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December 6, 2016

Board of Trustees  
Harrison County Hospital  
1141 Hospital Drive, NW  
Corydon, IN 47112

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2015 to December 31, 2015. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Report of Independent Auditors, the financial statements included in the report present fairly the financial condition of Harrison County Hospital, as of December 31, 2015 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The audit report is filed with this letter in our office as a matter of public record.

A handwritten signature in blue ink that reads "Paul D. Joyce".

Paul D. Joyce, CPA  
State Examiner



**HARRISON COUNTY HOSPITAL  
AND AFFILIATED ORGANIZATION**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**REQUIRED SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2015 AND 2014**

*CPAs / ADVISORS*



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

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## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Harrison County Hospital and  
Affiliated Organization  
Corydon, Indiana

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Harrison County Hospital and Affiliated Organization (collectively the "Hospital"), a component unit of Harrison County, Indiana, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, changes in net position, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these 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 these consolidated financial statements based on our audits. We did not audit the financial statements of Harrison MOB, LLC ("MOB"), a 61 percent owned subsidiary, which statements reflect total assets of \$5,856,294 and \$6,125,872 as of December 31, 2015 and 2014, respectively, and total revenues of \$925,851 and \$899,598, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the MOB, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Uniform Compliance Guidelines for Audit of State and Local Governments by Authorized Independent Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

Board of Trustees  
Harrison County Hospital and  
Affiliated Organization  
Corydon, Indiana

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2015 and 2014, and the results of its operations, its changes in net position, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented 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 an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits 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.

*Blue & Co., LLC*

Louisville, KY  
November 3, 2016

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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The purpose of the Management's Discussion and Analysis of financial condition and results of operations is to provide a narrative explanation of the financial position and operations of Harrison County Hospital ("HCH") and its affiliated organization, Harrison MOB, LLC ("the MOB"), (collectively described as "the Hospital") that enables users of the Hospital's financial statements to better understand the Hospital's operations, to enhance the Hospital's overall financial disclosures, to provide the context within which the Hospital's financial information may be analyzed, and to provide the Hospital's financial condition, results of operations and cash flows.

Unless otherwise indicated, all financial and statistical information included herein relates to continuing operations. MD&A, which should be read in conjunction with accompanying Consolidated Financial Statements and Supplementary Information, includes the following sections:

- Strategies for Enhancement of Hospital Services
- Results of Operations – Consolidated
- Liquidity and Other Performance Measures

### **STRATEGIES FOR ENHANCEMENT OF HOSPITAL SERVICES**

The Hospital continues to look for continuous improvement of its services to the residents of Harrison and surrounding counties. The strategic approach in providing quality care continues to be a driving force for growth.

#### **Norton Healthcare Affiliation (Louisville, Kentucky)**

Enhancing its working relationship with Norton Healthcare that started in 1981, the Hospital expanded its affiliation with Norton Healthcare in 2012 by entering into an agreement to further increase more convenient access to Norton Healthcare specialists. Examples of benefits derived from this agreement include full time oncology and hematology services, inpatient and outpatient access to cardiology services including a jointly developed STEMI heart attack program, and neurosurgical care.

#### **Healthcare Information and Management Systems Society**

The Hospital continued to look to increase operational efficiencies of its support services. During 2015, the Hospital reached HIMSS level 6. HIMSS Level 6 hospitals are at the forefront of Electronic Health Records (EHR) adoption. The attainment is an important indicator that an organization delivers high quality patient care with an interoperable EHR in place.

Additionally, the Hospital reached the level of Meaningful Use Stage 2 during 2015. Meaningful use is a Medicare and Medicaid program that awards incentives for use of certified health records (EHRs) to improve patient care. To achieve Meaningful Use, providers must follow a set of criteria that serve as a roadmap for effectively using EHR. Meaningful use is implemented in a phased approach over a series of 3 stages. Stage 1 promotes a basic HER adoption and data gathering. Stage 2 emphasizes care coordination and exchange of patient information. State 3 is focused on improving healthcare outcomes.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
DECEMBER 31, 2015 AND 2014

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## **Medicare Four Star Hospital**

During 2015, the Hospital was designated a Medicare Four Start Hospital for quality service based on patient satisfaction feedback. This designation put the Hospital in the top third of all hospitals nationally for customer service.

## **Lean Training**

The Hospital continued to look for outcome improvements during 2015 with the selection of four employees to attend lean training. This selection was initiated to meet the Hospital's continual focus on improvement of care delivery, reduction of errors, improving patient outcomes. The Hospital will evaluate the impact of the lean training on outcome and look to have further participation if measureable increases result during 2016.

