

Ohio State University Physicians, Inc. (A component unit of The Ohio State University)

Consolidated Financial Statements as of and
for the Years Ended June 30, 2013 and 2012,
Supplemental Consolidating Schedules as of and
for the Years Ended June 30, 2013 and 2012,
And Independent Auditor's Report

OHIO STATE UNIVERSITY PHYSICIANS, INC.
(A COMPONENT UNIT OF THE OHIO STATE UNIVERSITY)

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Independent Auditor's Report

To the Board of Directors of
Ohio State University Physicians, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Ohio State University Physicians, Inc. ("OSUP"), a component unit of The Ohio State University, which comprise the consolidated statements of net position as of June 30, 2013 and June 30, 2012, and the related consolidated statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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



Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of OSUP as of June 30, 2013 and June 30, 2012, and the changes in net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The accompanying management's discussion and analysis on pages 3 through 6 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise OSUP's basic financial statements. The consolidating information on pages 31 and 32 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2013 on our consideration of OSUP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering OSUP's internal control over financial reporting and compliance.

PricewaterhouseCoopers LLP

October 31, 2013

Management's Discussion and Analysis for the Year Ended June 30, 2013 and June 30, 2012 (Unaudited)

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of Ohio State University Physicians, Inc. for the years ended June 30, 2013 and June 30, 2012. We encourage you to read this MD&A section in conjunction with the audited financial statements and footnotes appearing in this report.

About Ohio State University Physicians

Ohio State University Physicians, Inc. and subsidiaries (OSUP) located in Columbus, Ohio, is a 501c (3) tax-exempt physician organization for the physicians providing medical care, supporting medical research and supporting medical education at The Ohio State University (the University). It was incorporated in Ohio in 2002, and the physicians primarily serve communities within the Central Ohio region.

OSUP is the single member of 17 limited liability companies (LLCs). As of June 30, 2013, only 15 of the LLCs are active and included in the consolidated financial statements and the accompanying supplemental consolidating schedules. In the year ended June 30, 2012 a new LLC was added, OSU Plastic Surgery, which was created out of the OSU Surgery LLC. Two of the LLCs (Anesthesiology and Orthopedics) have been created, but had no business activity within the OSUP structure, through June 30, 2013.

OSUP is governed by a board of managers who are responsible for oversight of clinical programs, budgets, general administration, and employment of faculty and staff. Effective January 1, 2011 any new faculty members hired were employed through The Ohio State University Faculty Group Practice (FGP) and were leased back to OSUP. Physicians previously employed through OSUP began integrating to the FGP effective July 1, 2011. All physicians that were to be employed through the FGP were integrated by June 30, 2013 and are being leased back to OSUP in the same manner as new hires that started after January 1, 2011.

The following financial statements reflect all assets, liabilities and net position (equity) of Ohio State University Physicians, Inc. The complete set of entities reflected in the financial statements is provided in the Basis of Presentation section of Note 1 to the consolidated financial statements.

About the Financial Statements

OSUP presents its financial statements in a "business type activity" format, in accordance with GASB Statement No. 61, The Financial Reporting Entity. In addition to this MD&A section, the financial statements include Statements of Net Position, Statements of Revenues, Expenses and Other Changes in Net Position, Statements of Cash Flows and Notes to the Financial Statements.

The Statement of Net Position is OSUP's balance sheet. It reflects the total assets, liabilities and net position (equity) as of June 30, 2013 and June 30, 2012. Liabilities due within one year, and assets available to pay those liabilities are classified as current. Other assets and liabilities are classified as noncurrent. Investment assets are carried at market value. Capital assets, which include land, buildings, improvements, and equipment, are shown net of accumulated depreciation.

The Statement of Revenues, Expenses and Other Changes in Net Position is OSUP's income statement. It details how net position has increased (or decreased) during the year ended June 30, 2013 and June 30, 2012. Patient care revenue is shown net of allowances for collectability, depreciation is provided for capital assets, and there are required subtotals for operating income (loss) and nonoperating income (loss).

The Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2013 and June 30, 2012. It breaks out the sources and uses of OSUP cash into logical categories such as, operating activities, capital financing activities, and investing activities.

Management's Discussion and Analysis for the Year Ended June 30, 2013 and June 30, 2012 (Unaudited)

The Notes to the Financial Statements, which follow the financial statements, provide additional details on the numbers in the financial statements. Behind the notes is a section that provides supplemental consolidating information.

Financial Highlights and Key Trends

OSUP's net position (equity) increased \$5.2 million to \$78.4 million at June 30, 2013. This is a decrease when compared to prior years' growth in net position of \$2.6 million. Net Patient Revenues grew by \$22.3 million, and Other Revenue and Medical Center Investment increased by \$6.7 million, while expenses grew by \$32.2 million. Nonoperating income/(expense) grew by \$500 thousand associated primarily with the Columbus tax abatement and rental income growth.

Condensed Consolidated Statements of Net Position (in thousands)

	June 30, 2013	June 30, 2012	June 30, 2011
<u>ASSETS</u>			
Current assets	107,268	98,697	89,508
Noncurrent assets	31,637	37,777	40,999
TOTAL ASSETS	<u>138,905</u>	<u>136,474</u>	<u>130,507</u>
<u>LIABILITIES</u>			
Current liabilities	39,145	36,394	34,428
Long term liabilities	21,311	26,798	30,608
TOTAL LIABILITIES	<u>60,456</u>	<u>63,192</u>	<u>65,036</u>
<u>NET POSITION</u>			
Total net position	<u>78,449</u>	<u>73,282</u>	<u>65,471</u>
TOTAL LIABILITES & NET POSITION	<u>138,905</u>	<u>136,474</u>	<u>130,507</u>

Current assets consist of cash and cash equivalents, and other assets that are expected to be collected within the year following the balance sheet date. Noncurrent assets consist of Property, Plant, Furniture, and Equipment and other long term assets with more than a one year expected lifespan. Current liabilities consist of debt that is expected to be liquidated within the year, and long term liabilities consist of long term debt associated with long term assets and with a lifespan of greater than one year.

Cash and cash equivalents increased \$10.3 million versus the prior year. The primary reasons for the increase were: the net position increase of \$5.2 million from Operating and Nonoperating sources, the decrease of \$4.0 million in net patient care accounts receivable, and \$2.2 million issuance in long term debt to fund the loss on the interest rate swap on the refinancing of debt.

Net patient care accounts receivables decreased by \$4.0 million as the second year impact of the new electronic medical record system implementation and improvements associated with the preparation of a more centralized business office was experienced in the current fiscal year.

Property, plant, furniture, and equipment- net decreased \$0.9 million for the year primarily based upon depreciation taken in excess of assets purchased. PP&E purchases were approximately \$1.6 million for the year. Depreciation expense on these assets was \$2.5 million.

Long- term investments decreased by \$3.6 million primarily related to the movement of long term investments to short term investments.

Management's Discussion and Analysis for the Year Ended June 30, 2013 and June 30, 2012 (Unaudited)

EPIC ambulatory electronic medical records use agreement reflects OSUP's cost of using the electronic medical records system implemented by OSU Health System, which is accounted for similar to a lease arrangement and depreciated over the useful life of the asset. The physicians of OSUP are funding approximately \$11.3 million in total to this joint project with OSU Health System.

The increase in Current liabilities as of June 30, 2013 of \$2.7 million came primarily from the growth in amounts due to affiliated entities, primarily The Ohio State University, and are based upon agreements between the LLC's and the university.

Long term liabilities decreased \$2.7 million associated with reduction in long term amounts related to affiliated organizations within The Ohio State University, primarily due to the debt for the electronic medical record system . The remaining amount due to the OSU Health System for the system is approximately \$8.7 million

Statement of Revenue, Expenses, and Changes in Net Position

The statement of revenue, expenses, and changes in net position presents OSUP's results of operations. A comparison for the years ended June 30, 2013, 2012, and 2011 is summarized as follows.

