
Non-operating revenues and expenses:		
Interest expense on swap agreements	(27,832)	(27,811)
Change in fair value of swap agreements	(6,201)	95,103
Change in realized and unrealized gains on investments	218,948	129,701
Other non-operating expenses	(14,480)	(22,494)
Excess of revenues over expenses before noncontrolling interests	357,271	350,298
Noncontrolling interests	(18,965)	(11,270)
Excess of revenues over expenses	338,306	339,028
Contributions to affiliates	(8,268)	(4,314)
Change in funded status of defined benefit plans	(68,722)	185,360
Net assets released from restrictions used for purchases of property, plant, and equipment	6,295	16,064
Noncontrolling interests	18,965	11,270
Other	(103)	(320)
Increase in unrestricted net assets	286,473	547,088
Changes in temporarily restricted net assets:		
Gifts, grants and bequests	26,500	29,207
Net change in Howard Hospital Foundation	(417)	675
Net assets released from restrictions used for purchases of property, plant, and equipment	(6,295)	(16,064)
Net assets released from restrictions used for operations	(7,806)	(6,615)
Other	(2,405)	(1,021)
Increase in temporarily restricted net assets	9,577	6,182
Changes in permanently restricted net assets:		
Gifts, grants and bequests	1,711	4,385
Net change in Howard Hospital Foundation	158	-
Increase in permanently restricted net assets	1,869	4,385
Increase in net assets	297,919	557,655
Net assets at beginning of year	3,429,607	2,871,952
Net assets at end of year	\$ 3,727,526	\$ 3,429,607

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

The Johns Hopkins Health System Corporation and Affiliates
Combined Statements of Cash Flows
for the years ended June 30, 2014 and 2013
(in thousands)

	2014	2013
Operating activities:		
Change in net assets	\$ 297,919	\$ 557,655
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	267,158	263,779
Provision for bad debts	141,364	144,051
Net realized and changes in unrealized gains on investments	(219,182)	(130,348)
Change in fair value of swap agreements	6,201	(95,103)
Change in funded status of defined benefit plans	68,722	(185,360)
Restricted contributions and investment income received	(23,394)	(25,340)
Gains on and returns on equity investments	(14,354)	(10,363)
Other operating activities	(1,702)	5,702
Change in assets and liabilities:		
Patient accounts receivables	(141,879)	(222,036)
Inventories of supplies, prepaid expenses and other current assets	(139,660)	(10,872)
Due from affiliates, net	(17,681)	15,803
Pledges receivable	466	(1,810)
Swap counterparty deposit and other assets	(11,628)	53,104
Accounts payable, accrued liabilities and accrued vacation	40,499	23,522
Medical claims reserve	(3,294)	5,777
Deferred revenue	25,164	(2,533)
Advances from third-party payors	11,324	(554)
Accrued pension benefit costs	(28,011)	47,431
Estimated malpractice costs	158,901	15,562
Other long-term liabilities	(217)	(1,439)
Net cash and cash equivalents provided by operating activities	<u>416,716</u>	<u>446,628</u>
Investing activities:		
Purchases of property, plant and equipment	(260,082)	(195,702)
Return of equity investments	2,054	151
Purchases of investment securities	(3,986,405)	(2,479,155)
Sales of investment securities	3,670,349	2,316,412
Payments received on Affiliate notes	36,058	-
Advances on Affiliate notes	(33,930)	(62,401)
Other investing activities	(752)	1,153
Net cash and cash equivalents used in investing activities	<u>(572,708)</u>	<u>(419,542)</u>
Financing activities:		
Proceeds from restricted contributions and investment income received	23,394	25,340
Proceeds from long-term borrowings	247,000	567,935
Repayment of long-term debt and obligations under capital lease	(46,737)	(490,162)
Distributions attributable to noncontrolling interests	(6,692)	(3,035)
Other financing activities	(1,764)	(3,710)
Net cash and cash equivalents provided by financing activities	<u>215,201</u>	<u>96,368</u>
Change in cash and cash equivalents	59,209	123,454
Cash and cash equivalents at beginning of year	<u>510,493</u>	<u>387,039</u>
Cash and cash equivalents at end of year	<u>\$ 569,702</u>	<u>\$ 510,493</u>

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

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

1. Organization and Summary of Significant Accounting Policies

Organization. The Johns Hopkins Health System Corporation ("JHHSC") is incorporated in the State of Maryland to, among other things, formulate policy among and provide centralized management for JHHSC and Affiliates ("JHHS"). In addition, it provides certain shared services including finance, human resources, payroll, accounts payable, purchasing, patient financial services, legal, and other functions. JHHS is organized and operated for the purpose of promoting health by functioning as a parent holding company of affiliates whose combined mission is to provide patient care in the treatment and prevention of human illness which compares favorably with that rendered by any other institution in this country or abroad.

JHHSC is the sole member of The Johns Hopkins Hospital ("JHH"), an academic medical center, Johns Hopkins Bayview Medical Center, Inc. ("JHBMC"), a community based teaching hospital, Howard County General Hospital, Inc. ("HCGH"), a community based hospital, Suburban Hospital, Inc. ("SHI"), a community based hospital, Sibley Memorial Hospital ("SMH"), a community based hospital, All Children's Hospital, Inc. ("ACH"), an academic children's hospital, Suburban Hospital Healthcare System, Inc. ("SHHS"), a diverse healthcare system, All Children's Health System ("ACHS"), a diverse healthcare system, Johns Hopkins Community Physicians ("JHCP"), a community based physician practice group, The Johns Hopkins Medical Services Corporation ("JHMSC"), the contracting entity for the Uniformed Services Family Health Plan contract, and the HCGH OB/GYN Associates Series, LLC ("HCOB"), a taxable community based obstetrics and gynecology practice. JHHSC is also the sole shareholder of Howard County Health Services, Inc. ("HCSI"), a taxable entity organized to hold interests in various health care enterprises, Johns Hopkins Medical Management Corp. ("JHMMC"), a taxable entity organized to provide temporary nursing and clerical staffing and to promote ambulatory care arrangements in support of JHHS, and Johns Hopkins Employer Health Programs, Inc. ("EHP"), a taxable third-party administrator for employee health benefit plans self-funded by the constituent employee sponsors. JHHSC owns a 99.7% interest in Ophthalmology Associates, LLC ("OA"), a taxable professional services organization which operates an ophthalmology center at Green Spring Station. JHHSC and the Johns Hopkins University (the "University") each own a 50% membership interest in Johns Hopkins HealthCare LLC ("JHHC"), a taxable managed care entity supporting JHHS and the University in cooperative strategies by which patient care, education, and research may be advanced. JHHSC consolidates JHHC. These entities are all consolidated operating entities and are collectively known as the "Affiliates".

Use of estimates. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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.

Basis of presentation. The accompanying combined financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Principles of combination. The combined financial statements include the accounts of JHHSC and all Affiliates after elimination of all significant intercompany accounts and transactions.

Cash and cash equivalents. Cash and cash equivalents include amounts invested in accounts with depository institutions which are readily convertible to cash, with original maturities of three months or less. Total deposits maintained at these institutions at times exceed the amount insured by federal agencies and therefore, bear a risk of loss. JHHS has not experienced such losses on these funds.

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

Through arrangements with banks, excess operating cash is invested daily. This investment is considered a cash equivalent in the accompanying Combined Balance Sheets. JHHS earns interest on these funds at a rate that is based upon the bank's Federal Funds rate. The interest is recorded in the Combined Statements of Operations and Changes in Net Assets as investment income.

Inventories of supplies. Inventories of supplies are composed of medical supplies, drugs, linen, and parts inventory for repairs. Inventories of supplies are recorded at lower of cost or market using a first in, first out method.

Assets whose use is limited. Assets whose use is limited or restricted by the donor are recorded at fair value at the date of donation. Investment income or losses on investments of temporarily or permanently restricted assets is recorded as an increase or decrease in temporarily or permanently restricted net assets to the extent restricted by the donor or law. The cost of securities sold is based on the specific identification method.

Assets whose use is limited include assets held by trustees under debt agreements, assets restricted by the board of trustees, pledges receivable, beneficial interest remainder trusts, interest in the net asset of Howard Hospital Foundation, and net asset set aside pursuant to their temporarily and permanently restricted nature. These assets consist primarily of cash and short term investments, accrued interest and pledges receivable. The carrying amounts reported in the Combined Balance Sheets represent fair value.

Investments and investment income. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the Combined Balance Sheets. Debt and equity securities traded on a national securities and international exchange are valued as of the last reported sales price on the last business day of the fiscal year; investments traded on the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and ask prices.

Investments include equity method investments in managed funds, which include hedge funds, private partnerships and other investments which do not have readily ascertainable fair values and may be subject to withdrawal restrictions. Investments in hedge funds, private partnerships, and other investments in managed funds (collectively "alternative investments"), are accounted for under the equity method. The equity method income or loss from these alternative investments is included in the Combined Statements of Operations and Changes in Net Assets as an unrealized gain or loss above excess of revenues over expenses.

Alternative investments are less liquid than other types of investments held by JHHS. These instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments, and nondisclosure of portfolio composition.

Investment income earned on cash and investment balances (interest and dividends) is reported in the operating income section of the Combined Statements of Operations and Changes in Net Assets under 'Investment income'. Realized gains or losses related to the sale of investments, and unrealized gains or losses on alternative investments are included in the non-operating section of the Combined Statements of Operations and Changes in Net Assets included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

Investments in companies in which JHHS does not have control, but has the ability to exercise significant influence over operating and financial policies, are accounted for using the equity method of accounting, and operating results flow through investment income on the Combined Statements of Operations and Changes in Net Assets. Dividends received are recorded as a reduction of the carrying amount of the investment.

Investments in companies in which JHHS does not have control, nor has the ability to exercise significant influence over operating and financial policies, are accounted for using the cost method of accounting. Investments are originally recorded at cost, with dividends received being recorded as investment income.

Property, plant and equipment. Property, plant and equipment acquisitions are recorded at cost. Equipment is recorded as an asset if the individual cost is at least \$5 thousand and the useful life is at least two years. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of lease term or estimated useful life of the equipment. Estimated useful lives assigned by JHHS range from 5 to 25 years for land improvements, 3 to 40 years for buildings and improvements, 2 to 25 years for fixed and movable equipment, and 5 to 20 years for leasehold improvements. Interest costs incurred on borrowed funds, net of income earned, during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Repair and maintenance costs are expensed as incurred. When property, plant and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operating income.

The cost of software is capitalized provided the cost of the project is at least \$30 thousand (\$100 thousand for JHH) and the expected life is at least two years. Costs include payment to vendors for the purchase of software and assistance in its installation, payroll costs of employees directly involved in the software installation, and capitalized interest costs of the software project. Preliminary costs to document system requirements, vendor selection, and any costs incurred before the software purchase are expensed. Capitalization of costs ends when the project is completed and is ready to be used. Where implementation of the project is in phases, only those costs incurred which further the development of the project are capitalized. Costs incurred to maintain the system are expensed.

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

Impairment of long-lived assets. Long-lived assets are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. JHHS' policy is to record an impairment loss when it is determined that the carrying amount of the asset exceeds the sum of the expected undiscounted future cash flows resulting from use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value and are reported in the non-operating section of the Combined Statements of Operations and Changes in Net Assets. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell. No material impairment charges were recorded in 2014 or 2013.

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

Financing expenses. Financing expenses incurred in connection with the issuance of debt have been capitalized and are included in other assets in the Combined Balance Sheets. The expenses are being amortized over the terms of the related debt issues using the effective interest method. The total amount capitalized as of June 30, 2014 and 2013 was \$7.4 million and \$6.8 million, respectively. The total amount expensed for the period ended June 30, 2014 and 2013 was \$721 thousand and \$1.1 million, respectively.