## **Recruitment**

Rather than having physicians maintain independent practices, the Hospital has utilized a widespread industry strategy to employ its physicians. This strategy not only affords the community with a pool of both primary and specialty providers but has increased patients and ultimately revenue streams for the Hospital. With the addition of physicians practicing in the area of OB GYN, the Hospital saw a record number of births during 2014 and 2015 reaching nearly 450 births each year.

## **Kids First Pediatric Specialists**

Additional growth was realized in 2015 from Kids First Pediatric Specialists. During January 2015, the Hospital opened its second location establishing an office in Georgetown, Indiana. The addition of this location resulted in patient visits more than doubling 2014 activity. The 2015 visits of 12,753 resulted in a 144% increase over 2014 visits.

## **RESULTS OF OPERATIONS – CONSOLIDATED**

The following tables reflect limited financial information on a consolidated basis of the Hospital. The Balance Sheet and Statement of Operations and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps aid in determining the strength of the Hospital.

## **Balance Sheet**

This financial information presented below offers both short-term and long-term financial information. The Consolidated Balance Sheet (Table 1) includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Hospital's creditors (liabilities). It also provides the basis for compiling rate of return, evaluating the capital structure and assessing the liquidity and financial flexibility of the Hospital.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

Table 1: Consolidated Balance Sheet

	2015	2014	\$ Change	% Change
<b>Assets</b>				
Cash and investments	\$ 15,494,943	\$ 16,235,887	\$ (740,944)	-4.6%
Capital assets	33,947,300	37,173,051	(3,225,751)	-8.7%
Other assets	8,776,728	7,777,835	998,893	12.8%
Deferred outflows	308,563	328,578	(20,015)	-6.1%
Total assets and deferred outflows	<u>\$ 58,527,534</u>	<u>\$ 61,515,351</u>	<u>\$ (2,987,817)</u>	-4.9%
<b>Liabilities</b>				
Current liabilities	\$ 4,484,102	\$ 4,706,379	\$ (222,277)	-4.7%
Long-term liabilities	14,802,930	15,636,896	(833,966)	-5.3%
Total liabilities	19,287,032	20,343,275	(1,056,243)	-5.2%
<b>Net position</b>				
Net investment in capital assets	20,726,819	23,511,225	(2,784,406)	-11.8%
Restricted net position	1,683,185	3,422,136	(1,738,951)	-50.8%
Unrestricted	16,924,898	14,392,858	2,532,040	17.6%
Restricted non-expendable net position	(94,400)	(154,143)	59,743	38.8%
Total net position	<u>39,240,502</u>	<u>41,172,076</u>	<u>(1,931,574)</u>	-4.7%
Total liabilities and net position	<u>\$ 58,527,534</u>	<u>\$ 61,515,351</u>	<u>\$ (2,987,817)</u>	-4.9%
	2014	2013	\$ Change	% Change
<b>Assets</b>				
Cash and investments	\$ 16,235,887	\$ 16,132,459	\$ 103,428	0.6%
Capital assets	37,173,051	40,620,881	(3,447,830)	-8.5%
Other assets	7,777,835	7,499,536	278,299	3.7%
Deferred outflows	328,578	348,593	(20,015)	100.0%
Total assets and deferred outflows	<u>\$ 61,515,351</u>	<u>\$ 64,601,469</u>	<u>\$ (3,086,118)</u>	-4.8%
<b>Liabilities</b>				
Current liabilities	\$ 4,706,379	\$ 5,541,352	\$ (834,973)	-15.1%
Long-term liabilities	15,636,896	16,020,106	(383,210)	-2.4%
Total liabilities	20,343,275	21,561,458	(1,218,183)	-5.6%
<b>Net position</b>				
Investment in capital assets net of related debt	23,511,225	26,577,968	(3,066,743)	-11.5%
Restricted expendable net position	3,422,136	3,403,188	18,948	0.6%
Unrestricted	14,392,858	13,274,015	1,118,843	8.4%
Restricted non-expendable net position	(154,143)	(215,160)	61,017	28.4%
Total net position	<u>41,172,076</u>	<u>43,040,011</u>	<u>(1,867,935)</u>	-4.3%
Total liabilities and net position	<u>\$ 61,515,351</u>	<u>\$ 64,601,469</u>	<u>\$ (3,086,118)</u>	-4.8%