Condensed Consolidated Statements of Revenue, Expenses, and Changes in Net Position (in thousands)

	<u>2013</u>		<u>2012</u>		<u>2011</u>
Net patient care revenue less provisions for bad debts	\$ 249,050	\$	226,776	\$	222,231
Other revenue	82,766		76,026		68,370
Total Operating Expense	(329,003)		(296,843)		(285,827)
Operating income	\$ 2,813	\$	5,959	\$	4,774
Nonoperating income (expense)	2,354		1,852		3,129
Increase in net position	\$ 5,167	\$	7,811	\$	7,903

Average monthly patient volume increased from 140 thousand per month in the fiscal year ended June 30, 2012 to 154 thousand per month in the fiscal year ended June 30, 2013. This was primarily related to the growth in the number of physicians and other providers providing patient services during fiscal year 2013.

Other revenue increased \$6.7 million and represents both revenue associated with outside health related organizations, and support payments associated with funding of programs deemed important through The Ohio State University. Additionally Nonoperating income /(expense) increased \$500 thousand related to an increase in the tax rebate with the City of Columbus, for payroll growth incentives.

Increases in Net patient care revenue are associated with volume increases noted above as well as changes in rates charged and payments received for services, including the change in mix of services rendered to patients, and the payer mix of patients seen. Net patient care revenue less provisions for bad debts increased \$22.3 million from fiscal year 2012 to fiscal year 2013.

Operating expenses increased by \$32.2 million year over year. Approximately \$17.7 million of that increase came in physician related costs. New physicians entering the practice generally take 1-2 years of service to grow their clinical practice before they are considered a mature practice. Fiscal year ended June 30, 2013 included an increase of 92 physicians to the OSUP/FGP practice, 18 added in fiscal year ended June 30, 2012, and 86 added in fiscal year ended June 30, 2011.

Management's Discussion and Analysis for the Year Ended June 30, 2013 and June 30, 2012 (Unaudited)

Economic Factors That Will Affect the Future

As in prior years the Medicare program has automatic cuts that if implemented would mean significant reductions of income for clinical services. Historically Congress has found support to eliminate these automatic cuts before they have become law. For January 1, 2014 these cuts would approximate \$17.1 million annually.

Healthcare reform is a source of concern as estimates of payment reductions over time based upon all commercial payers moving to Medicare payment rates would result in as much as a \$51.4 million dollar negative annual impact. This would be phased in over a number of years which will allow time to adjust, however significant operational changes would be necessary to handle such change. OSUP is undergoing significant financial redesign of operations in order to offset expected revenue losses, which include projects associated with physician productivity, patient access improvements, federal upper payment limit and Medicaid expansion projects, and overhead cost reductions.

Ongoing governmental funding for our investment in an electronic medical record system (EPIC) has and will continue to provide to pay for OSUP's \$11.3 million share of the system cost. The expectation is to recoup more than the \$11.3 million in system cost over the next several years from the stimulus funding set by Congress in prior years. We have received approximately \$5.9 million in payments as of June 30, 2013. Over the next year we are expecting an additional \$3 million from the Centers for Medicare & Medicaid Services related to our year two funding, which began January 1, 2013.

OHIO STATE UNIVERSITY PHYSICIANS, INC.

(A component unit of The Ohio State University)

CONSOLIDATED STATEMENTS OF NET POSITION

AS OF JUNE 30, 2013 and 2012

(IN THOUSANDS)

	<u>2013</u>	<u>2012</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 46,285	\$ 35,933
Short-term investments	11,621	11,396
Accounts receivable — patient care — net of allowance	32,266	36,314
Accounts receivable — other	5,016	6,933
Due from affiliates	10,276	6,440
Inventories	994	786
Prepaid expenses	810	894
Notes receivable	-	1
Total current assets	<u>107,268</u>	<u>98,697</u>
NONCURRENT ASSETS:		
Property, plant, furnitures, and equipment — net of accumulated depreciation (\$17,259 in 2013 and \$15,429 in 2012)	22,368	23,283
Long-term investments	1,529	5,106
EPIC ambulatory electronic medical record use agreement	5,704	7,257
Other assets	2,036	2,131
Total noncurrent assets	<u>31,637</u>	<u>37,777</u>
TOTAL ASSETS	<u>\$ 138,905</u>	<u>\$ 136,474</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Accounts payable	\$ 3,210	\$ 2,993
Accrued expenses	741	1,676
Accrued salaries and wages	9,141	9,214
Due to affiliates-current portion	20,187	14,897
Notes payable and capital leases-current portion	895	811
Retirement and health plan accrual	439	598
Other current liabilities	4,532	6,205
Total current liabilities	<u>39,145</u>	<u>36,394</u>
LONG TERM LIABILITIES:		
Notes payable and capital leases-less current portion	17,180	15,400
Due to affiliates - less current portion	2,674	7,020
Other long term liabilities	1,457	4,378
Total long term liabilities	<u>21,311</u>	<u>26,798</u>
COMMITMENTS AND CONTINGENCIES (Note 11)		
NET POSITION:		
Invested in capital assets, net of related debt	\$3,016	\$5,400
Unrestricted	75,433	67,882
Total net position	<u>\$78,449</u>	<u>\$73,282</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$138,905</u>	<u>\$136,474</u>

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

OHIO STATE UNIVERSITY PHYSICIANS, INC.

(A component unit of The Ohio State University)

CONSOLIDATED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION

AS OF JUNE 30, 2013 and 2012

(IN THOUSANDS)

	<u>2013</u>	<u>2012</u>
OPERATING REVENUE:		
Net patient care revenue	\$ 265,420	\$ 246,682
Provisions for bad debt	16,370	19,906
Net patient care revenue less provisions for bad debts	<u>249,050</u>	<u>226,776</u>
Other revenue	<u>82,766</u>	<u>76,026</u>
Total operating revenue	331,816	302,802
OPERATING EXPENSES:		
Salaries and benefits	251,428	230,022
Supplies and pharmaceuticals	24,020	21,039
Services	28,056	21,869
Malpractice	2,106	2,683
Dean's tax	7,892	6,455
Occupancy and utilities	7,220	6,874
Amortization and depreciation	4,317	4,178
Interest	713	764
Other expenses	<u>3,251</u>	<u>2,959</u>
Total operating expenses	<u>329,003</u>	<u>296,843</u>
Operating income	<u>2,813</u>	<u>5,959</u>
NONOPERATING INCOME (EXPENSES):		
Interest income	139	81
Nonoperating income	3,759	3,084
Income from investments	99	785
Loss on sale of assets	(15)	(7)
Nonoperating expense	<u>(1,628)</u>	<u>(2,091)</u>
Total nonoperating income (expense)	2,354	1,852
INCREASE IN NET POSITION	5,167	7,811
NET POSITION- Beginning of year	<u>73,282</u>	<u>65,471</u>
NET POSITION- End of year	<u>\$ 78,449</u>	<u>\$ 73,282</u>

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

OHIO STATE UNIVERSITY PHYSICIANS, INC.