Intangible asset. In connection with the acquisition of ACH in 2011, an intangible asset for the trade name "All Children's Hospital" of \$11.7 million was recognized, and is recorded in other long-term assets on the Balance Sheets. The trade name is considered to have an indefinite useful life and is not amortized into results of operations. The trade name is reviewed for impairment annually or more often if impairment indicators arise. No impairment charges were recorded for the years ended June 30, 2014 and 2013.

Medical claims reserve. JHHC's medical claims reserve is an estimate of payments to be made for reported claims and losses incurred but not reported. The estimate was developed using actuarial methods based upon historical data for payment patterns, cost trends, and other relevant factors. The estimate is continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operating income.

Deferred revenue. JHHC's capitated receipts received in advance for future services to be provided are recorded as deferred revenue.

Accrued vacation. JHHS records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior periods.

Advances from third-party payors. JHHS receives advances from some of its third-party payors so that those payors can receive the stated prompt pay discount allowed in the State of Maryland. Advances are recorded as a liability in the Combined Balance Sheets.

Estimated malpractice costs. The provision for estimated medical malpractice claims includes estimates of the ultimate gross costs for both reported claims and claims incurred but not reported. Additionally, an insurance recovery has been recorded representing the amount expected to be recovered from the self-insured captive insurance company.

Swap agreements. The value of the interest rate swap agreements entered into by JHHS are adjusted to fair value monthly at the close of each accounting period based upon quotations from market makers. The change in fair value, if any, is recorded in the Statement of Operations and Changes in Net Assets. Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the Balance Sheets. Such risks involve the possibility that there will be no liquid market for these agreements. The counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates.

Noncontrolling interests. JHHC is owned by JHHSC and the University, each member having a 50% interest. JHHC's profits are divided between the members based on product line. Based on control, JHHSC consolidates JHHC and records noncontrolling interests for the profits attributable to the University. Additionally, JHHC owns a 50% interest in Priority Partners Managed Care Organization, Inc. ("Priority Partners"), a for-profit joint venture. Based on control, JHHC consolidates Priority Partners and records noncontrolling interests for 50% of the profits.

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

Asset retirement obligations. Accounting for asset retirement obligations provides for the recognition of an estimated liability for legal obligations associated with the retirement of tangible long-lived assets, including obligations that are conditional upon a future event. JHHS measures asset retirement obligations at fair value when incurred and capitalizes a corresponding amount as part of the related long-lived assets. The increase in the capitalized cost is included in determining depreciation expense over the estimated useful life of these assets. Since the fair value of the asset retirement obligation is determined using a present value approach, accretion of the obligation due to the passage of time until its settlement is recognized each year as part of interest expense in the Combined Statements of Operations and Changes in Net Assets.

Temporarily and permanently restricted net assets. Temporarily restricted net assets are those whose use has been limited by donors or law to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Income generated from these assets is available as restricted by the donor or for general program support.

Donor restricted gifts. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Unconditional promises to give cash to JHHS greater than one year are discounted using a rate of return that a market participant would expect to receive at the date the pledge is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose for the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Combined Statements of Operations and Changes in Net Assets as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the Combined Statements of Operations and Changes in Net Assets.

Grants. JHHS receives various grants from individuals and agencies of the Federal and State Governments for the purpose of furthering its mission of providing patient care. Grants are recognized as support and the related project costs are recorded as expenses when services related to grants are incurred. Grant receivables are included in due from others in the Combined Balance Sheets and grant income is included in other revenue in the Combined Statements of Operations and Changes in Net Assets.

Managed care revenues. Premium revenue is recognized during the period in which JHHC or Priority Partners is obligated to provide services to its enrollees. Global contract revenue is based on global rate agreements with various third-party payors who, based on medical procedures, pay contractual packaged prices. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered. Management fees represent capitated payments for management services from Johns Hopkins University, JHMSC, and EHP are recognized when obligated to provide the service.

Other revenue. In July 2012, SHI was awarded a \$25.0 million settlement from a binding arbitration case with Healthcare Initiative Foundation ("HIF"), a separate foundation that held SHI's endowment funds, for breach of trust. SHI received the \$25.0 million settlement in October 2012 and recorded the revenue in other operating revenue in fiscal year 2013. Additionally, other revenues contain ancillary services such as discharge pharmacies and shared services provided to non-consolidating affiliates.

The Johns Hopkins Health System Corporation and Affiliates

Notes to Combined Financial Statements

for the years ended June 30, 2014 and 2013

Excess of revenues over expenses. The Combined Statements of Operations and Changes in Net Assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include, among other items, changes in unrealized gains and losses on investments other than trading securities, change in funded status of defined benefit plans, changes in accounting principle, permanent transfers of assets to and from affiliates for other than goods or services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Non-operating revenues and expenses. Transactions deemed by management to be ongoing, significant, or central to the provision of health care services are reported as operating revenues and expenses. Peripheral or incidental transactions are reported as non-operating revenues or expenses. JHH has entered into an agreement to support capital improvements to the Johns Hopkins University School of Medicine's ("JHUSOM") infrastructure at the John Hopkins Hospital's East Baltimore campus through annual contributions. These contributions amounted to \$7.1 million and \$7.2 million for the years ended June 30, 2014 and 2013, respectively, and are recognized each year as other non-operating expenses in the Statements of Operations and Changes in Net Assets.

Income taxes. JHHSC and Affiliates, except JHMMC, EHP, HCSI, OA, HCOB, and JHHC are not-for-profit organizations that qualify under Section 501(c)(3) of the Internal Revenue Code, and are therefore not subject to tax under current income tax regulations.

JHHC is classified as a partnership for Federal and State income tax purposes and accordingly, there is no provision for income taxes in the accompanying combined financial statements. Taxable income or loss passes through to and is reported by the members in their respective tax returns. Taxable subsidiaries of Affiliates account for income taxes in accordance with Financial Accounting Standards Board ("FASB") guidance on accounting for income taxes. Deferred income taxes are recognized for the tax consequences in future years for differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end. Affiliate subsidiaries otherwise exempt from Federal and State taxation are nonetheless subject to taxation at corporate tax rates at both the Federal and State levels on their unrelated business income. Total taxes paid to Federal and State tax authorities during the years ended June 30, 2014 and 2013 amounted to \$33.9 million and \$22.6 million, respectively.

FASB's guidance on accounting for uncertainty in income taxes clarifies the accounting for uncertainty of income tax positions. This guidance defines the threshold for recognizing tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on its technical merits. The guidance also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. There was no impact on JHHS' financial statements during the years ended June 30, 2014 and 2013.

Reclassifications. Certain amounts from the prior year have been reclassified in order to conform to the current year presentation.

2. Net Patient Service Revenue

JHHS has agreements with third-party payors that provide for payments to JHHS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. 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 under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an

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estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Adjustments mandated by the Health Services Cost Review Commission are also included in contractual adjustments, a portion of which are also included in established rates.

SMH and ACH operate outside of the State of Maryland, and are paid prospectively based upon negotiated rates for commercial insurance carriers, and predetermined rates per discharge for Medicaid and Medicare program beneficiaries. Payment arrangements include cost-based reimbursement, per diem payments prospectively determined rates per discharge, discounted charges, and fee schedules. Net patient service revenue are booked at estimated realizable amounts due from patients, third-party payors, and others for services rendered, and include estimated retroactive revenue adjustments due to future audits and reviews. Retroactive adjustments are estimated and are considered in the recognition of revenue in the period the services are rendered. Such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to audits and reviews.

During the year ended June 30, 2014, ACH received no final audits for Medicaid cost report years. ACH's Medicaid interim rates are based on Medicaid cost reports which have been audited for cost report years 2001, 2002, and 2005 through 2009. However, final audited rates have not been issued by Medicaid for these years.

During the year ended June 30, 2014, SMH received no final audits for Medicare cost report years. As of June 30, 2014, SMH has Medicare cost report years 2009 through 2013 open.

Capitation payments included in net patient service revenue are recognized as premium revenues during the period in which JHHS Affiliates are obligated to provide services to its enrollees at contractually determined rates.

JHHS' not-for-profit Affiliates provide care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Such patients are identified based on information obtained from the patient and subsequent analysis. Because the Affiliates do not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Direct and indirect costs for these services amounted to \$62.3 million and \$65.0 million for the years ended June 30, 2014 and 2013, respectively. The costs of providing charity care services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on JHHS' total expenses (less bad debt expense) divided by gross patient service revenue.

Patient accounts receivable are reported net of estimated allowances for uncollectible accounts and contractual adjustments in the accompanying financial statements. The provision for bad debts is based upon a combination of the payor source, the aging of receivables and management's assessment of historical and expected net collections, trends in health insurance coverage, and other collection indicators. The provision for bad debts related to patient service revenue is presented as a deduction from patient service revenue on the face of the Combined Statements of Operations and Changes in Net Assets. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospitals uninsured patients will be unable or unwilling to pay for the services provided. Thus, a significant provision for bad debts is recorded related to uninsured patients in the period services are provided. Management continuously assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience and payment trends by payor classification.

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Patient service revenue, net of contractual allowances (but before the provision for bad debts), recognized in the year ending June 30, 2014 from these major payor sources is as follows:

	<u>Third-Party Payors</u>	<u>Self-pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances)	\$ 4,608,343	\$ 118,305	\$ 4,726,648

Patient service revenue, net of contractual allowances (but before the provision for bad debts), recognized in the year ending June 30, 2013 from these major payor sources is as follows:

	<u>Third-Party Payors</u>	<u>Self-pay</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances)	\$ 4,435,185	\$ 142,760	\$ 4,577,945

The following table depicts the mix of gross accounts receivable from patients and third-party payors as of June 30, 2014 and 2013:

	2014	2013
Medicare	20.6%	20.7%
Medicaid	15.9%	12.2%
Blue Cross and Blue Shield	11.8%	12.2%
Medicaid managed care organizations	8.5%	6.2%
Self pay and other third-party payers	<u>43.2%</u>	<u>48.7%</u>
Total	<u>100.0%</u>	<u>100.0%</u>

3. Pledges Receivable

As of June 30, 2014 and 2013, the value of pledges receivable before discounts was \$32.3 million and \$30.4 million, respectively. Pledges receivable have been discounted at rates ranging from 0.11% to 6.0% and consist of the following (in thousands):

	1 Year	2 –5 Years	5 Years or Greater	Totals
As of June 30, 2014				
Departmental campaigns	\$ 3,183	\$ 7,412	\$ 1,664	\$ 12,259
Future campus development	<u>4,450</u>	<u>8,812</u>	<u>2,556</u>	<u>15,818</u>
	<u>\$ 7,633</u>	<u>\$ 16,224</u>	<u>\$ 4,220</u>	<u>\$ 28,077</u>

	1 Year	2 –5 Years	5 Years or Greater	Totals
As of June 30, 2013				
Departmental capital campaigns	\$ 1,912	\$ 3,171	\$ 1,716	\$ 6,799
Future campus development	<u>7,038</u>	<u>12,199</u>	<u>2,504</u>	<u>21,741</u>
	<u>\$ 8,950</u>	<u>\$ 15,370</u>	<u>\$ 4,220</u>	<u>\$ 28,540</u>

Pledges are deemed to be fully collectible and therefore, no allowance for uncollectible pledges has been recorded.

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4. Fair Value Measurements

FASB's guidance on the fair value option for financial assets and financial liabilities permits companies to choose to measure many financial assets and liabilities, and certain other items at fair value. This guidance requires a company to record unrealized gains and losses on items for which the fair value option has been elected in its performance indicator. The fair value option may be applied on an instrument by instrument basis. Once elected, the fair value option is irrevocable for that instrument. The fair value option can be applied only to entire instruments and not to portions thereof. JHHS has not elected fair value accounting for any asset or liability that is not currently required to be measured at fair value.

JHHS follows the guidance on fair value measurements, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, this guidance does not require any new fair value measurements.

This guidance discusses valuation techniques such as the market approach, cost approach and income approach. The guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset or liability as of the measurement date. The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2 – Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions. There are no instruments requiring Level 3 classification.

The financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Each of the financial instruments below has been valued utilizing the market approach.

The following table presents the financial instruments carried at fair value as of June 30, 2014 grouped by hierarchy level:

	Total Fair Value	Level 1	Level 2
<u>Assets</u>			
Cash equivalents (1)	\$ 613,394	\$ 613,394	\$ -
Commercial paper (1)	22,521	22,521	-
Certificates of deposit (1)	2,033	-	2,033
U.S. Treasuries (2)	513,485	-	513,485
Corporate bonds (2)	367,592	-	367,592
Asset backed securities (2)	117,486	-	117,486
Equities and equity funds (3)	993,172	668,330	324,842
Fixed income funds (4)	227,634	220,769	6,865
Totals	<u>\$ 2,857,317</u>	<u>\$ 1,525,014</u>	<u>\$ 1,332,303</u>
<u>Liabilities</u>			
Interest rate swap agreements (5)	<u>\$ 190,621</u>	<u>\$ -</u>	<u>\$ 190,621</u>

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The following table presents the financial instruments carried at fair value as of June 30, 2013 grouped by hierarchy level:

<u>Assets</u>	<u>Total Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>
Cash equivalents (1)	\$ 579,486	\$ 579,486	\$ -
Commercial paper (1)	28,588	28,588	-
Certificates of deposit (1)	2,322	-	2,322
U.S. Treasuries (2)	332,414	-	332,414
Corporate bonds (2)	338,616	-	338,616
Asset backed securities (2)	96,815	-	96,815
Equities and equity funds (3)	832,943	589,817	243,126
Fixed income funds (4)	117,106	110,394	6,712
Totals	<u>\$ 2,328,290</u>	<u>\$ 1,308,285</u>	<u>\$ 1,020,005</u>
<u>Liabilities</u>			
Interest rate swap agreements (5)	<u>\$ 184,417</u>	<u>\$ -</u>	<u>\$ 184,417</u>

- (1) Cash equivalents, commercial paper, money market funds, and overnight investments include investments with original maturities of three months or less. Certificates of deposit are carried at amortized cost. Certificates of deposit and commercial paper that have original maturities greater than three months are considered short-term investments. Cash and cash equivalents, commercial paper, money market funds, and overnight investments are rendered level 1 due to their frequent pricing and ease of converting to cash. Computed prices and frequent evaluation versus fair value render the certificates of deposit level 2.
- (2) For investments in U.S. Treasuries (notes, bonds, and bills), corporate bonds, and asset backed securities, fair value is based on quotes for similar securities; therefore these investments are rendered level 2. These investments fluctuate in value based upon changes in interest rates.
- (3) Equities include individual equities and investments in mutual funds, and commingled trusts. The individual equities and mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts and hedge funds are valued regularly within each month utilizing NAV per unit and are rendered level 2.
- (4) Fixed income funds are investments in mutual funds and commingled trusts investing in fixed income instruments. The underlying fixed investments are principally U.S. Treasuries, corporate bonds, commercial paper, and mortgage backed securities. The mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts are valued regularly within each month utilizing NAV per unit and are rendered level 2.
- (5) The interest rate swap agreements, discussed further in footnote 9 "Derivative Financial Instruments," are valued using a swap valuation model that utilizes an income approach using observable market inputs including long-term interest rates, LIBOR swap rates, and credit default swap rates.

During 2014 and 2013, there were no transfers between level 1 and 2.

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

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JHHS holds alternative investments that are not traded on national exchanges or over-the-counter markets. JHHS is provided a net asset value per share for these alternative investments that has been calculated in accordance with investment company rules, which among other requirements, indicates that the underlying investments be measured at fair value. There are no unfunded commitments related to JHHS' alternative investments.

The following table displays information by major alternative investment category as of June 30, 2014 (in thousands):

Description	Carrying Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	\$ 230,986	Daily or monthly	Same day or 5 days	Day after trade, or within 15 to 30 days, 95% in 5 days of redemption, 5% in 30 days after withdrawal
Fund of funds	\$ 108,368	Monthly or quarterly	25 to 70 days	Within 30 days, or 90% in 30 to 60 days, 10% after annual audit
Hedge Funds	\$ 11,822	Quarterly	60 days	95% within 30 days of redemption date; 5% within 120 days of redemption date
Total	<u>\$ 351,176</u>			

The following table displays information by major alternative investment category as of June 30, 2013 (in thousands):

Description	Carrying Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	\$ 192,333	Monthly	5 days	Within 15 to 30 days, 95% in 5 days of redemption, 5% in 30 days after withdrawal
Fund of funds	\$ 86,817	Monthly or quarterly	25 to 70 days	Within 30 days, or 90% in 30 to 60 days, 10% after annual audit
Hedge Funds	\$ 7,155	Quarterly	60 days	95% within 30 days of redemption date; 5% within 120 days of redemption date
Total	<u>\$ 286,305</u>			

Financial instruments are reflected in the Combined Balance Sheets as of June 30, 2014 and 2013 as follows (in thousands):

	2014	2013
Cash equivalents measured at fair value	\$ 613,394	\$ 579,486
Cash and cash equivalents included in AWUIL	(43,692)	(68,993)
Total cash and cash equivalents	<u>\$ 569,702</u>	<u>\$ 510,493</u>
Short and long-term investments measured at fair value	\$ 1,259,932	\$ 1,026,937
Investments accounted for under equity method	434,588	369,880
Total short and long-term investments	<u>\$ 1,694,520</u>	<u>\$ 1,396,817</u>
Assets whose use is limited measured at fair value	\$ 983,991	\$ 721,867
Cash in AWUIL reported in cash and equivalents on leveling table	43,692	68,993
Investments accounted for under equity method	84,742	68,977
Pledges receivable	28,077	28,540
Interest in net assets of HHF	13,644	13,903
Beneficial interest remainder trust	17,366	16,710
Other	1,392	235
Total assets whose use is limited	<u>\$ 1,172,904</u>	<u>\$ 919,225</u>

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The estimated total fair value of long-term debt excluding capital leases, rendered level 2 based on quoted market prices for the same or similar issues, was approximately \$1.8 billion and \$1.5 billion for the years ended June 30, 2014, and 2013, respectively.

5. Investments and Assets Whose Use is Limited

Investments (short and long-term) as of June 30 consisted of the following (in thousands):

	2014	2013
	Carrying	Carrying
	Amount	Amount
Investments in affiliates	\$ 168,154	\$ 152,552
U.S. Treasuries	252,770	198,935
Commercial paper	21,968	24,914
Certificates of deposit	2,033	2,322
Corporate bonds	249,090	227,369
Asset backed securities	62,170	61,092
Fixed income funds	168,413	89,991
Equities and equity funds	503,488	422,314
Alternative investments	266,434	217,328
	<u>\$1,694,520</u>	<u>\$1,396,817</u>

Assets whose use is limited as of June 30 consisted of the following (in thousands):

	2014	2013
	Carrying	Carrying
	Amount	Amount
Cash and cash equivalents	\$ 43,692	\$ 68,993
Commercial paper	553	3,674
U.S. Treasuries	260,715	133,479
Corporate bonds	118,502	111,247
Asset backed securities	55,316	35,724
Fixed income funds	59,221	27,115
Equities and equity funds	489,684	410,628
Alternative investments	84,742	68,977
Pledges receivable	28,077	28,540
Beneficial interest remainder trust	18,525	16,710
Interest in net assets of HHF	13,644	13,903
Other	233	235
	<u>\$ 1,172,904</u>	<u>\$ 919,225</u>

Realized and unrealized gains on investments for the years ended June 30, included in the non-operating revenues and expenses section of the Statement of Operations consisted of the following (in thousands):

	2014	2013
Realized gains on investments	\$ 54,703	\$ 40,916
Unrealized gains on investments	<u>164,245</u>	<u>88,785</u>
Total	<u>\$ 218,948</u>	<u>\$ 129,701</u>

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Investments recorded under the cost or equity method as of June 30 consisted of the following (in thousands):

Affiliate	Cost / Equity	%	2014	2013
Johns Hopkins International, LLC ("JHI")	Equity	50.00%	\$ 22,436	\$ 17,642
Johns Hopkins Home Care Group, Inc. ("JHHCG")	Equity	50.00%	8,515	8,320
FSK Land Corporation	Equity	50.00%	6,564	5,098
Broadway Development Corp.	Equity	50.00%	1,824	1,950
Mt. Washington Pediatric Hospital and Foundation	Equity	50.00%	30,092	24,921
Dome Corporation	Equity	50.00%	2,139	5,074
JHMI Utilities, LLC	Equity	50.00%	11,602	8,660
Sibley-Suburban Home Health Agency, Inc.	Equity	50.00%	5,089	5,579
Suburban/NRH Medical Rehabilitation, Inc.	Equity	50.00%	1,232	1,247
Germantown Wellness and Fitness, LLC	Equity	50.00%	222	99
Eager Park Pharmacy and Health Services, LLC	Equity	49.00%	323	597
Rockville Imaging, LLC	Equity	40.00%	388	479
Chevy Chase Imaging, LLC	Equity	27.00%	458	545
Ten Acres Medical Center, LLC	Equity	25.00%	1,500	1,647
Sleep Services of America	Equity	24.30%	-	1,436
Central Maryland Radiation Oncology, LLC	Equity	20.00%	1,500	1,534
Johns Hopkins Suburban Health Center, L.P.	Cost	19.00%	1,802	1,721
MCIC Bermuda	Cost	10.00%	57,941	55,220
MCIC Vermont	Cost	10.00%	-	1,000
Patient First Corporation	Cost	3.00%	750	750
Other			13,777	9,033
			<u>\$168,154</u>	<u>\$152,552</u>

During the year ended June 30, 2014, JHHS entered into a stock purchase agreement with Premier, Inc. ("Premier") whereby JHHS acquired 1.44 million class B shares of common stock for \$1.5 million in cash and \$1.0 million in value from its existing ownership of Premier. Premier went public on November 1, 2013. The class B shares vest ratably over a seven year period. Once vested, JHHS has the option to convert the vested class B shares to class A shares. The cost basis of the class B shares increases as the shares vest. As of June 30, 2014 the total cost basis of the class B shares was \$3.7 million.

JHHS consolidates certain affiliates that it owns 50% or more, but less than 100%, because JHHS has control and significant influence over those affiliates. The net asset activity attributable to the noncontrolling interests consisted of the following as of June 30, (in thousands):

	2014	2013
Net assets attributable to noncontrolling interests at beginning of period	\$ 59,105	\$ 50,870
Income attributable to noncontrolling interests	18,965	11,270
Distributions attributable to noncontrolling interests	(6,692)	(3,035)
Other comprehensive income attributable to noncontrolling interests	<u>43</u>	<u>-</u>
Net assets attributable to noncontrolling interests at end of period	<u>\$ 71,421</u>	<u>\$ 59,105</u>

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6. Property, Plant and Equipment

Property, plant and equipment and accumulated depreciation and amortization consisted of the following as of June 30 (in thousands):

	2014		2013	
	Cost	Accumulated Depreciation and Amortization	Cost	Accumulated Depreciation and Amortization
Land and land improvements	\$ 158,752	\$ 11,438	\$ 155,699	\$ 8,713
Buildings and improvements	2,164,271	709,494	2,101,862	651,547
Fixed and moveable equipment	1,664,795	771,656	1,668,412	658,311
Capitalized software	168,812	128,592	158,434	104,114
Construction in progress	229,417	-	104,488	-
	<u>\$ 4,386,047</u>	<u>\$ 1,621,180</u>	<u>\$ 4,188,895</u>	<u>\$ 1,422,685</u>

Accruals for purchases of property, plant and equipment as of June 30, 2014 and 2013 amounted to \$22.4 million and \$21.9 million, respectively, and are included in accounts payable and accrued liabilities in the Combined Balance Sheets. Depreciation and amortization expense for the years ended June 30, 2014 and 2013 amounted to \$266.2 million and \$263.0 million, respectively.