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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The decrease in the Hospital's net position in 2015 is primarily attributed to depreciation charges incurred for the years ended December 31, 2015 and 2014. The Hospital also incurred atypical claims for health and workers compensation during 2015. The decrease in cash and cash equivalents was offset by a corresponding increase in other assets which demonstrates management's desire to move idle cash into conservative investment instruments to provide both higher returns for the Hospital, as well as, set aside funds for future capital purchases. The decrease in the Hospital's net position from 2013 to 2014 was primarily related to an unrealized gain on the change in value of the interest rate swap in 2013 versus a loss in 2014. See additional information on capital assets in the notes to the consolidated financial statements in Note 5.

The majority of long-term debt remaining is from the construction of the \$51 million dollar hospital and the adjacent \$7 million dollar medical office building completed during 2008. At December 31, 2015, the Hospital had total long-term debt related to these buildings (including \$530,023 current portion) of \$13,884,283. This balance is comprised of \$8,719,997 revenue bonds outstanding and \$5,164,286 of real estate debt secured by the MOB medical office building. See additional information on long-term debt in the notes to the consolidated financial statements in Note 10.

Subsequent to year end, the Hospital issued the Harrison County, Indiana Economic Development Revenue Refunding Bonds, series 2016 (2016 bonds) to refinance the 2011 revenue bonds outstanding. In conjunction with the issuance of the 2016 bonds, the Hospital terminated the interest rate swap associated with the 2011 bonds. See additional information on the subsequent event in the notes to the consolidated financial statements in Note 24.

Additionally, Harrison County Hospital has the first right of refusal to purchase the medical office building owned by MOB, LLC. This option becomes available during 2017 when the debt obligation matures.

### **Statement of Operations and Changes in Net Position**

All of the current and prior year's revenues and expenses are accounted for in the Consolidated Statement of Operations and Changes in Net Position (Table 2). This statement measures the financial results of the Hospital's operations and presents revenues earned and expenses incurred. It also discloses the changes in net position resulting from operating activities. The net position of the Hospital is one measurement of the Hospital's financial health. You will need to consider other nonfinancial factors such as changes in patient base and measure of quality of service the Hospital provides to the community, as well as, local economic factors to assess the overall health of the Hospital.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

Table 2: Consolidated Statement of Operations and Changes in Net Position

	2015	2014	\$ Change	% Change
<b>Operating revenues</b>				
Net patient service revenue	\$ 47,222,791	\$ 45,704,393	\$ 1,518,398	3.3%
Other revenue	<u>1,872,921</u>	<u>2,016,098</u>	<u>(143,177)</u>	-7.1%
Total operating revenues	49,095,712	47,720,491	1,375,221	2.9%
<b>Operating expenses</b>				
Salaries and benefits	29,413,513	27,616,789	1,796,724	6.5%
Supplies and drugs	5,571,392	5,572,263	(871)	0.0%
Depreciation and amortization	4,356,472	4,371,396	(14,924)	-0.3%
Other operating expenses	<u>10,948,058</u>	<u>10,981,237</u>	<u>(33,179)</u>	-0.3%
Total operating expenses	<u>50,289,435</u>	<u>48,541,685</u>	<u>1,747,750</u>	3.6%
Income (loss) from operations	(1,193,723)	(821,194)	(372,529)	45.4%
<b>Nonoperating revenues (expenses)</b>	(705,051)	(1,013,941)	308,890	30.5%
<b>Member distributions</b>	<u>(32,800)</u>	<u>(32,800)</u>	<u>-0-</u>	100.0%
Change in net position	<u>\$ (1,931,574)</u>	<u>\$ (1,867,935)</u>	<u>\$ (63,639)</u>	-3.4%
<b>Net position, end of year</b>	<u>\$ 39,240,502</u>	<u>\$ 41,172,076</u>	<u>\$ (1,931,574)</u>	-4.7%
	2014	2013	\$ Change	% Change
<b>Operating revenues</b>				
Net patient service revenue	\$ 45,704,393	\$ 42,341,796	\$ 3,362,597	7.9%
Other revenue	<u>2,016,098</u>	<u>4,044,523</u>	<u>(2,028,425)</u>	-50.2%
Total operating revenues	47,720,491	46,386,319	1,334,172	2.9%
<b>Operating expenses</b>				
Salaries and benefits	27,616,789	25,693,055	1,923,734	7.5%
Supplies and drugs	5,572,263	4,917,368	654,895	13.3%
Depreciation and amortization	4,371,396	4,529,757	(158,361)	-3.5%
Other operating expenses	<u>10,981,237</u>	<u>11,235,287</u>	<u>(254,050)</u>	-2.3%
Total operating expenses	<u>48,541,685</u>	<u>46,375,467</u>	<u>2,166,218</u>	4.7%
Income from operations	(821,194)	10,852	(832,046)	-7667.2%
<b>Nonoperating revenues (expenses)</b>	<u>(1,013,941)</u>	<u>241,573</u>	<u>(1,255,514)</u>	-519.7%
<b>Member distributions</b>	<u>(32,800)</u>	<u>(32,800)</u>	<u>-0-</u>	100.0%
Change in net position	<u>\$ (1,867,935)</u>	<u>\$ 219,625</u>	<u>\$ (2,087,560)</u>	-950.5%
<b>Net position, end of year</b>	<u>\$ 41,172,076</u>	<u>\$ 43,040,011</u>	<u>\$ (1,867,935)</u>	-4.3%