(A component unit of The Ohio State University)

CONSOLIDATED STATEMENTS OF CASH FLOWS

AS OF JUNE 30, 2013 and 2012

(IN THOUSANDS)

	<u>2013</u>	<u>2012</u>
Cash flow from operating activities:		
Patient receipts-net	\$ 252,782	\$ 223,350
Other receipts	80,178	72,841
Payments to and on behalf of employees	(248,461)	(234,615)
Payments to vendors for supplies and services	(54,487)	(38,855)
Payments on malpractice and dean's tax	(9,291)	(8,741)
Payments on occupancy and utilities	(7,132)	(6,874)
Payments on other expenses	(3,134)	(2,553)
Net cash provided by operating activities	<u>10,455</u>	<u>4,553</u>
Cash flows from capital financing activities:		
Purchase of capital assets	(1,562)	(1,096)
Proceeds from sale of capital assets	48	222
Proceeds from debt	172	-
Payments on debts and capital leases	(1,787)	(2,528)
Payments on interest	(558)	(764)
Net cash used in capital financing activities	<u>(3,687)</u>	<u>(4,166)</u>
Cash flows from investing activities		
Purchase of other assets	(578)	(1,173)
Purchase of investments	(12,464)	(20,144)
Proceeds from sale of investments	15,816	8,393
Proceeds from sale of other assets	-	5
Interest income	139	82
Rental income	2,299	2,334
Non operating expense	(1,628)	(1,400)
Proceeds from sale of affiliate investment	-	4,572
Net cash provided by (used in) investing activities	<u>3,584</u>	<u>(7,331)</u>
Net Increase (Decrease) in Cash	10,352	(6,944)
Cash and cash equivalents- Beginning of year	<u>35,933</u>	<u>42,877</u>
Cash and cash equivalents-End of year	<u>\$ 46,285</u>	<u>\$ 35,933</u>

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

OHIO STATE UNIVERSITY PHYSICIANS, INC.

(A component unit of The Ohio State University)

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

AS OF JUNE 30, 2013 and 2012

(IN THOUSANDS)

	<u>2013</u>	<u>2012</u>
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$ 2,813	\$ 5,959
Adjustments to reconcile net operating income to net cash		
Amortization and depreciation	4,317	4,178
Interest	713	764
Bad debt-non patient	53	407
Changes in assets and liabilities:		
Accounts receivable-patient care - net of allowance	4,048	(3,680)
Accounts receivable- other	1,917	(4,984)
Due from affiliates	(3,836)	354
Note receivable	-	1
Inventories	(208)	247
Other Assets	88	-
Prepaid expenses	84	624
Accounts payable	217	(235)
Due to affiliates	3,577	2,898
Accrued salaries and wages	(73)	(3,836)
Retirement and health plans accrual	(159)	(1,060)
Accrued expenses	(935)	912
Other liabilities	(2,161)	2,004
Net cash provided by operating activities	<u>\$ 10,455</u>	<u>\$ 4,553</u>

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

OHIO STATE UNIVERSITY PHYSICIANS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013 AND 2012

NOTE 1 - DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Ohio State University Physicians, Inc. and subsidiaries ("OSUP") located in Columbus, Ohio, is a 501c (3) tax-exempt physician organization for the physicians providing medical care and supporting medical research and medical education at The Ohio State University (the University). It was incorporated in Ohio in 2002, and the physicians primarily serve communities within the Central Ohio region.

OSUP is the single member of 17 limited liability companies (LLCs). As of June 30, 2013, only 15 of the LLCs are active and included in the consolidated financial statements and the accompanying supplemental consolidating schedules. Two of the LLCs (Anesthesiology and Orthopedics) have been created, but had no business activity through June 30, 2013.

Basis of Presentation - The accompanying financial statements present the activity of the following entities:

Practice Plan

Family Medicine Foundation, LLC ("FM")
OSU Emergency Medicine, LLC ("EM")
OSU Eye Physicians and Surgeons, LLC ("Eye")
OSU GYN and OB Consultants, LLC ("OBGYN")
OSU Internal Medicine, LLC ("IM")
OSU Neuroscience Center, LLC ("Neurology")
OSU Otolaryngology-Head and Neck Surgery, LLC ("Otolaryngology")
OSU Pathology, LLC ("Pathology")
OSU Physical Medicine and Rehabilitation ("Phys Med")
OSU Plastic Surgery, LLC ("Plastics")
OSU Psychiatry, LLC ("Psychiatry")
OSU Radiation Oncology, LLC ("Radiation Oncology")
OSU Radiology, LLC ("Radiology")
OSU Surgery, LLC ("Surgery")
OSU Urology, LLC ("Urology")

All LLCs listed above are included within OSUP's consolidated financial statements on a blended basis. Additionally, OSUP has a corporate function that operates as a shared service center that supports all of the LLCs. Services offered include shared practice management services, clinical information systems, and certain financial management services. Given that this corporate function does not have any substantive activities on its own and exists only to provide the LLCs with these administrative services, the LLCs are displayed in a single column format in the consolidated financial statements.

OSUP obtains certain unique benefits from its association with the University. The consolidated financial statements of OSUP may not necessarily be indicative of the conditions that would have existed or the results of operations if OSUP had been operated without its affiliation with the University.

Principles of Consolidation - The consolidated financial statements include the accounts of OSUP, which are then included in the financial statements of the University because OSUP is a component unit of the University for reporting purposes, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 61. All significant LLC intercompany balances and transactions have been eliminated in consolidation.

OHIO STATE UNIVERSITY PHYSICIANS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013 AND 2012

OSUP is reporting as a special purpose entity engaged in business type activities (BTA). Business type activities are those that are financed in whole or in part by fees charged to external parties for goods and services. In accordance with BTA reporting, OSUP presents Management’s Discussion and Analysis; Consolidated Statements of Net Position; Consolidated Statements of Revenue, Expense, and Changes in Net Position; Consolidated Statements of Cash Flows; and Notes to the Financial Statements.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (“GASB”).

Certain amounts have been reclassified from the prior year to conform to the current year presentation. These reclassifications had no material impact on the previously reported consolidated financial statements.

Revision in Previously Reported Financial Statements- A classification error due to misapplication of Accounting Standards Codification (ASC) 305-*Cash and Cash Equivalents* between Cash and cash equivalents and Short-term investments as of June 30, 2012 has been corrected on the Consolidated Statement of Net Position. The classification error also impacted cash used in investing activities for the year ended June 30, 2012, which was corrected on the Consolidated Statement of Cash Flows presented herein.

Furthermore, an understatement of the provision for bad debts and the related allowance for doubtful accounts to the Company’s prescribed reserve model for the year ended June 30, 2012 has been corrected on the Consolidated Statement of Net Position, Consolidated Statement of Revenue, Expenses, and Changes in Net Position presented herein.

The Company has elected to revise prior year financial statements to correct for the impact of these errors within the appropriate period. However, the Company believes these errors were immaterial to the previously issued financial statements. The impact of these adjustments are summarized as follows (in thousands):

Consolidated Statement of Net Position			
	As Reported	Adjustment	As Revised
Cash and cash equivalents	\$ 39,503	\$ (3,569)	\$ 35,934
Short-term investments	7,827	3,569	11,396
Total current assets	101,199	(2,502)	98,697
Total assets	138,976	(2,502)	136,474
Net position-unrestricted	70,384	(2,502)	67,882
Total net position	75,784	(2,502)	73,282
Total liabilities and net position	138,976	(2,502)	136,474
Consolidated Statement of Revenue, Expenses, and Changes in Net Position			
Net patient care revenue less provision for bad debts	\$ 229,278	\$ (2,502)	\$ 226,776
Increase in net position	10,313	(2,502)	7,811
Net position-end of year	75,784	(2,502)	73,282
Consolidated Statement of Cash Flows			
Purchase of investments	\$ (16,575)	\$ (3,569)	\$ (20,144)
Net cash used in investing activities	(3,762)	(3,569)	(7,331)
Net decrease in cash	(3,375)	(3,569)	(6,944)
Cash and cash equivalents-end of year	39,502	(3,569)	35,933
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities			
Operating income	\$ 8,461	\$ (2,502)	\$ 5,959
Accounts Receivable-patient care-net of allowance	(6,182)	2,502	(3,680)
Net cash provided by operating activities	4,553	-	4,553

OHIO STATE UNIVERSITY PHYSICIANS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013 AND 2012

Cash and Cash Equivalents — Cash and cash equivalents consist of petty cash, demand deposit accounts, money market accounts, savings accounts and investments with original maturities of three months or less, stated at fair market value.