During the year ended June 30, 2014 and 2013, JHHS retired long-lived assets determined to have no future value. During 2014, the original cost and corresponding accumulated depreciation of these long-lived assets was \$67.7 million and \$66.4 million, respectively. No proceeds from retirement were received in 2014. During 2013, the original cost and corresponding accumulated depreciation of these long-lived assets was \$154.4 million and \$149.6 million, respectively. No proceeds from retirement were received in 2013.

JHH and the University share various facilities, equipment, software, and services. The costs related to these facilities, equipment, software, and services are generally paid for in their entirety by one institution. Under the provisions of a Joint Administrative Agreement and a lease agreement between JHH and the University, these costs are allocated to both institutions on the basis of usage. The University leased approximately 24.5% and 22.0% of the net square footage within JHH's buildings as of June 30, 2014 and 2013, respectively.

7. Medical Claims Reserves

JHHC's activity related to its liability for unpaid health claims for the years ended June 30 are summarized in the table below (in thousands):

	2014	2013
Balance, July 1	\$ 105,825	\$ 100,048
Incurring related to:		
Current year	981,898	958,566
Prior year	(24,541)	(29,289)
Total incurred	<u>957,357</u>	<u>929,277</u>
Paid related to:		
Current year	878,367	852,741
Prior year	82,284	70,759
Total paid	<u>960,651</u>	<u>923,500</u>
Balance, June 30	<u>\$ 102,531</u>	<u>\$ 105,825</u>

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The medical claims reserve is inherently subject to a number of highly variable circumstances, including changes in payment patterns, cost trends and other relevant factors. Consequently, the actual experience may vary materially from the original estimate. The above medical claims reserves include intercompany activity that is eliminated in combination.

8. Debt

Debt as of June 30 is summarized as follows (in thousands):

	2014		2013	
	Current Portion	Long-term Portion	Current Portion	Long-term Portion
Tax Exempt Maryland Health and Higher Education Facilities Authority ("MHHEFA") Bonds and Notes:				
1985 Series A and B – Pooled Loan Program Issue (JHBMC, JHHSC)	\$ 2,424	\$ 2,987	\$ 1,284	\$ 5,840
1990 Series - Revenue Bonds (JHH)	9,370	37,873	9,370	43,941
2004 Series A - Revenue Bonds (SHI) – including original issue premium of \$91 and \$150 as of June 30, 2014 and 2013, respectively	4,835	3,401	2,400	10,795
2004 – Commercial Paper Revenue Notes Series B (JHBMC)	4,420	69,510	4,210	73,930
2008 Series - Revenue Bonds (JHH) – including original issue premium of \$527 and \$1,054 as of June 30, 2014 and 2013, respectively	48,772	-	-	49,299
2010 Series - Revenue Bonds (JHH) – including original issue premium of \$1,552 and \$1,615 as of June 30, 2014 and 2013, respectively	-	149,747	-	149,810
2011 Series A - Revenue Bonds (JHH) – including original issue premium of \$5,595 and \$6,327 as of June 30, 2014 and 2013, respectively	2,660	72,690	2,600	76,082
2011 Series B – Revenue Bonds (JHH)	-	48,245	-	48,245
2012 Series A – Note (JHH)	1,375	49,470	1,345	50,845
2012 Series B - Revenue Bonds (JHH) – including original issue premium of \$11,596 and \$12,644 as of June 30, 2014 and 2013, respectively	2,890	102,796	2,770	106,734
2012 Series C – Revenue Bonds (JHH)	375	83,600	375	83,975
2012 Series D – Revenue Bonds (JHH)	430	83,900	405	84,330
2012 Series E – Floating Rate Note (JHH)	11,000	89,000	9,000	91,000
2013 Series A – Revenue Bonds (JHHSC)	-	88,250	-	88,250
2013 Series B – Revenue Bonds (JHHSC)	2,220	57,490	2,140	59,710
2013 Series C – Revenue Bonds (JHHSC) - including net original issue discount of \$833 as of June 30, 2014)	-	237,167	-	-
Tax Exempt City of St. Petersburg Health Facilities Authority Revenue				
2002 Series - Revenue Bonds (ACH)	1,885	16,807	1,800	18,741
2007 Series B – Revenue Refunding Bonds (ACH)	800	25,075	775	25,875
2009 Series A – Revenue Refunding Bonds (ACH)	290	66,746	190	67,090
2012 Series A – Revenue Refunding Bonds (ACH)	1,650	97,450	1,675	99,100
Tax Exempt District of Columbia Revenue Bonds:				
2009 Series - Revenue Bonds (SMH)	1,050	67,982	1,010	69,539
Taxable Revenue Bonds:				
2013 Series – Taxable Bonds (JHHSC)	-	148,165	-	148,165
Other debt:				
Capital leases (SHHS, ACH and JHHC)	1,832	33,319	1,745	35,151
Johns Hopkins Endowment (JHHSC)	427	1,446	402	1,873
	<u>\$ 98,705</u>	<u>\$1,633,116</u>	<u>\$ 43,496</u>	<u>\$1,488,320</u>

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The above debt amounts for SMH and ACH includes an adjustment made at the time of acquisition to increase the value of the debt to fair value and is being amortized to interest expense over the life of the respective debt. As of June 30, 2014 the unamortized fair value adjustment was \$7.0 million and \$3.8 million for SMH and ACH, respectively. As of June 30, 2013 the unamortized fair value adjustment was \$7.5 million and \$3.9 million for SMH and ACH, respectively.

Obligated Groups

The Johns Hopkins Health System Obligated Group ("JHHS Obligated Group") consists of JHH, JHBMC, HCGH, SHI, SHHS, SMH and JHHSC. JHBMC was admitted into the JHHS Obligated Group in 2004 as part of a plan of debt refinancing. SHI and SHHS were admitted into the JHHS Obligated Group in 2010 as part of a JHH debt issuance. HCGH was admitted to the JHHS Obligated Group in May 2012 as part of a JHH debt issuance. JHHSC was admitted in May 2013 as part of a JHHSC debt issuance. SMH was admitted into the JHHS Obligated Group in August 2013 pursuant to a JHHSC debt issuance. All of the debt of JHH, JHBMC, HCGH, SHI, SHHS, SMH and JHHSC are parity debt, and as such are collateralized equally and ratably by a claim on and a security interest in all of JHH's, JHBMC's, HCGH's, SHI's, SHHS', SMH's, and JHHSC's receipts as defined in the Master Loan Agreement with MHHEFA. JHH, JHBMC, HCGH, SHI, SHHS, SMH, and JHHSC are required to achieve a defined minimum debt service coverage ratio each year. As of June 30, 2014 the outstanding JHH, JHBMC, HCGH, SHI, SHHS, SMH, and JHHSC parity debt was \$1.5 billion. As of June 30, 2013 the outstanding JHH, JHBMC, SHI, and SHHS parity debt was \$1.2 billion.

The All Children's Hospital Obligated Group ("ACH Obligated Group") consists of ACH. The 2002 and 2005 Series Revenue Bonds, and the 2007B and 2009A Revenue Refunding Bonds are parity debt, and as such are collateralized equally and ratably by a claim on and a security interest in all of ACH's gross receipts. ACH is required to achieve a defined minimum debt service coverage ratio each year. As of June 30, 2014, the total amount of debt outstanding under the ACH Obligated Group was \$211.0 million. As of June 30, 2013, the total amount of debt outstanding under the ACH Obligated Group was \$216.1 million.

1985A and B – Pooled Loan Program – JHBMC, JHHSC & JHCP

JHBMC, JHHSC and JHCP entered into loan agreements by borrowing through draws from the \$175.0 million MHHEFA Revenue Bonds, Pooled Loan Program Issue, Series 1985A and Series 1985B. The debt bears interest at a variable rate. The interest rate in effect for the years ended June 30, 2014 and 2013 was 1.50% and 1.00%, respectively. The JHCP loan was paid off during the year ended June 30, 2014.

As of June 30, 2014, the MHHEFA Pooled Loan Program Issue was supported by a letter of credit agreement provided by JPMorgan Chase Bank, N.A. ("JPM"), which had an expiration date of December 31, 2014. The letter of credit agreement provider established a maturity date for the loan of September 30, 2014, at which time the outstanding principal amount of the loan becomes due. Effective August 27, 2014 MHHEFA replaced the JPM letter of credit by a letter of credit provided by TD Bank. The effect is that principal payments are payable monthly based on a pro forma level debt service amortization schedule that runs through June 15, 2015.

1990 Series – Revenue Bonds – JHH

Portions of the tax-exempt MHHEFA 1990 Series Revenue Bonds have been advance refunded. The bonds outstanding consist of Capital Appreciation Bonds. Interest on the Capital Appreciation Bonds accrues interest from the date of delivery, is compounded semi-annually on each July 1, and January 1, and is to be paid at maturity or redemption. Serial Capital Appreciation Bonds of \$18.1 million and \$26.2 million as of June 30, 2014 and 2013, respectively, bearing interest at rates ranging from 7.30% to 7.35% per annum, are due each July 1 in the amount of \$9.4 million from 2014 to 2015. Term Capital Appreciation Bonds of \$29.2 million and

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\$27.1 million as of June 30, 2014 and 2013, respectively, are due July 1, 2019 and bear interest, compounded semi-annually at a rate of 7.40%. Annual sinking fund installments for the Term Capital Appreciation Bonds are \$9.4 million from July 1, 2016 to July 1, 2019.

2002 Series – Revenue Bonds – ACH

In December 2002, ACH obtained a loan in the amount of \$35.0 million representing proceeds of tax-exempt Revenue Bonds issued through the City of St. Petersburg Health Facilities Authority. The loan requires annual principal payments ranging from \$1.8 million to \$2.7 million through 2021, plus semi-annual interest payments at fixed rates ranging from 4.0% to 5.5%. The recorded loan amount includes a fair value adjustment from the acquisition of ACH of \$362 thousand and \$441 thousand as of June 30, 2014 and 2013, respectively.

2004 Series A – Revenue Bonds – SHI

In June 2004, SHI issued \$72.4 million principal amount of tax-exempt MHHEFA Revenue Bonds, 2004 Series A ("2004 Series A Bonds"). The 2004 Series A Bonds consist of Serial bonds due in annual installments beginning July 1, 2005 at interest rates between 4.7% and 5.5%, and \$8.2 million Term bonds due on July 1, 2016 at a rate of 5.5%. Interest is payable semiannually on January 1 and July 1 of each year on the fixed rate 2004 Series A Bonds. The 2004 Series A Bonds were sold at a premium of \$1.3 million which is being accounted for using the bond outstanding method.

2004 Commercial Paper Revenue Notes – Series B – JHBMC

The tax-exempt MHHEFA Commercial Paper Revenue Notes - Series B ("2004 Series B Notes") pay interest as the notes mature at a variable rate based on the commercial paper sold by a designated re-marketing agent for terms ranging from 1 to 270 days. The rates for the years ended June 30, 2014 and 2013 were approximately 0.10% and 0.17%, respectively. Annual payments of principal began July 1, 2004 and range in amounts from \$425 thousand on July 1, 2004 to \$8.3 million on July 1, 2025.

In connection with the 2004 Series B Notes, JHBMC entered into an \$89.6 million line of credit agreement with Wells Fargo to provide for payment of such commercial paper at maturity, subject to certain conditions described therein. This agreement expires on October 31, 2016 subject to extension or earlier termination. No amounts were outstanding as of June 30, 2014 or 2013.

2007 Series B – Revenue Bonds – ACH

In October 2007, ACH obtained a loan in the amount of \$92.2 million representing proceeds of tax-exempt Revenue Bonds issued through the City of St. Petersburg Health Facilities Authority ("2007 Series Bonds"). The loan requires annual principal payments ranging from \$775 thousand to \$1.8 million through 2034, plus interest at a weekly rate paid monthly. The rates for the years ended June 30, 2014 and 2013 were 0.45% and 0.55%, respectively.

2008 Series Revenue Bonds – JHH

In June 2008 JHH issued \$144.7 million of tax-exempt MHHEFFA Revenue Bonds ("2008 Revenue Bonds") to finance construction of two new clinical care buildings. The bonds are term bonds that were sold in three tranches of approximately \$48.2 million each that have final maturities in 2042, 2046 and 2048. The payment terms require sinking fund deposits that begin in 2036 in amounts of \$2.3 million to \$20.2 million in 2048. The interest rates on the bonds are based on initial term rate periods of three, five and seven years and currently range between 3.65% and 5.0%. Interest is payable semi-annually.

At the end of the initial term rate periods on November 15, 2011, May 15, 2013 and May 15, 2015, \$48.2 million of 2008 Revenue Bonds are subject to mandatory repurchase by JHH. The first two tranches of term bonds have been purchased by JHH. The first tranche in November 2011 through the issuance of the 2011 Series B Revenue Bonds described below and the second

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in May 2013 through the issuance of a note payable to JHHSC. JHH has the option at the end of each term period to change the length of the term periods or extend the fixed rate period to the final maturity of the bonds. JHH also has the right to retire the bonds at par value at the end of each term period. The 2008 Revenue Bonds were sold at a premium of \$5.3 million which is being accounted for using the bond outstanding method.

2009 Series A – Revenue Refunding Bonds – ACH

In April 2009, ACH obtained a loan in the amount of \$64.4 million representing proceeds of tax-exempt Revenue Bonds issued through the City of St. Petersburg Health Facilities Authority. The loan requires annual principal payments ranging from \$190 thousand to \$13.3 million through 2039, plus semi-annual interest payments at fixed rates ranging from 3.50% to 6.50%. The recorded loan amount includes a fair value adjustment from the acquisition of ACH of \$3.5 million and \$3.5 million as of June 30, 2014 and 2013, respectively.

2009 Series Revenue Bonds – SMH

In July 2009, SMH obtained a loan in the amount of \$63.0 million representing proceeds of tax-exempt Revenue Bonds issued through a public offering by the District of Columbia, with stated interest rates ranging from 4.00% to 6.50%, maturing October 1, 2039. The loan required semi-annual interest payments until October 1, 2013, at which time SMH will begin making annual principal payments ranging from \$1.0 million to \$4.6 million until maturity. The recorded loan amount includes a fair value adjustment from the acquisition of SMH of \$7.0 million and \$7.5 million as of June 30, 2014 and 2013, respectively.

2010 Series Revenue Bonds – JHH

In June 2010, JHH issued \$148.2 million of tax-exempt MHHEFA 2010 Series Revenue Bonds ("2010 Revenue Bonds") to further finance construction of the two new clinical buildings. \$29.8 million of the bonds are serial bonds that mature in 2031 through 2035 and pay interest semi-annually at rates ranging from 4.38% to 4.63%. The remaining 2010 Revenue Bonds are Term Bonds amounting to \$118.4 million paying interest semi-annually at a rate of 5.0% and maturing in 2040. The payment terms for the Term Bonds require sinking fund deposits in 2036 through 2040 in amounts ranging from \$21.0 million to \$26.3 million. The Serial Bonds were sold at a discount of \$500 thousand and the Term Bonds were sold at a premium of \$2.3 million, both of which are being accounted for using the bond outstanding method.

2011 Series A Revenue Bonds – JHH

In November 2011, JHH issued \$74.6 million of tax-exempt MHHEFA 2011 Series A Revenue Bonds ("2011 Series A Bonds"). The 2011 Series A Bonds are serial bonds with maturities from 2013 through 2026 and pay a fixed rate of interest ranging from 2.00% to 5.00%. The repayment terms require semi-annual interest payments on May 15th and November 15th. Principal payments range from \$100 thousand to \$13.5 million, and are due upon maturity beginning May 15, 2013. The 2011 Series A Bonds were sold at a premium of \$7.6 million which are being accounted for using the bond outstanding method.

2011 Series B Revenue Bonds – JHH

In November 2011, JHH issued \$48.2 million of tax-exempt MHHEFA 2011 Series B Revenue Bonds ("2011 Series B Bonds"). The 2011 Series B Bonds are variable rate bonds that were issued with a five year term, and a mandatory repurchase date of November 15, 2016. The 2011 Series B Bonds pay interest monthly based on 67% of LIBOR plus 1.15%. The LIBOR rate is reset on the first business day of each month. The interest rates for the years ended June 30, 2014 and 2013 were approximately 1.25% and 1.28%, respectively.

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2012 Series A Note - JHH

In February 2012, JHH issued a \$53.5 million tax-exempt MHHEFA 2012 Floating Rate Note ("2012 Note") in a private placement. The 2012 Note has a term of five years, carries a variable rate of interest at 67% of the one-month LIBOR rate plus a spread of 0.44% that resets and is payable monthly. The interest rates for the years ended June 30, 2014 and 2013 were approximately 0.54% and 0.57%, respectively.

2012 Series B Revenue Bonds – JHH

In May 2012, JHH issued \$97.6 million of tax-exempt MHHEFA 2012 Series B Revenue Bonds ("2012 Series B Bonds") to finance the construction of its two new clinical buildings. The 2012 Series B Bonds are serial bonds and mature annually from 2012 through 2033 in installments that range from \$700 thousand in 2012 to \$7.1 million in 2033, and pay interest semi-annually at rates ranging from 2.00% to 5.00%. The 2012 Series B Bonds were sold at a premium of \$13.9 million which are being accounted for using the bond outstanding method.

2012 Series A Revenue Refunding Bonds – ACH

In June 2012, ACH issued 2012 Series A Revenue Refunding Bonds ("2012 Refunding Bonds") in the amount of \$102.4 million representing proceeds of tax-exempt Revenue Bonds issued through the City of St. Petersburg Health Facilities Authority. The 2012 Refunding Bonds were issued as a direct bank placement with a five year term, and require annual principal payments ranging from \$1.7 million to \$8.0 million through 2035. Interest is calculated and paid monthly at the one-month LIBOR plus a spread of 0.50%. Interest for the years ended June 30, 2014 and 2013 were 0.61% and 0.64%, respectively.

2012 Series C and Series D Revenue Bonds – JHH

In August 2012, JHH issued \$84.6 million and \$85.1 million of tax-exempt MHHEFA 2012 Series C and D Revenue Bonds ("2012 Series C Bonds and 2012 Series D Bonds"). The 2012 Series C Bonds and 2012 Series D Bonds were issued to refund JHH Series 2008 E and Series 2008 F Notes, and are due in 2038. The 2012 Series C Bonds are subject to mandatory sinking fund installments ranging from \$260 thousand to \$8.7 million. The 2012 Series D Bonds are subject to mandatory sinking fund installments ranging from \$325 thousand to \$8.7 million. The 2012 Series C Bonds and 2012 Series D Bonds are variable rate bonds, and carry a mandatory repurchase date of November 15, 2017. The 2012 Series C Bonds and 2012 Series D Bonds pay interest monthly based on 67% of LIBOR plus a spread of 0.83% that resets and is payable monthly. The interest rates for the years ended June 30, 2014 and 2013 were approximately 0.94% and 0.96%, respectively.

2012 Series E Floating Rate Note – JHH

In November 2012, JHH issued a \$100.0 million tax-exempt MHHEFA Floating Rate Note ("2012 Series E Note") through a private placement to refinance its 2004 Series C Notes and 2007 Series D Notes. The 2012 Series E Note has a term of five years, carries a variable rate of interest at 67% of LIBOR plus a spread of 0.55% that resets and is payable monthly. The interest rates for the years ended June 30, 2014 and 2013 were approximately 0.66% and 0.68%, respectively.

On July 1, 2013, JHH made a \$9.0 million principal repayment related to the scheduled maturity of its 2012 Series E Note. In connection with this principal payment, In October 2013, JHH issued an additional \$9.0 million of bonds to replace the matured principal amount. The additional borrowing is subject to the same terms and conditions of the original 2012 Series E Note.

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2013 Series A Revenue Bonds - JHHSC

In May 2013, JHHSC issued \$88.3 million of tax-exempt MHHEFA Revenue Bonds ("2013 Series A Bonds") to refinance \$48.3 million of the JHH 2008 Revenue Bonds, as well as \$40.0 million of the HCGH 2008 Bonds. The 2013 Series A Bonds are variable rate bonds that were issued with a five year term and a mandatory repurchase date of May 15, 2018. The 2013 Series A Bonds pay interest monthly based on 67% of LIBOR plus .60%. The LIBOR rate is reset on the first business day of each month. The interest rates for the years ended June 30, 2014 and 2013 were approximately 0.72% and 0.73%, respectively.

2013 Series B Revenue Bonds – JHHSC

In May 2013, JHHSC issued \$61.9 million of tax-exempt MHHEFA Revenue Bonds ("2013 Series B Bonds") to refinance \$10.0 million of the JHBMC 2008 Series A Bonds, as well as \$51.9 million of the SHI 2008 Series Bonds. The 2013 Series B Bonds are variable rate bonds that were issued with a five year term and a mandatory repurchase date of May 15, 2018. The 2013 Series B Bonds pay interest monthly based on 67% of LIBOR plus .58%. The LIBOR rate is reset on the first business day of each month. The interest rates for the years ended June 30, 2014 and 2013 were approximately 0.70% and 0.71%, respectively.

2013 Series Taxable Revenue Bonds - JHHSC

In May 2013, JHHSC issued \$148.2 million of Revenue Bonds ("2013 Taxable Bonds") in the taxable market to finance various capital projects. The 2013 Taxable Bonds are structured as two tranches with five and ten year bullet maturities. The five-year bullet of \$48.2 million is due on May 15, 2018, and the ten-year bullet of \$100.0 million is due on May 15, 2023. Interest is due semiannually beginning November 15, 2013 at a fixed interest rate of 1.424% for the five-year bullet and 2.767% for the ten-year bullet.

2013 Series C Revenue Bonds - JHHSC

In August 2013, JHHSC issued \$238.0 million of tax-exempt MHHEFA Revenue Bonds ("2013 Series C Bonds") to finance construction of a new hospital on the SMH campus, and construction of a new Cancer Center and Emergency Department expansion projects on the JHBMC campus. The 2013 Series C Bonds were structured as serial bonds with maturities from 2016 through 2033, as well as two term bonds maturing 2038 and 2043. The 2013 Series C Bonds pay a fixed rate of interest ranging from 3.00% to 5.00%. The 2013 Series C Bonds pay interest semi-annually on May 15th and November 15th. Principal and sinking fund payments range from \$1.6 million to \$39.5 million starting May 15, 2016.

Johns Hopkins Endowment Loan – JHHSC

JHHSC has a \$6.1 million loan from The Johns Hopkins Endowment Fund, Incorporated ("Endowment Corporation"). The proceeds of this loan were used for the renovation of the Pavilions II building at Green Spring Station. The loan is payable in monthly installments beginning July 1, 1998 and bears an interest rate of 6%. The amount outstanding on the loan was \$1.9 million and \$2.3 million as of June 30, 2014 and 2013, respectively.

For the debt of JHHS and Affiliates, total maturities of debt and sinking fund requirements, excluding capital leases, during the next five fiscal years and thereafter are as follows as of June 30, 2014 (in thousands):

2015	96,873
2016	41,086
2017	82,375
2018	39,500
2019	39,695
Thereafter	<u>1,367,748</u>
	<u>\$1,667,277</u>

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For the debt of JHHS and Affiliates described above, interest costs incurred, paid and capitalized in the years ended June 30 are as follows (in thousands):

	2014	2013
Net interest costs:		
Capitalized	\$ 11,629	\$ 583
Expensed	66,870	67,848
Allocated to others	58	64
	<u>\$ 78,557</u>	<u>\$ 68,495</u>
Interest costs paid	<u>\$ 76,182</u>	<u>\$ 69,731</u>

Capital Leases

SHHS has a lease agreement with an unrelated party for the lease of real property. The leased property consists of land and a building, located in north Bethesda, Maryland, which is known as the Suburban Outpatient Medical Center ("SOMC"). The lease term began on August 1, 2001 and will continue through December 31, 2026. The base rent escalates 2.25% per year, in accordance with the lease agreement. The lease contains four optional renewal periods for five years each. The SOMC lease has been recorded as a capital lease.