Short Term and Long Term Investments — OSUP holds investments in money market funds and certificates of deposit extending beyond three months. In 2012, corporate bonds and mutual funds were also held in addition to the aforementioned. Fair values for these investments are based on market quotes as applicable, in accordance with GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Realized gains and losses are calculated based on the type of investment and are included in income (loss) from investments in nonoperating income (expense).

Investment income is recognized on an accrual basis. Interest and dividend income is recorded when earned.

Accounts Receivable- Patient Care — OSUP accounts receivable are reduced by an allowance for doubtful accounts and contractual adjustments. In evaluating the collectability of accounts receivable, OSUP analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for contractual adjustments and provisions for bad debts. For receivables associated with services provided to patients who have third party coverage, OSUP analyzes contractually due amounts and provides an allowance for contractual adjustments. For receivables associated with self-pay patients, including patient deductibles and co-insurance, OSUP records a provision for bad debts in the period of service on the basis of its past experience, which indicates many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

OSUP utilizes the allowance method for providing for the possibility of uncollectible accounts. The allowance is provided based on management's estimate of the collectibility of the accounts receivable as of June 30, 2013 and 2012. The estimates take into consideration historical trends, payment history, and current economic conditions. Actual results could vary from the estimate. Accounts are charged against the allowance when management deems them to be uncollectible. Interest is not charged by OSUP on past due accounts.

Inventory — OSUP's inventory, which consists primarily of prescription drugs and medical supplies, is valued at cost on a first-in, first-out basis.

Property, Plant, Furniture, and Equipment, net— Property, plant, furniture, and equipment are stated at cost and include assets leased under capitalized lease obligations. Depreciation and amortization are calculated on the straight-line method. The depreciation and amortization methods are designed to amortize the assets over their estimated useful lives. Capitalized lease amortization is included in depreciation expense. Ranges for useful lives by fixed asset category are shown below:

Land and land improvements	2-29 years
Buildings	5-40 years
Furniture and fixtures	5-15 years

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Maintenance and repairs are charged to expense as incurred. Upon retirement of equipment, the cost is removed from the asset accounts and the related depreciation allowance is adjusted with the difference being charged or credited to non-operating income.

EPIC ambulatory electronic medical record use agreement- OSUP entered into a Software System Use agreement with OSU Medical Center for the purchase of an electronic medical records system (i.e. EPIC). The agreement, treated for accounting purposes similar to a capital lease, was between OSU Health System and OSUP. The total acquisition cost related to OSUP's share of the software and implementation was approximately \$11.3 million; these costs were discounted using a rate of 2.5% as of June 30, 2013 and 2012, respectively. This cost is being amortized over no more than seven years, and amortization began upon effective implementation within a physician's group. At June 30, 2013 and 2012, accumulated amortization was \$4.6 million and \$3.1 million, respectively

Long-Lived Assets — OSUP continually evaluates whether circumstances have occurred that would indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, OSUP uses an estimate of the undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. To date, no such impairments have been necessary.

Professional and General Insurance — On July 1, 2003, OSUP joined with the University Health System, a consolidating organization within The Ohio State University, to establish a new self-insurance fund for professional liability claims (Fund II), covering the OSUP physicians as well as the Health System. The assets and liabilities of Fund II are not reflected in OSUP's financial statements as a result of the retained risk being held by the University. Annual insurance costs are allocated to OSUP by the University and reflected in the Consolidated Statements of Revenue, Expenses, and Changes in Net Position.

The University has also established a pure captive insurer (Oval Limited) that provides excess coverage over Fund II. Fund II has a retention of \$4 million per occurrence. Unique to Fund II is aggregate loss of \$14 million per year for fiscal years 2010 through 2013. Oval Limited covers up to \$55 million per occurrence with a \$55 million annual aggregate limit. A portion of the risk written to date is reinsured by a combination of three reinsurance companies rated A by A. M. Best. Oval Limited's net retention is 50% of the first \$15 million and 0% for the remaining \$40 million per occurrence.

Oval Limited's assets and liabilities are consolidated in the financial statements of the University, but are not included in OSUP's financial statements.

There have been no settlements in the past 3 fiscal years which have exceeded the coverage provided by Fund II or Oval Limited. OSUP has not made any additional contributions in the last 3 years beyond its actuarially determined and Self Insurance Board approved premiums.

Derivative Instruments and Hedging Activities — OSUP accounts for all derivative instruments on the balance sheets at fair value. Changes in the fair value (i.e., gains or losses) of OSUP's interest rate swap derivative are recorded each period in the consolidated statements of operations and changes in net position as a component of non-operating expense. At June 30, 2013, OSUP held no derivative instruments.

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Operating and Non-Operating Revenues

Net Patient Care Revenue- Net patient care revenue represents amounts received and estimated net realizable amounts due from patients and third-party payers for services rendered. OSUP provides care to patients under various reimbursement agreements, including governmental and commercial payers (third party payers). These arrangements provide for payment on covered services at agreed-upon rates, which may result in discounts from charges. Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between customary charges and related reimbursements, and for administrative adjustments. Additionally bad debts are recorded as a reduction of net patient care revenues to calculate net patient care revenues less provisions for bad debt. Amounts recorded for fiscal year 2013 and fiscal year 2012 are as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Gross patient care revenue	672,714	628,007
Contractual adjustments	(401,677)	(375,701)
Administrative adjustments	(5,617)	(5,624)
Net patient care revenue	<u>265,420</u>	<u>246,682</u>
Provisions for bad debts	(16,370)	(19,906)
Net patient care revenue less provisions for bad debt	<u>249,050</u>	<u>226,776</u>

Additionally, net patient care revenue amounts recognized from major payor sources for fiscal year 2013 and fiscal year 2012 are as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Third party payors	\$ 247,955	\$ 230,352
Self pay	17,465	16,330
	<u>\$ 265,420</u>	<u>\$ 246,682</u>

Non-Patient Care Revenue — Non-patient care revenue includes contract services, rent, salary recovery, educational and research revenue. This revenue is recognized in accordance with the underlying agreement when it is earned. Based on management's analysis, it was determined that OSUP acts as a principal in these types of transactions. As such, income is shown gross of related expenses in accordance with the applicable accounting guidance.

Charity Care — Care is provided to patients regardless of their ability to pay. A patient is classified as charity care in accordance with policies established by the OSU Health System and OSUP. Because collection of amounts determined to qualify as charity care are not pursued, such amounts are written off as administrative adjustments and not reported as gross patient care revenue. OSUP maintains records to identify and monitor the level of charity care provided, including the amount of charges foregone for services furnished. Charity care provision costs as of June 30, 2013 and 2012 are \$19.9 million and \$12.3 million respectively. The cost of charity care is calculated by taking the ratio of operating expenses divided by gross patient revenue. Changes between years for Charity care adjustments were a result of better upfront identification of patients that qualify for charity care and increased self-pay mix of patients.

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Federal Income Taxes — OSUP is a not-for-profit corporation and has been recognized as tax exempt pursuant to Section 501c (3) of the Internal Revenue Code. Under a now disregarded legal entity name, OSUP obtained its determination letter on October 21, 1996, in which the Internal Revenue Service stated that the organization was in compliance with applicable requirements of the Internal Revenue Code. OSUP management and legal counsel believe that the organization is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. OSUP has determined no provision for income taxes is necessary nor has been included in the accompanying consolidated financial statements. Any unrelated business income is taxable.