JHHC has a lease agreement with an unrelated party for the lease of equipment. The leased equipment consists of a Cat Scan machine. The lease term began in May 2013 and will continue through May 2018. The base rent is fixed in accordance with the lease agreement. The lease has been recorded as a capital lease.

The total leased property of \$39.9 and \$39.9 million is reflected in property, plant and equipment as of June 30, 2014 and 2013, respectively. Accumulated depreciation on the leased assets was \$20.1 million and \$18.1 million as of June 30, 2014 and 2013, respectively.

Depreciation expense on these leased assets is included within depreciation expense in the Combined Statements of Operations and Changes in Net Assets.

The future minimum lease payments required under JHHS capital leases are as follows as of June 30, 2014 (in thousands):

	Capital Lease Payments
2015	\$ 4,753
2016	4,411
2017	4,502
2018	4,595
2019	4,341
2020 and thereafter	<u>35,884</u>
Minimum lease payments	58,486
Interest on capital lease obligations	<u>(23,335)</u>
Net minimum payments	35,151
Current portion of capital lease obligation	<u>(1,832)</u>
Capital lease obligation, less current	<u>\$ 33,319</u>

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9. Derivative Financial Instruments

JHHS' primary objective for holding derivative financial instruments is to manage interest rate risk. Derivative financial instruments are recorded at fair value and are included in other long-term liabilities. The total notional amount of interest rate swap agreements was \$766.6 million and \$773.1 million as of June 30, 2014 and 2013, respectively.

JHHS follows accounting guidance on derivative financial instruments that are based on whether the derivative instrument meets the criteria for designation as cash flow or fair value hedges. The criteria for designating a derivative as a hedge include the assessment of the instrument's effectiveness in risk reduction, matching of the derivative instrument to its underlying transaction, and the assessment of the probability that the underlying transaction will occur. All of JHHS' derivative financial instruments are interest rate swap agreements without hedge accounting designation.

JHHS does not hold derivative instruments for the purpose of managing credit risk and limits the amount of credit exposure to any one counterparty and enters into derivative transactions with high quality counterparties. JHHS recognizes gains and losses from changes in fair values of interest rate swap agreements as a non-operating revenue or expense within excess of revenues over expenses on the Combined Statements of Operations and Changes in Net Assets.

Each swap agreement has certain collateral thresholds whereby, on a daily basis, if the fair value of the swap agreement declines such that its devaluation exceeds the threshold, cash must be deposited by JHHS with the swap counterparty for the difference between the threshold amount and the fair value. As of June 30, 2014 and 2013, the amount of required collateral was \$80.3 million and \$72.8 million, respectively.

Fair value of derivative instruments as of June 30 (in thousands):

	Derivatives reported as liabilities			
	2014		2013	
	Balance Sheet Caption	Fair Value	Balance Sheet Caption	Fair Value
Interest rate swaps not designated as hedging instruments	Interest Rate Swap liabilities	\$ 190,621	Interest Rate Swap liabilities	\$ 184,417

Derivatives not designated as hedging instruments as of June 30 (in thousands):

Classification of derivative loss in Statement of Operations	Amount of gain (loss) recognized in change in unrestricted net assets	
	2014	2013
Interest rate swaps: Non-operating expense	\$ (6,201)	\$ 95,103

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The following is a description of JHHS' interest rate swap agreements:

In January 2004, JHH entered into a fixed payor interest swap with J.P. Morgan. The notional amount on this swap agreement was \$50.8 million and \$52.2 million as of June 30, 2014 and 2013, respectively. This agreement carries a term of 17 years. JHH will pay J.P. Morgan a fixed annual rate of 3.329% in return for the receipt of a floating rate of interest equal to 67% of the one month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In January 2004, JHBMC entered into a fixed payor interest rate swap agreement with Bank of America. The notional amount on this swap agreement was \$73.9 million and \$78.1 million as of June 30, 2014 and 2013, respectively, and carries a term of 21 years with payments beginning on February 1, 2004. JHBMC will pay Bank of America a fixed annual rate of 3.3265% in return for the receipt of a floating rate of interest equal to 67% of the one month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In May 2004, SHI entered into a fixed payor interest rate swap agreement with J.P. Morgan. The notional amount on this swap agreement was \$25.0 million as of June 2014 and 2013, and carries a term of 17 years. SHI will pay J.P. Morgan a fixed annual rate of 3.919% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 68% of the one month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In May 2005, ACH entered into two fixed payor interest rate swap agreements. The first swap agreement with the Royal Bank of Canada ("RBC") had a notional amount of \$14.5 million and \$14.6 million as of June 30, 2014 and 2013, respectively. The second swap agreement with Citibank, N.A. ("Citibank"), had a notional amount of \$24.2 million and \$24.3 million as of June 30, 2014 and 2013, respectively. These agreements carry a term of 29 years. ACH will pay RBC and Citibank a fixed annual rate of 3.6235% on the notional amount of the swap agreements in return for the receipt of a floating rate of interest equal to 62.2% of the one-month LIBOR plus 0.27%. The floating rates as of June 30, 2014 and 2013 were 0.36% and 0.39%, respectively, under these swap agreements.

In April 2006, JHH entered into two fixed payor interest rate swap agreements with Goldman Sachs Capital Markets, L.P. ("GSCM"). The notional amount on these swap agreements is \$150.0 million each. These agreements carry a term of 32 years. JHH will pay GSCM a fixed annual rate of 3.911% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 67% of the one-month LIBOR rate. Under the second swap agreement, JHH will pay GSCM a fixed annual rate of 3.922% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 67% of the one-month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In May 2006, HCGH entered into a forward start fixed payor interest rate swap agreement with GSCM. The notional amount on this swap agreement is \$40.0 million and carries a term of 32 years. HCGH will pay GSCM a fixed annual rate of 3.946% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 67% of the one month LIBOR rate. JHHS has guaranteed the prompt payment of this interest rate swap agreement. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In July 2007, JHH entered into two fixed payor interest rate swap agreements. One with GSCM in a notional amount of \$84.1 million and another with Merrill Lynch Capital Services ("MLCS") in a notional amount of \$84.6 million. These agreements carry a term of 31 years. JHH will pay GSCM a fixed annual rate of 3.819% and will pay MLCS a fixed annual rate of 3.8091% on the

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outstanding loan values in return for the receipt of a floating rate of interest equal to 67% of the one-month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In July 2007, JHBMC entered into a forward start fixed payor interest rate swap agreement with GSCM with a notional amount of \$9.5 million and \$10.0 million as of June 30 2014 and 2013, respectively, and carries a term of 19.5 years. JHBMC will pay GSCM a fixed annual rate of 3.691% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 67% of the one month LIBOR rate. The floating rates as of June 30, 2014 and 2013 were 0.10% and 0.13%, respectively.

In October 2007, ACH entered into a fixed payor interest rate swap agreement with Citibank with a notional amount of \$60.0 million as of June 30, 2012 and carries a term of 40 years. ACH will pay Citibank a fixed annual rate of 3.8505% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 61.8% of the one-month LIBOR plus 0.25%. The floating rates under this agreement as of June 30, 2014 and 2013 were 0.34% and 0.37%, respectively.

10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets as of June 30 (in thousands) are restricted to:

	2014	2013
Purchase of property, plant, and equipment	\$ 35,797	\$ 38,812
Health care services	126,073	113,086
Health education and counseling	3,235	3,330
Indigent care	2,346	2,646
	<u>\$ 167,451</u>	<u>\$ 157,874</u>

Permanently restricted net assets as of June 30 (in thousands) are restricted to:

	2014	2013
Health care services	\$ 45,982	\$ 42,980
Health education and counseling	12,609	13,742
	<u>\$ 58,591</u>	<u>\$ 56,722</u>

The JHHS endowments do not include amounts designated by the Board of Trustees to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees of the JHHS has interpreted UPMIFA in the State of Maryland, the State of Florida, and the District of Columbia as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the JHHS classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

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11. Pension Plans

The Affiliates sponsor a variety of defined benefit pension plans (the "Plans") covering substantially all of their employees. The retirement income benefits are based on a combination of years of service and compensation at various points of service. The FASB's guidance on employer's accounting for defined benefit pension and other postretirement plans requires that the funded status of defined benefit postretirement plans be recognized on JHHS' Combined Balance Sheets, and changes in the funded status be reflected as a change in net assets.

The funding policy of all Affiliates is to make sufficient contributions to meet the Internal Revenue Service minimum funding requirements. Assets in the Plans as of June 30, 2014 and 2013 consisted of cash and cash equivalents, equities and equity funds, fixed income funds, and alternative investments. All assets are managed by external investment managers, consistent with the Plan's investment policy.

The change in benefit obligation, plan assets, and funded status of the Plans is shown below (in thousands):

<u>Change in benefit obligation</u>	2014	2013
Benefit obligation as of beginning of year	\$ 1,421,257	\$ 1,465,815
Service cost	52,881	61,876
Interest cost	71,507	67,237
Actuarial loss (gain)	196,275	(137,269)
Benefits paid	(44,248)	(36,402)
Benefit obligation as of June 30	<u>\$ 1,697,672</u>	<u>\$ 1,421,257</u>
 <u>Change in plan assets</u>	 2014	 2013
Fair value of plan assets as of beginning of year	\$ 1,013,133	\$ 919,972
Actual return on plan assets	164,579	57,838
Employer contribution	115,523	71,884
Benefits paid	(44,398)	(36,561)
Fair value of plan assets as of June 30	<u>\$ 1,248,837</u>	<u>\$ 1,013,133</u>
 <u>Funded Status as of June 30</u>	 2014	 2013
Fair value of plan assets	\$ 1,248,837	\$ 1,013,133
Projected benefit obligation	(1,697,672)	(1,421,257)
Unfunded status	<u>\$ (448,835)</u>	<u>\$ (408,124)</u>

Amounts recognized in the Combined Balance Sheets consist of (in thousands):

	2014	2013
Net pension liability	<u>\$ (448,835)</u>	<u>\$ (408,124)</u>
Net amount recognized	<u>\$ (448,835)</u>	<u>\$ (408,124)</u>

The projected benefit obligation is greater than the fair value of plan assets for all plans that are aggregated with these statements.

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Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets consist of (in thousands):

	2014	2013
Actuarial net loss	\$ 539,711	\$ 470,927
Prior service cost	273	1,066
	<u>\$ 539,984</u>	<u>\$ 471,993</u>
Accumulated benefit obligation	<u>\$ 1,563,231</u>	<u>\$ 1,322,577</u>

Net Periodic Pension Cost

Components of net periodic pension cost (in thousands):

	2014	2013
Service cost	\$ 52,881	\$ 61,876
Interest cost	71,507	67,237
Expected return on plan assets	(79,694)	(72,024)
Amortization of prior service cost	794	1,658
Recognized net actuarial loss	39,647	58,844
Settlement loss recognized	2,082	2,023
Net periodic pension cost	<u>\$ 87,217</u>	<u>\$ 119,614</u>

	2014	2013
Other Changes in Plan Assets and Benefit Obligations Recognized in Unrestricted Net Assets		
Net loss (gain)	\$ 111,389	\$ (123,138)
Amortization of net loss	(41,576)	(60,564)
Amortization of prior service cost	(794)	(1,658)
Total recognized in unrestricted net assets	<u>\$ 69,019</u>	<u>\$ (185,360)</u>
Total loss (gain) recognized in net periodic benefit cost and unrestricted net assets	<u>\$ 156,236</u>	<u>\$ (65,746)</u>

The estimated net loss and prior service cost credit that will be amortized from unrestricted net assets into net periodic pension cost over the next fiscal year are \$51.9 million and (\$6) thousand, respectively.