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

Estimated Fair Value of Financial Instruments — Carrying values of cash and cash equivalents, receivables, accounts payable, accrued liabilities, and other current liabilities are estimated at approximate fair value because of the short-term maturity. Carrying values of notes payable approximate the fair value due to their variable interest rates. The fair value of derivative instruments are determined based on the terms of the agreement and the underlying data and inputs related to the instrument.

Newly Issued Accounting Pronouncements – In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2012. OSUP management is currently assessing the impact that implementation of Statement No. 65 will have on OSUP's financial statements.

Also, in March 2012, the GASB issued Statement No. 66, *Technical Corrections-2012*. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This Statement also amends Statement 62 by modifying the specific guidance on accounting for certain operating lease payments, purchases of loans and mortgage loan servicing fees. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2012. OSUP management is currently assessing the impact that implementation of Statement No. 66 will have on OSUP's financial statements.

Meaningful Use- The America Recovery and Reinvestment Act of 2009 ("ARRA") established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. OSUP recognizes its' EHR incentive payments using a government grant recognition model. OSUP determined the EHR incentive payments are similar to grants that are related to income and recognizes the incentive payments when there is reasonable assurance that it will comply with the conditions

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attached to them and that the grants will be received. The recognition of the income related to the EHR incentive payments is based on management's best estimates and the amounts are subject to change, with such changes impacting the operations in the period in which they occur. Any material changes would be disclosed by OSUP as a change in accounting estimate. OSUP recognized \$1.6 million and \$4.3 million in Other Revenue in the fiscal year ended June 30, 2013 and June 30, 2012, respectively.

NOTE 2 – CASH AND CASH EQUIVALENTS AND INVESTMENTS

During fiscal years 2013 and 2012, cash in accounts that are subject to the Federal Depository Insurance Corporation (FDIC) limits are spread across multiple financial institutions to limit the potential exposure to losses.

Noninterest bearing accounts are covered under FDIC for unlimited balances. Amounts invested in interest bearing accounts are spread through other banks primarily in certificate of deposits in amounts less than \$250 thousand. As of June 30, 2013 and 2012, no losses have been experienced on these accounts. At June 30, 2013, the carrying amount of the primary institution's cash, and cash equivalents is \$46,285 as compared to bank balances of \$51,056. The differences in carrying amount and bank balances are caused by outstanding checks and deposits in transit. Of the bank balances, \$42,067 is covered by federal deposit insurance and \$8,989 is invested in interest bearing accounts spread among certificates of deposits and money market funds in amounts less than \$250 thousand.

OSUP Investments are grouped into three major categories for financial reporting purposes: Cash Equivalents, Short term investments and Long term investments. Instruments with original maturity of 0-90 days are treated as cash equivalents.

Short Term Investments are investments that have a maturity of 1 year or less. Long Term Investments have a maturity of greater than 1 year. All Long Term Investments held at June 30, 2013 and 2012 mature within five years.

Detail for fiscal years 2013 and 2012 follows (in thousands):

	<u>Cash and Cash</u>	<u>Short Term</u>	<u>Long Term</u>
	<u>Equivalents</u>	<u>Investments</u>	<u>Investments</u>
<u>2013</u>			
Demand Deposits & Cash	\$ 37,296	\$ -	\$ -
Money Market Fund	7,099	-	-
Certificates of Deposits (maturing 2013-2015)	1,890	11,621	1,529
	<u>\$ 46,285</u>	<u>\$ 11,621</u>	<u>\$ 1,529</u>
<u>2012</u>			
Demand Deposits & Cash	\$ 31,423	\$ -	\$ -
Money Market Fund	3,780		
Certificates of Deposits (maturing 2013-2015)	730	10,646	2,689
Corporate Bonds	-	750	2,352
Mutual Funds	-	-	65
	<u>\$ 35,933</u>	<u>\$ 11,396</u>	<u>\$ 5,106</u>

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Additional Risk Disclosures for Investments

Statement Nos. 3 and 40 of the Governmental Accounting Standards Board require certain additional disclosures related to the interest-rate, credit and foreign currency risks associated with deposits and investments.

Interest-rate risk – Interest-rate risk is the risk that changes in interest rates will adversely affect the value of an investment. Investments with interest rates that are fixed for longer periods are likely to be subject to more variability in their values as a result of future changes in interest rates.

Credit risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality information – as commonly expressed in terms of the credit ratings issued by nationally recognized statistical rating organizations such as Moody’s Investors Service, Standard & Poor’s, or Fitch Ratings – provides a current depiction of potential variable cash flows and credit risk.

The credit ratings of all of OSUP’s interest-bearing investments at June 30, 2013 are AAA by S&P. The credit ratings for the majority of OSUP’s interest-bearing investments at June 30, 2012 were also AAA by S&P.

As of June 30, 2013, OSUP had no deposits or investments denominated in foreign currencies.

NOTE 3 - PATIENT ACCOUNTS RECEIVABLE AND CONCENTRATIONS OF CREDIT RISK

OSUP grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Patient accounts receivable as of June 30, 2013 and 2012 consist of the following (in thousands):

	2013	2012
Gross patient accounts receivable	\$ 87,074	\$ 99,551
Allowance for contractual adjustments	(44,550)	(51,604)
Allowance for bad debt	<u>(10,258)</u>	<u>(11,633)</u>
Total	<u>\$ 32,266</u>	<u>\$ 36,314</u>

Risk of loss for third party payors would be based upon contractual obligations, legislative changes, or bankruptcy of the payor. Risk of loss for the patient self-payors is related to economic factors of the individual, and thus has a higher reserve for loss based upon our historical indicators. The mix of receivables from patients and third-party payors as of June 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Medicare	25%	25%
Medicaid	13%	13%
Commercial/other third party payors	39%	47%
Patient	<u>23%</u>	<u>15%</u>
	<u>100%</u>	<u>100%</u>

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NOTE 4 - PROPERTY, PLANT, FURNITURES, AND EQUIPMENT

The composition of property, plant, furniture, and equipment as of June 30, 2013 is as follows (in thousands):

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Retirements/ Reductions</u>	<u>Ending</u> <u>Balance</u>
Property, Plant and Equipment, not being depreciated:				
Land	\$ 2,090	\$ -	\$ -	\$ 2,090
Construction in progress	-	133	110	23
Total non-depreciable assets	<u>2,090</u>	<u>133</u>	<u>110</u>	<u>2,113</u>
Property, Plant and Equipment, being depreciated:				
Land improvements	\$ 3,227	\$ 53	\$ -	\$ 3,280
Buildings	17,789	42	-	17,831
Equipment	13,116	1,113	572	13,657
Furniture and Fixtures	2,490	330	74	2,746
	<u>\$ 36,622</u>	<u>\$ 1,538</u>	<u>\$ 646</u>	<u>\$ 37,514</u>
Less: Accumulated Depreciation	(15,429)	(2,429)	(599)	(17,259)
Total depreciable assets, net	<u>21,193</u>	<u>(891)</u>	<u>47</u>	<u>20,255</u>
Property, Plant, and Equipment, Net	<u>\$ 23,283</u>	<u>\$ (758)</u>	<u>\$ 157</u>	<u>\$ 22,368</u>

Depreciation expense for the year ended June 30, 2013 was \$2.4 million.

Additions to property, plant, furniture, and equipment, net of retirements and reductions, include \$110 thousand of transfers from construction in progress.