The assumptions used in determining net periodic pension cost for all plans except the SMH plan where noted are as follows for the years ended June 30:

	2014	2013
Discount rate	5.12%	4.66%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase - ultimate	2.50%	3.00%

The SMH plan utilized a rate of return on assets of 7.00% for the years ended June 30, 2014 and 2013, respectively, due to the nature of the plan being frozen and management's future expectations surrounding this plan.

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The assumptions used in determining the benefit obligations for all plans except the SMH plan where noted are as follows as of July 1:

	2014	2013
Discount rate	4.64%	5.12%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase - ultimate	2.50%	2.50%

The SMH plan utilized an expected rate of return on assets of 7.00% for the years ended June 30, 2014 and 2013, respectively, due to the nature of the plan being frozen and management's future expectations surrounding this plan.

The expected rate of return on plan assets assumption, excluding SMH, was developed based on historical returns for the major asset classes. This review also considered both current market conditions and projected future conditions.

Plan Assets

Pension plan weighted average asset allocations as of June 30 by asset class are as follows:

<u>Asset Class</u>	2014	2013
Cash and cash equivalents	1.88%	2.15%
Equities and equity funds	32.49%	33.55%
Fixed income funds	28.49%	30.82%
Alternative investments	<u>37.14%</u>	<u>33.48%</u>
Total	<u>100.00%</u>	<u>100.00%</u>

The Plans assets are invested among and within various asset classes in order to achieve sufficient diversification in accordance with JHHS' risk tolerance. This is achieved through the utilization of asset managers and systematic allocation to investment management style(s), providing a broad exposure to different segments of the fixed income and equity markets. The Plans strive to allocate assets between equity securities (including global asset allocation) and debt securities at a target rate of approximately 75% and 25%, respectively.

Fair Value of Plan Assets

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2 – Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions.

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The following table presents the plan assets carried at fair value as of June 30, 2014 grouped by hierarchy level (in thousands):

Assets	Fair Value	Level 1	Level 2
Cash equivalents (1)	\$ 23,488	\$ 23,488	\$ -
Equities and equity funds (2)	405,780	52,024	353,756
Fixed income funds (3)	355,816	244,771	111,045
Alternative investments (4)	463,753	-	463,753
Totals	<u>\$ 1,248,837</u>	<u>\$ 320,283</u>	<u>\$ 928,554</u>

The following table presents the plan assets carried at fair value as of June 30, 2013 grouped by hierarchy level (in thousands):

Assets	Fair Value	Level 1	Level 2
Cash equivalents (1)	\$ 21,668	\$ 21,668	\$ -
Equities and equity funds (2)	339,974	58,309	281,665
Fixed income funds (3)	312,292	244,658	67,634
Alternative investments (4)	339,199	-	339,199
Totals	<u>\$ 1,013,133</u>	<u>\$ 324,635</u>	<u>\$ 688,498</u>

- (1) Cash and cash equivalents, commercial paper, and money market funds include investments with original maturities of three months or less, and are rendered level 1 due to their frequent pricing and ease of converting to cash.
- (2) Equities include individual equities and investments in mutual funds, and commingled. The individual equities and mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts and hedge funds are valued regularly within each month utilizing NAV per unit and are rendered level 2.
- (3) Fixed income funds are investments in mutual funds and commingled trusts investing in fixed income instruments. The underlying fixed investments are principally U.S. Treasuries, corporate bonds, commercial paper, and mortgage backed securities. The mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts are valued regularly within each month utilizing NAV per unit and are rendered level 2.
- (4) Alternative investments include investments that are not traded on national exchanges or over-the-counter markets. These investments are valued at net asset value per share that has been calculated in accordance with investment company rules, which among other things, indicates that the underlying investments be measured at fair value. This valuation technique coupled with short term redemption notice periods renders these investments level 2.

There are no unfunded commitments related to the Plans' alternative investments.

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The following table displays information by major alternative investment category as of June 30, 2014 (in thousands):

Description	Fair Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	\$ 260,875	Daily or monthly	Same day or 5 to 30 days	Day after trade, or within 15 days, or 95% on redemption date, 5% within 3 days
Fund of funds	2,912	Quarterly	45 days	90% within 30, 10% after annual audit
Hedge funds	162,280	Monthly, quarterly, or bi-annually	30 to 95 days	90% to 95% within 15 to 30 days, 5% to 10% after annual audit or redemption date
Credit funds	37,686	Annually	60 to 90 days	Within 30 days, or 90% within 10 days, 10% after annual audit
Total	<u>\$ 463,753</u>			

The following table displays information by major alternative investment category as of June 30, 2013 (in thousands):

Description	Fair Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	\$ 169,657	Monthly	5 to 30 days	Within 15 days, or 95% on redemption date and 5% within 3 days
Fund of funds	2,756	Monthly, quarterly, or annually	45 days	90% within 30, 10% after annual audit
Hedge funds	134,842	Monthly or Quarterly	30 to 65 days	90 to 95% within 3 to 30 days, 5 to 10% after annual audit or redemption date
Credit funds	31,384	Annual	60 to 90 days	Within 30 days, or 90% within 10 days, 10% after annual audit
Distressed credit	560	December 31, 2013		
Total	<u>\$ 339,199</u>			

Contributions and Estimated Future Benefit Payments

JHHS expects to contribute \$111.2 million to its pension plans in the fiscal year ending June 30, 2015.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in each of the following fiscal years as of June 30, 2014 (in thousands):

2015	\$ 55,709
2016	59,788
2017	64,927
2018	70,793
2019	76,987
Thereafter	475,279

HCGH participates in a defined contribution 401(k) savings plan available to all employees, which was amended during 1996. The revised plan provides that HCGH will contribute 1% to 2% of each employee's total compensation in addition to contributing from fifty cents to one dollar and fifty cents, based on years of service, for each dollar contributed by the employee. HCGH's contribution match basis is limited to 6% of the employee's total compensation. HCGH contributed approximately \$3.1 million and \$3.2 million to the plan for the years ended June 30, 2014 and 2013, respectively.

SMH participates in a defined contribution 401(k) savings plan available to all eligible employees. Under the plan, SMH matches one-half of a maximum 3% of employee contributions. SMH contributed approximately \$1.3 million and \$1.0 million to the plan for the years ended June 30, 2014 and 2013, respectively.

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ACH participates in a defined contribution retirement plan of ACHS covering substantially all of its employees. Contributions are determined at the discretion of the Board of Directors of ACHS. ACH contributed approximately \$5.7 million and \$5.6 million to the plan for year ended June 30, 2014 and 2013, respectively.

12. Maryland Health Services Cost Review Commission (“Commission” or “HSCRC”)

The State of Maryland has been granted a waiver by the federal government exempting the State from national Medicare and Medicaid reimbursement principles. JHH, JHBMC, HCGH and SHI charges for inpatient as well as outpatient and emergency services performed at the hospitals are regulated by the Commission. JHHS’ management has made all submissions required by the Commission and believes JHHS is in compliance with Commission requirements. Management believes that the waiver and Commission regulation will remain in effect through December 31, 2018.

Prior to January 1, 2014, hospitals in the State of Maryland were reimbursed on an all payor basis whereby all payors were paid the same rate based on a methodology that established a Medicare per admission cap for each hospital. Hospital specific charge per admission was adjusted annually to reflect inflation and each hospital’s case mix index. A waiver test was applied annually to determine if the growth of cost per Medicare admission was below the national average.

Effective January 1, 2014, with retroactive application to revenues generated by services provided after June 30, 2013, the Commission and the Center for Medicare and Medicaid Services entered into a Global Budget Revenue Agreement (“GBR”). The agreement will remain in effect through December 31, 2018. The GBR moves from a Medicare per admission methodology to a per capita population health based methodology. However, all hospitals continue to receive reimbursement under an all payor basis. The methodology also includes a new waiver test. Under the new waiver test, growth in revenue per capita will be limited to a rate of 3.58% for the State of Maryland in total. The new agreement sets a hospital’s revenue base annually under a global budget arrangement, whereby revenue would be fixed regardless of changes in volume and patient mix for Maryland residents. Hospital revenue for Maryland residents receiving care at Maryland hospitals would be subject to this global budget. However, out of state patients receiving care at Maryland hospitals would not be subject to the global budget. The hospital would receive full rate authority for any out of state volume and growth, or would receive less revenue for lower volumes of out of state patients. HCGH has negotiated to include out of state volume within their global budget; therefore, all in state and out of state volumes are subject to their global budget.

Under the Commission reimbursement methodology, amounts collected for services to patients under the Medicare and Medicaid programs are computed at approximately 94% of Commission approved charges. Other payors are eligible to receive up to a 2.25% discount on prompt payment of claims.

13. Professional and General Liability Insurance

The University and JHHS and Affiliates participate in an agreement with four other medical institutions to provide a program of professional and general liability insurance for each member institution. As part of this program, the participating medical institutions have formed a risk retention group (“RRG”) and a captive insurance company to provide self-insurance for a portion of their risk.

The Johns Hopkins Health System Corporation and Affiliates

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for the years ended June 30, 2014 and 2013

JHH and the University each have a 10% ownership interest in the RRG and the captive insurance company, which is included in investments on the Combined Balance Sheets. The medical institutions obtain primary and excess liability insurance coverage from commercial insurers and the RRG. The primary coverage is written by the RRG, and a portion of the risk is reinsured with the captive insurance company. Commercial excess insurance and reinsurance is purchased under a claims-made policy by the participating institutions for claims in excess of primary coverage retained by the RRG and the captive. Primary retentions range between \$1.0 million and \$5.0 million per incident. Primary coverage is insured under a retrospectively rated claims-made policy; premiums are accrued based upon an estimate of the ultimate cost of the experience to date of each participating member institution. The basis for loss accruals for unreported claims under the primary policy is an actuarial estimate of asserted and unasserted claims including reported and unreported incidents and includes costs associated with settling claims. Projected losses were discounted using 0.64% and 0.57% as of June 30, 2014 and 2013, respectively.

Effective December 15, 2013, ACH entered into the RRG to provide self-insurance for a portion of its risk. Prior to December 15, 2013, ACH maintained a claims-made commercial insurance policy. Losses from asserted and un-asserted claims identified under the ACH's incident reporting systems are accrued based on estimates that incorporate ACH's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors.

JHHS applies the provisions of ASU 2010-24, "Presentation of Insurance Claims and Related Insurance Recoveries", which clarifies that health care entities should not net insurance recoveries against the related claims liabilities. JHHS recorded an increase in its assets and liabilities in the accompanying consolidated Balance Sheet as of June 30, 2014 and 2013 as follows:

Caption on Combined Balance Sheet	2014	2013
Estimated malpractice recoveries, current portion	\$ 224,902	\$ 28,590
Estimated malpractice recoveries, net of current	42,260	56,177
Total assets	<u>\$ 267,162</u>	<u>\$ 84,767</u>
Current portion of estimated malpractice costs	\$ 224,902	\$ 28,590
Estimated malpractice costs, net of current portion	42,260	56,177
Total liabilities	<u>\$ 267,162</u>	<u>\$ 84,767</u>

The assets and liabilities represent JHHS' estimated self-insured captive insurance recoveries for claims reserves and certain claims in excess of self-insured retention levels. The insurance recoveries and liabilities have been allocated between short-term and long-term assets and liabilities based upon the expected timing of the claims payments. The adoption had no impact on JHHS' results of operations or cash flows.

Professional and general liability insurance expense incurred by JHHS and Affiliates was \$45.2 million and \$49.6 million for the years ended June 30, 2014 and 2013, respectively. Reserves were \$361.6 million and \$171.1 million as of June 30, 2014 and 2013, respectively.

14. Related Party Transactions

During the years ended June 30, 2014 and 2013, JHHS and its Affiliates engaged in various related party transactions. These transactions were not eliminated because these entities are not consolidated. There were no significant intercompany profits that were eliminated. The following is a summary of the significant related party transactions and balances for the year ended June 30:

The Johns Hopkins Health System Corporation and Affiliates

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Revenue/(expense) transactions (in thousands):

	2014	2013
Pharmacy management and patient discharge planning costs to JHHCG	\$(20,872)	\$(16,983)
Security and management of housekeeping and parking garage services provided by Broadway Services, Inc	(21,888)	(23,642)
Utility, telecommunication and clinical application services provided by JHMI Utilities, LLC	(71,269)	(50,889)

Current due from/(to) related party balances as of June 30 (in thousands):

	2014	2013
Due (to) from JHHCG	\$ (2,383)	\$ 41
Due from JHMI Utilities, LLC	7,971	15,020
Due (to) from JHI	(158)	66
Due from others	5,224	4,514

Affiliate Notes Receivable:

JHHS has made loans to certain affiliates that are accounted for under either the cost or equity method. As these affiliates do not consolidate within JHHS, the loans to these affiliates do not eliminate in consolidation. The short-term portion of these notes receivable are included in Due from affiliates, current portion, and the long-term portion is included in Due from affiliates, net of current portion in the Combined Balance Sheets.

JHHSC has two affiliate notes receivable from White Marsh Surgery Center. One note with a balance of \$1.9 million and \$1.4 million as of June 30, 2014 and 2013, respectively, that is due on June 1, 2023, accrues interest at a fixed rate of 6.5%. Principal and interest payments are made on a monthly basis. The second note with a balance of \$104 thousand as of June 30, 2014 that is due on February 1, 2015, accrues interest at a variable rate equal to the 2-year Treasury rate. Principal and interest payments began in August 2014, and are made monthly on the first day of each month.

JHHSC has an affiliate note receivable from Johns Hopkins Suburban Health Center, L.P. with a balance of \$2.6 million and \$2.3 million as of June 30, 2014 and 2013, respectively. The note is due in full on June 30, 2021. Interest accrues at a variable rate equal to the Prime Rate, which was 3.25% for each of the years ended June 30, 2014 and 2013.

JHHSC has an affiliate note receivable from FSK Land Corporation with a balance of \$2.2 million and \$2.4 million as of June 30, 2014 and 2013, respectively that is due on December 1, 2026, and accrues interest at 4.0%. Principal and interest payments are paid monthly.

JHH and JHHSC have affiliate notes receivable with JHMI Utilities, LLC. JHH's note receivable has a balance of \$5.0 million and \$5.0 million as of June 30, 2014 and 2013, respectively. JHHSC's note receivable has a balance of \$90.0 million and \$62.4 million as of June 30, 2014 and 2013, respectively. The JHH note receivable has an initial repayment date of December 1, 2019, accrues interest in the initial period at a fixed rate of 6.0%, with interest payments paid monthly. The JHHSC note receivable is due in April 2023, accrues interest at a fixed rate of 5.85%, with principal and interest payments paid monthly.

The Johns Hopkins Health System Corporation and Affiliates

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15. Contracts, Commitments and Contingencies

There are several lawsuits pending in which JHHS has been named as a defendant. In the opinion of JHHS' management, after consultation with legal counsel, the potential liability, in the event of adverse settlement, will not have a material impact on JHHS' financial position.

In one such case, a physician formerly employed by JHHSC and leased to JHCP to provide obstetrical and gynecological services, illegally and without the knowledge of JHHS, photographed his patients and possibly others with what JHHS understands to be his personal photographic and video equipment and stored those images electronically. This occurred for an unknown period of time. JHHS reached an agreement with plaintiff's attorneys to settle the class action lawsuit in the amount of \$190 million. The settlement has been formalized by the plaintiffs' attorneys and JHHS and given preliminary approval by a judge. JHHS maintains both primary and excess medical malpractice insurance coverage for this claim through its captive insurer, MCIC, with commercial excess reinsurance policies providing additional protection. MCIC and its reinsurers will cover \$186M of the indemnity payment plus expense costs and \$4M of the indemnity will be paid from other policies and deductibles other than MCIC. In connection with the settlement, under the provisions of ASU 2010-24, JHHS recorded a current liability and corresponding insurance recovery for \$190.0 million. As of June 30, 2014, all insurance recoveries are expected to be collectible.

As a result of the settlement agreement, JHH will be required to post collateral to MCIC in the amount of approximately \$124M which is expected to occur in fiscal 2015. JHH will post the collateral by entering into a Control Agreement between JHH, MCIC, and PNC bank which will provide MCIC with the first priority perfected security interest in a dedicated account within the PNC investment pool. On July 21, 2014, JHH signed a pledge agreement with MCIC which outlines the terms that would permit MCIC to draw from the account under the Control Agreement. Drawdown of the collateral by MCIC would take place only in the event another large claim develops which would require use of the excess layers within the 2013 policy year above the level of reinsurance coverage that still remains. The collateral requirement will be monitored annually by MCIC and released accordingly as the 2013 policy matures based upon actuarially determined measures. As of June 30, 2014, there are no additional claims in the 2013 policy year which exceed the self-insured layers within MCIC.

JHHS and Affiliates

JHHS has made an indirect guarantee with the University in connection with debt issued by the East Baltimore Development Inc. ("EBDI"). EBDI entered into a loan commitment for \$15.0 million that is due on October 1, 2014. In connection with the terms of the loan, the University entered into a participation agreement with an unrelated third party to provide a guarantee up to \$3.8 million. In the event that the University would be called to fulfill its guarantee, there is reasonable likelihood that JHHS would share in 50% of any payments made by the University.

JHHS has agreements with the University, under which the University provides medical administration and educational services, conducts medical research programs, provides patient care medical services, and provides certain other administrative and technical support services through the physicians employed by The Johns Hopkins University School of Medicine ("JHUSOM"). Compensation for providing medical administration and educational services is paid to the University by JHHS; funding for services in conducting medical research is paid from grant funds and by JHHS; compensation for patient care medical care services is derived from billings to patients (or third-party payors) by the University; and compensation for other support services is paid to the University by JHHS. The aggregate amount of purchased services incurred by JHHS under these agreements was \$262.0 million and \$255.5 million for the years ended June 30, 2014 and 2013, respectively.

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JHHS has an agreement with the University under which the University recruits and pays interns and resident physicians who furnish services to JHHS on a rotating basis. Included in supplies and other expenses in the accompanying Combined Statements of Operations and Changes in Net Assets for services under this agreement is \$5.4 million and \$5.3 million for the years ended June 30, 2014 and 2013, respectively, for physicians providing services on a rotating basis, and \$3.9 million and \$3.7 million for the years ended June 30, 2014 and 2013, respectively, for physicians providing services on a non-rotating basis.

JHHS provides departmental support for Chiefs of Service based on personal recruitment agreements between JHHS, JHUSOM and the respective Chief of Service. These commitments to the department are conditional to the extent the Chief of Service remains in the position. Future expected payments related to agreements currently in place were \$3.0 million and \$4.2 million as of June 30, 2014 and 2013, respectively.

JHH had non-cancellable commitments under construction contracts of \$30.6 million and \$60.0 million as of June 30, 2014 and 2013, respectively, relating primarily to its campus redevelopment plan which includes the construction of a new Cardiovascular and Critical Care Adult Tower and a Children's Hospital.

Commitments for leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2014, that have initial or remaining lease terms in excess of one year (in thousands).

2015	\$	20,044
2016		18,228
2017		17,414
2018		14,848
2019		13,859

Rental expense for all operating leases for the years ended June 30, 2014 and 2013 amounted to \$41.7 million and \$44.1 million, respectively.

Asset Retirement Obligations

During 2006, JHHS recorded asset retirement obligations associated with the abatement of asbestos in several of its buildings constructed prior to 1980. The fair value of the estimated asset retirement obligations as of June 30, 2014 and 2013 was \$19.4 million and \$19.4 million, respectively.

The change in asset retirement obligation for the years ended June 30 consisted of the following (in thousands):

	2014	2013
Retirement obligation at beginning of year	\$ 19,398	\$ 20,037
Liabilities settled	(657)	(1,224)
Accretion expense	705	585
Retirement obligation at end of year	<u>\$ 19,446</u>	<u>\$ 19,398</u>

The Johns Hopkins Hospital

In 2005, JHH and the University created a Limited Liability Company (JHMI Utilities, LLC) to provide utility and telecommunication services for their East Baltimore Campus. Each member owns 50% of the LLC and shares equally in the governance of the LLC. The LLC has also

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assumed the liability for the JHH's 1985 Pooled Loan obligation of \$8.5 million. The cost of acquiring and upgrading the existing utility facilities, the construction of a new power plant and an upgrade of the telecommunication system have been financed through the issuance of tax exempt bonds by MHHEFA and the proceeds of the Pooled Loan program sponsored by MHHEFA. JHH and the University have guaranteed the total debt issued by MHHEFA. As of June 30, 2014, the amount of the debt guarantee by JHH was \$38.5 million. JHH accounts for this investment under the equity method of accounting.

JHH has pledged investments having an aggregate market value of \$25.9 million and \$25.3 million as of June 30, 2014 and 2013, respectively, for JHHS compliance with regulations of the Workers Compensation Commission and the Department of Economic and Employment Development's Unemployment Insurance Fund. These investments are included in assets whose use is limited by board of trustees in the Combined Balance Sheet.

Department of Defense Agreement - MSC

JHMSC entered into a contract with the Department of Defense to provide the TRICARE Prime benefit to eligible beneficiaries enrolled in the Johns Hopkins Uniformed Services Family Health Plan ("USFHP"). Under the USFHP contract, JHMSC provides services covered under the TRICARE Designated Provider Contract to enrollees for a monthly capitation fee. Revenues generated under the contract were \$353.0 million and \$331.6 million for the years ended June 30, 2014 and 2013, respectively. The current sole source commercial contract was awarded for the period commencing October 1, 2013 through September 30, 2023, with a Base Year and nine one-year Option Periods to be exercised at the Government's discretion. The Base Year has been exercised with the first Option Period to begin on October 1, 2014.

16. Functional Expenses

JHHS provides general health care services to residents within its geographic location as well as to national and international patients. Expenses related to providing these services for the years ended June 30 consisted of the following (in thousands):

	2014	2013
Health care services	\$ 3,997,378	\$ 3,943,284
General and administrative services	933,686	833,599
Fundraising	6,417	5,995
Program service	1,208	1,115
Total expenses	<u>\$ 4,938,689</u>	<u>\$ 4,783,993</u>

17. The Johns Hopkins Hospital Endowment Fund, Incorporated

The Endowment Corporation was organized for the purpose of holding and managing the endowment and certain other funds transferred from and for the benefit of JHHS. The affairs of the Endowment Corporation are managed by a Board of Trustees, comprised of Trustees who are self-perpetuating. Neither JHHS nor any Affiliate holds legal title to any Endowment Corporation funds. The Board of Trustees may, in its discretion, award funds from the Endowment Corporation to organizations other than JHHS if the Board of Trustees determines that doing so is for the support, benefit of, or in furtherance of the mission of JHHS. Accordingly, these amounts are not presented in the combined financial statements of JHHS and its Affiliates until they are subsequently distributed to JHHS and its affiliates from the Endowment Corporation. The Endowment Corporation's net assets were \$668.0 million and \$605.2 million as

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of June 30, 2014 and 2013, respectively. The Endowment Corporation's distributions from net assets to JHHS and its affiliates were \$12.9 million and \$8.9 million for the years ended June 30, 2014 and 2013, respectively, and were recorded as other revenue.

18. Subsequent Events

JHHS has performed an evaluation of subsequent events through September 25, 2014, which is the date the financial statements were issued.