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The composition of property, plant, furniture, and equipment as of June 30, 2012 is as follows (in thousands):

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Retirements/ Reductions</u>	<u>Ending</u> <u>Balance</u>
Property, Plant, and Equipment not being depreciated:				
Land	\$ 2,090	\$ -	\$ -	\$ 2,090
Construction in progress	1,303	-	1,303	-
Total non-depreciable assets	<u>3,393</u>	<u>-</u>	<u>1,303</u>	<u>2,090</u>
Property, Plant, and Equipment being depreciated:				
Land improvements	\$ 3,150	\$ 114	\$ 37	\$ 3,227
Buildings	17,763	26	-	17,789
Equipment	11,192	2,112	188	13,116
Furniture and Fixtures	2,511	440	461	2,490
Total	<u>34,616</u>	<u>2,692</u>	<u>686</u>	<u>36,622</u>
Less: Accumulated Depreciation	<u>(13,144)</u>	<u>(2,456)</u>	<u>(171)</u>	<u>(15,429)</u>
Total depreciable assets, net	<u>21,472</u>	<u>236</u>	<u>515</u>	<u>21,193</u>
Property, Plant, and Equipment Net	<u>\$ 24,865</u>	<u>\$ 236</u>	<u>\$ 1,818</u>	<u>\$ 23,283</u>

Depreciation expense for the year ended June 30, 2012 was \$2.5 million.

Additions to property, plant, furniture, and equipment, net of retirements and reductions, include \$1,303 thousand of transfers from construction in progress.

NOTE 5 - NOTE PAYABLE — LINE OF CREDIT AND LONG TERM DEBT

LINE OF CREDIT - On November 30, 2007, OSUP and each LLC existing at that time, individually and collectively entered into a line of credit agreement with a bank (the "Agreement"). Since the initiation of this Agreement, certain LLCs have been added and removed as parties to the Agreement, and the maturity date was extended through September 30, 2013. Management is in the process of renegotiating the maturity date extension of this Agreement.

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Each individual LLC is limited to borrow as follows, which are the same amounts as of June 30, 2012 (in thousands):

	June 30, 2013
Family Medicine Foundation, LLC	150
OSU Emergency Medicine, LLC	500
OSU Eye Physicians and Surgeons, LLC	400
OSU GYN and OB Consultants, LLC	500
OSU Internal Medicine, LLC	2,000
OSU Neuroscience Center, LLC	250
OSU Otolaryngology - Head and Neck Surgery, LLC	500
OSU Pathology, LLC	500
OSU Physical Medicine and Rehabilitation, LLC	100
OSU Psychiatry, LLC	100
OSU Radiation Oncology, LLC	100
OSU Radiology, LLC	500
OSU Surgery, LLC	1,000

Additionally, OSUP's corporate function is limited to borrow \$750 thousand.

The Agreement requires monthly interest payments at the bank's prime rate, less 0.75% (1.10% at June 30, 2013, and 2.75% at June 30, 2012). This Agreement is secured by accounts receivable, inventory, deposits, and equipment (not including OSU Eye Physicians and Surgeons, LLC), and is subject to certain restrictive and financial covenants. No borrowings were made on the line of credit as of June 30, 2013 and 2012.

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LONG TERM DEBT - A summary of long term debt as of June 30, 2013 is as follows(in thousands):

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current</u> <u>Portion</u>
Series 2010A and 2010B Adjustable Rate Demand Health Care Facilities Revenue Bonds payable to County of Franklin, Ohio. Semiannual installments of principal and interest based on Bond Market Association Index (BMA). Bonds were refinanced May 1, 2013	\$ 16,030	\$ -	\$ 16,030	\$ -	\$ -
New issuance Series 2013 Health Care Facilities Revenue Bond payable to County of Franklin, Ohio. Monthly installments of principal and fixed interest of 2.103% annum. Bond due July, 2035	-	15,381	45	15,336	553
Line of credit	-	-	-	-	-
Term loan payable in monthly installments of principal and fixed interest of 2.30% annum. Loan due May, 2023	-	2,635	19	2,616	237
Note payable due in monthly installments of \$4,444 principal and interest (LIBOR plus 3.85%, 4.1% as of June 30, 2012) due October, 2013	76	-	54	22	22
Capital lease obligations	105	90	94	101	83
	<u>\$ 16,211</u>	<u>\$ 18,106</u>	<u>\$ 16,242</u>	<u>\$ 18,075</u>	<u>\$ 895</u>

OSUP directly received cash of \$172 thousand related to new borrowings and paid cash of \$1,787 thousand related to repayments in fiscal year 2013. The balance of the borrowing and repayment activity is due to the refinancing of the Series 2010A and 2010B bonds with the issuance of the Series 2013 health care facilities revenue bond, which represented a noncash financing activity.

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A summary of long term debt as of June 30, 2012 is as follows (in thousands):

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current</u> <u>Portion</u>
Series 2010A and 2010B Adjustable Rate Demand Healthcare Facilities Revenue Bonds payable to County of Franklin, Ohio. Semiannual installments of principal and interest based on Bond Market Association Index (BMA). Rate as of June 30, 2012 was 4.09%. Bonds due July 2035.	\$ 17,030	\$ -	\$ 1,000	\$ 16,030	\$ 695
Note payable due in monthly installments of principal and interest (LIBOR plus 1.85% as of June 30, 2011), due in February 2012.	1,414	-	1,414	-	-
Line of credit	-	-	-	-	-
Note payable due in monthly installments of \$4,444 principal and interest (LIBOR plus 3.85%, 4.1% as of June 30, 2012) due October, 2013.	129	-	53	76	54
Capital lease obligations	165	-	60	105	62
	<u>\$ 18,738</u>	<u>\$ -</u>	<u>\$ 2,527</u>	<u>\$ 16,211</u>	<u>\$ 811</u>

The Series 2010A and 2010B bonds, which were secured by accounts receivable, equipment, and fixtures, were refinanced on May 1, 2013 with the issuance of the Series 2013 health care facilities revenue bond for \$15.4 million. Both the Series 2010 and 2013 bonds are subject to certain restrictive and financial covenants, requiring minimum debt service coverage ratios of 1.25 to 1.50 quarterly, which were met for all quarters during 2012 and 2013.

The Series 2013 healthcare facilities revenue bond is to be paid monthly with payments of principal and fixed interest to be made until July 1, 2035. An interest rate of 2.103% per annum is used to calculate payments.

On January 6, 2009, OSUP entered into an interest rate swap (the "swap") agreement. The swap was used to offset the variable interest rate on a portion of the 2010 bond financing obtained for the ambulatory facility in the amount of \$16 million. On May 1, 2013, at the same time the 2010 bond financing was refinanced, the swap was paid off with the proceeds from a term loan issuance in the amount of \$2.6 million.

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At June 30, 2012 an unrealized loss of \$2.4 million was included in other liabilities as the estimated fair value of the instrument.

OSUP recorded changes in fair value of the swap in the nonoperating expense section of the statement of revenue, expenses, and changes in net position. For fiscal years 2013 and 2012 a gain of \$167 thousand and a loss of \$560 thousand were recorded, respectively. The swap was settled monthly with net payments or receipts under the agreement being reflected as interest expense.

Also included in the newly issued term loan is the taxable portion of OBGYN's build out for their Mill Run location. Monthly payments of principal and fixed interest on the term loan are to be made until May 1, 2023. An interest rate of 2.3% per annum will be used to calculate payments.

OSUP did not hold any other position in a derivative instrument and did not have any other hedges outstanding in the current year as defined by GASB 53, *Accounting and Financial Reporting for Derivative Instruments*.

On September 30, 2010, OSU Otolaryngology-Head and Neck Surgery, LLC issued \$160 thousand, 3.85% plus one month LIBOR rate fixed by the British Bankers Association note for the purpose of purchasing equipment. The note was issued for a 36 month period with a final maturity of October 31, 2013.

Scheduled principal repayments on long term debt as of June 30, 2013, are as follows (in thousands):

	Principal	Interest	Total
2014	\$ 812	\$ 375	\$ 1,187
2015	806	358	1,164
2016	824	340	1,164
2017	842	322	1,164
2018	860	304	1,164
2019-2023	4,567	1,228	5,795
2024-2028	3,550	794	4,344
2029-2033	3,943	400	4,343
2034-2036	1,770	40	1,810
	\$ 17,974	\$ 4,161	\$ 22,135

CAPITAL LEASE OBLIGATIONS

OSUP has capital lease obligations that have varying maturity dates through 2015 and carry implicit interest rates ranging from 1.10% to 12.1%. Lease arrangements are being used to provide partial financing for certain movable equipment. Capital asset balances, net of accumulated amortization of \$115 thousand and \$98 thousand as of June 30, 2013 and 2012, respectively, are financed under capital leases.

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The scheduled maturities of these leases as of June 30, 2013, are as follows (in thousands):

Years Ending June 30	Capital Lease Obligations
2014	\$ 83
2015	18
Capital lease obligations	<u>\$ 101</u>
Less amount representing interest under capital lease obligations	<u>(1)</u>
Total	<u><u>\$ 100</u></u>

NOTE 6 – OTHER CURRENT AND LONG TERM LIABILITIES

Other liabilities include deferred rent, tenant allowances, interest rate swap, retention bonuses and patient credit balances prior to refunding. Other current and long term liability activity as of June 30, 2013 and 2012, respectively, is as follows (in thousands):

	<u>Beginning</u>		<u>Additions</u>		<u>Reductions</u>		<u>Ending</u>		<u>Current</u>
	<u>Balance</u>						<u>Balance</u>		<u>Portion</u>
2013									
Deferred Revenue	\$ 3,680	\$ 2,992	\$ 3,328	\$ 3,344	\$ 2,305				
Interest Rate Swap	2,370	-	2,370	-	-				
Retention Bonuses	1,658	429	1,669	418	-				
Due to Others	2,875	5,478	6,126	2,227	2,227				
	<u>\$ 10,583</u>	<u>\$ 8,899</u>	<u>\$ 13,493</u>	<u>\$ 5,989</u>	<u>\$ 4,532</u>				
2012									
Deferred Revenue	\$ 1,999	\$ 8,403	\$ 6,722	\$ 3,680	\$ 2,822				
Interest Rate Swap	1,810	609	49	\$ 2,370	-				
Retention Bonuses	1,334	861	537	1,658	835				
Due to Others	3,438	10,722	11,285	2,875	2,548				
	<u>\$ 8,581</u>	<u>\$ 20,595</u>	<u>\$ 18,593</u>	<u>\$ 10,583</u>	<u>\$ 6,205</u>				

NOTE 7 - RELATED-PARTY TRANSACTIONS AND INTERCOMPANY RECEIVABLES AND PAYABLES

OSUP is a component unit of the University. Due to this relationship with the University, related-party transactions are pervasive throughout the statements of revenues, expenses and changes in net position. A summary of the nature of these transactions and related due to/from affiliate balances reported in the statement of net position as of June 30, 2013 and 2012, are as follows (in thousands):

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Due From:

The Ohio State University Health System (the "Health System") — OSUP provides staffing, coding support, and medical directorships to The Ohio State University Hospital and The Ohio State University Hospital East. The Health System reimburses OSUP for its share of administration and information service overhead, and physician billing services provided to them.

The Ohio State University and The Ohio State University College of Medicine and Public Health (COMPH) — OSUP provides staffing, coding support, and medical directorships to The University.

Balances due from each affiliate as of June 30, 2013 and 2012 are as follows (in thousands):

	2013	2012
Due from the Health System	\$ 5,234	\$ 4,940
Due from COMPH	5,013	1,507
Due from Other Affiliates	29	(7)
	<u>\$ 10,276</u>	<u>\$ 6,440</u>

Due to:

Health System- OSUP pays premiums for the USIF (malpractice) and health insurance to the University Office of the Treasurer. Additionally, OSUP is responsible for certain costs of the EPIC ambulatory electronic medical record (EMR) implementation coordinated through the Health System. As of June 30, 2013 and 2012, OSUP has \$8.7 million and \$10.3 million payable, respectively, to the Health System for the EPIC EMR implementation. Interest of approximately \$47 thousand is accrued at June 30, 2013 on the amount due to the Health System.

*COMPH-*Under the College of Medicine Medical Practice Plan, OSUP is obligated to contribute to the OSU College of Medicine Academic Enrichment Fund, Teaching and Research Fund ("Academic Enrichment"), and Strategic Initiative Fund. Academic Enrichment is paid to the Dean's office for support of the academic, research, and clinical missions of the College. The Strategic Initiative Fund is comprised of various funds established by the College to support resident education. These funds are paid periodically during the year. Dean's tax and strategic initiative expenses as of June 30, 2013 and 2012 are \$7.9 million and \$6.5 million, respectively.

Balances due to each affiliate as of June 30, 2013 and 2012 are as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Due to Health System	\$ 11,500	\$ 14,784
Due to COMPH	11,273	7,006
Due to Other Affiliates	88	127
	<u>\$ 22,861</u>	<u>\$ 21,917</u>

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NOTE 8-INVESTMENT IN OTHER LIMITED LIABILITY COMPANIES

OSUP had a 40% ownership interest in Fresenius Medical Care- OSUIM Kidney Centers, LLC. In July, 2011, the investment was sold for \$4.6 million in proceeds. A gain of \$1.7 million, which netted the proceeds against the investment amount of \$2.9 million, was recognized in Income from investments on the statement of revenue, expenses, and changes in net position in fiscal year 2012. A portion of the proceeds were used to pay off the \$1.4 million loan held with Fifth Third, including paying off the swap instrument in place.

OSUP had a 49% ownership interest with Children's Hospital and OSU-Children's Pediatrics, LLC. On December 29, 2011, OSU- Children's Pediatrics LLC was divested, with no proceeds received. A loss of \$932 thousand was recorded in Income from investments on the statement of revenue, expenses, and changes of net position, representing the amount of investment at the time of divestiture in fiscal year 2012.

NOTE 9 - MEDICAL MALPRACTICE CLAIMS

OSUP purchases professional and general liability insurance to cover medical malpractice claims through the University. The University has established a trustee self-insurance fund for professional liability claims. The University's estimated liability and the related contributions to the University's self-insurance fund for professional liability claims are based upon an independent actuarial determination as of June 30, 2013 and 2012. Premiums are assessed to OSUP based on the physician's specialty and the types of procedures performed. Premiums paid for the years ended June 30, 2013 and 2012 were \$2.1 million and \$2.7 million, respectively, net of rebates received.

NOTE 10 - RETIREMENT AND HEALTH PLANS

Retirement benefits are provided for the employees of OSUP through a tax-sheltered 403(b) and 401(a) defined contribution plan administered by an insurance company. OSUP is required to make nondiscretionary contributions of no less than 7.5% under the Interim Retirement Plan; however, some LLCs make an additional discretionary contribution of up to 17.5%, for a range of total employer contributions of 7.5% to 25%. Employees are allowed, but not required, to make contributions to the 403(b) plan. OSUP's share of the cost of these benefits was \$3.9 million and \$7.1 million for the years ended June 30, 2013 and 2012, respectively. Employee contributions were \$1.1million and \$1.9 million for the years ended June 30, 2013 and 2012, respectively. The reduction in fiscal year 2013 was directly related to physician integration into the Faculty Practice Group.

OSUP participates in a health insurance plan covering substantially all non-physician employees. All physician employees and certain non-physician employees receive benefits through the health care plan sponsored by the University. Covered services under both plans include medical, dental, and vision benefits, life insurance, and long term disability.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Operating Leases — OSUP leases various equipment and facilities under operating leases expiring at various dates through September 2029. Total rental expense in 2013 and 2012 for all operating leases was approximately \$6.9 million and \$6.1 million, respectively, which includes leases that operate on a month-to-month basis.

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AS OF AND FOR THE YEAR ENDED JUNE 30, 2013 AND 2012

The following is a schedule by year of future minimum lease payments (in thousands) under operating leases as of June 30, 2013, that have initial or remaining lease terms in excess of one year.

Year ended June 30

2014	\$	5,964
2015		4,328
2016		4,238
2017		2,876
2018		2,052
2019-2029		7,583
TOTAL	\$	27,041

Litigation — OSUP is involved in litigation arising in the course of business. After consultation with legal counsel, management does not believe that claims and lawsuits individually or in the aggregate will have a material adverse effect on OSUP's future consolidated financial position, results from operations, or cash flows.

Health Care Legislation and Regulation — The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, and reimbursement for patient services. Federal and state government activity has continued with respect to investigations and allegations concerning possible violation of billing regulations by health care providers.

Violations of these regulations could result in the imposition of significant fines and penalties, as well as having a significant effect on reported net income or cash flows.

Management believes that OSUP is in compliance with applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

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

To the Board of Directors of
Ohio State University Physicians, Inc.

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Ohio State University Physicians, Inc. ("OSUP"), which comprise the statement of net position as June 30, 2013, and the related statement of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 31, 2013.

Internal Control Over Financial Reporting

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

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

Review of Contractual Allowance

- *New/Recurring Issue:* New
- *Observation:* The Company identified an under-accrual of certain allowances for aged patient care accounts receivable. The under-accrual resulted from an error in recording the year-end allowance which was discovered through the Company's annual hindsight analysis performed over fiscal year 2012 net patient care accounts receivable. Additionally, certain subledger to ledger



reconciliation input errors into these models have been identified by the audit team and corrected by the Company in the current year. Although the Company has a process in place to develop the monthly bad debt and contractual allowance models, the review of these models did not operate effectively to identify the misstatement.

- ***Implication:*** The lack of proper completion and thorough review of the contractual allowance has led to misstatements in net patient care revenue and accounts receivable. While the misstatements were not considered material, it is critical that management improve the controls around the contractual allowance to prevent material misstatements in the future.
- ***Recommendation:*** We recommend that OSUP corporate finance management establish additional oversight over the contractual allowance calculation performed by each of the LLC's to ensure consistency across all LLC's. We also recommend that the OSUP corporate Finance Director perform a more detailed review of the contractual allowance on a monthly basis, ensuring that the resulting journal entries are reflective of accurate inputs and calculations and consistent with the model's output.
- ***Management Response:*** The staff was educated on proper use of the allowance model. We will continue to develop standardized processes up to and including possible centralization of transactional accounting.

OSUP's response to the finding above was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of OSUP in a separate letter dated October 31, 2013.



Purpose of this Report

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

PricewaterhouseCoopers LLP

October 31, 2013

SUPPLEMENTAL CONSOLIDATING SCHEDULES

OHIO STATE UNIVERSITY PHYSICIANS INC., AND SUBSIDIARIES
(A component unit of The Ohio State University)
CONSOLIDATING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2013
(000)

	OSUP													Total						
	Corporate	FM	EM	Eye	OB&N	IM	Neurology	Otolaryngology	Pathology	Phys Med	Plastic Surgery	Psychiatry	Radiation Oncology		Radiology	Surgery	Urology	Aggregated	Eliminations	
OPERATING REVENUE:																				
Patient care revenue - net of bad debt expense	-	-	13,107	10,061	11,082	91,094	12,851	16,108	18,824	5,168	5,586	2,462	5,425	23,252	25,005	7,525	240,050	-	249,050	
Other revenue	20,161	428	5,431	2,814	6,085	38,403	1,671	1,760	10,257	2,615	4,090	6,252	1,079	5,013	12,591	428	99,078	16,312	82,766	
Total operating revenue	20,161	428	18,538	13,075	17,167	110,997	14,522	17,868	29,081	7,783	9,676	8,714	6,504	28,265	37,596	7,953	346,128	16,312	331,816	
OPERATING EXPENSES:																				
Salaries and benefits	11,790	199	13,835	6,713	12,465	79,291	9,977	13,120	21,042	4,976	5,723	7,415	5,716	21,290	31,685	6,329	251,566	138	251,428	
Supplies and pharmaceuticals	719	2	108	225	1,032	12,660	3,084	1,067	1,967	1,738	481	23	19	84	283	628	24,020	-	24,020	
Services	6,068	82	1,473	4,865	1,432	10,626	936	1,132	3,186	258	543	369	299	1,910	1,006	437	34,602	6,546	28,056	
Malpractice	-	1	125	30	182	305	35	72	47	39	66	42	43	379	510	30	2,106	-	2,106	
Rent's tax and utilities	-	-	815	265	581	2,135	218	845	184	78	135	168	187	1,123	789	253	7,852	-	7,852	
Office expenses	1,948	-	1,177	1,142	1,177	6,667	1,177	624	345	1,177	385	138	138	466	386	386	4,317	964	4,317	
Amortization and depreciation	495	-	103	313	348	1,376	172	183	385	76	47	18	16	113	193	82	4,317	-	4,317	
Interest	-	-	8	42	18	109	9	42	13	5	3	6	2	9	15	2	713	-	713	
Other expenses	352	153	768	438	445	3,175	525	645	1,050	280	646	281	365	1,273	1,673	816	12,885	9,634	3,251	
Total operating expenses	22,276	438	17,252	12,890	17,203	112,262	15,333	17,722	28,543	7,544	8,037	8,415	6,647	26,197	36,599	8,927	346,285	17,282	349,003	
Operating income	(2,115)	(10)	1,286	585	(36)	(1,865)	(811)	146	538	239	1,639	299	(143)	2,068	997	(974)	1,843	(970)	2,813	
NONOPERATING INCOME (EXPENSES):																				
Interest income	8	13	4	2	-	30	-	-	67	-	-	-	1	-	5	9	139	-	139	
Nonoperating income	3,891	-	-	-	298	331	-	-	-	-	-	-	-	(49)	209	-	4,728	970	3,759	
Income from investments	556	(16)	(41)	-	(31)	(110)	(21)	-	(73)	(10)	-	(18)	(8)	-	(80)	-	99	-	99	
(Loss) on sale of assets	-	-	-	-	-	(7)	(8)	-	-	-	-	-	-	-	-	-	-	(15)	-	(15)
Nonoperating expense	(1)	(5)	(1)	-	(2)	(4)	(8)	(16)	(45)	-	(80)	-	(2)	-	(707)	(44)	(1,628)	-	(1,628)	
Total nonoperating income (expense)	4,654	(8)	(38)	2	265	240	(29)	(16)	(51)	(10)	(80)	(18)	(9)	(49)	(573)	(35)	3,324	970	2,354	
INCREASE IN NET POSITION	2,339	(18)	1,248	587	229	(1,625)	(840)	130	487	229	838	281	(152)	2,019	424	(1,009)	5,167	-	5,167	
NET POSITION — Beginning of year	(916)	2,189	5,751	1,986	2,483	22,648	1,795	3,769	7,606	857	1,555	3,220	6,154	4,228	6,401	3,506	73,282	-	71,282	
NET POSITION — End of year	1,423	2,171	6,999	2,573	2,712	21,023	955	3,899	8,093	1,086	2,393	3,501	6,002	6,297	6,825	2,497	78,449	-	78,449	