### Patient Service Revenues

Net patient service revenues of the Hospital increased by \$1,518,398 or 3.3% in 2015, while Hospital gross patient service revenues increased by \$10,960,553 or 8.9%. The primary contributor to the increase in gross revenue was a rate increase of 4.5%. Outpatient service revenue, despite a decline in visits, benefited from the increase yielding an additional \$7.45 million in revenue during 2015. Laboratory, emergency room and

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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imaging departments were the primary drivers of growth in outpatient services. The increase in net patient service revenue in 2014 of \$3,362,597 was primarily driven by a 4.5% general rate increase and increased utilization, primarily in obstetrics and the hospitalist program.

Gross revenue from the professional fees generated by Hospital-owned physician practices increased by \$1,027,844 (8.4%) in 2015. Approximately fifty-three percent (53%) of this increase, or \$546,400, was attributable to Kids First Pediatric Specialist. Seventeen percent (17%) of the increase was attributable to patient growth by First Capital Medical Group which was contributed to the addition of a nurse practitioner. The remaining 30% of the increase was a result of increased volumes for some of the other hospital-employed physicians and mid-level providers. There was no rate increase for professional fees during 2015. The increase in gross revenues of Hospital-owned physician practices in 2014 of \$2,866,373 (31%) was attributable to a full year of activity in the Hospital's pediatric primary care practice (versus 6 months in 2013), the Hospital's CRNA group (versus 10 months in 2013), and the hospitalists' practice (versus 7 months in 2013).

### Sources of Revenue

The Hospital derives the majority of its revenue from charges for patient care and related services. The Hospital is reimbursed for services from a variety of sources including the Medicare and Medicaid programs, insurance carriers, managed care plans, and patients. The Hospital has established payment arrangements with Medicare, Medicaid, and various commercial insurance carriers. Services provided under those arrangements are paid at predetermined rates and/or reimbursable cost as defined. Provisions have been made in the consolidated financial statements for contractual adjustments representing the difference between the standard charges for services and the actual or estimated payment.

The Hospital's percentages of gross revenue by payer for 2015, 2014, and 2013 are as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Medicare	41 %	41 %	40 %
Medicaid	21	17	18
Blue Cross	16	15	15
Other third-party payors	19	18	19
Self-pay	<u>3</u>	<u>9</u>	<u>8</u>
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

### Uncompensated Care

Overall, while indigent care experienced significant declines in 2015 it continues to be a concern for the Hospital. Collection issue mainly due to indigent care (charity care and bad debt) and Medicaid revenue write-offs were approximately \$2 million in 2015 or 1.5% of gross revenue. This amount was 35.3% less than 2014 write-offs which represented 2.5% of gross revenue. Write-offs related to Medicaid represented 3.3% and 5.2% of gross revenue for the years ended December 31, 2015 and 2014, respectively.

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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Medicare and Medicaid contractual deductions continue to be a large adjustment against gross revenue. The adjustments were approximately \$83 million and \$71 million for the years ended December 31, 2015 and 2014, respectively. These deductions represented 43% and 40% of gross revenue for the years 2015 and 2014, respectively.

The overall reduction in indigent care (charity and bad debt) and increases to contractual adjustments are a direct result of the implementation of the Affordable Care Act.

### **Operating Expenses**

Total operating expenses increased by \$1,747,750 (3.6%) in 2015. Highlights of this increase are as follows:

- Salary costs increased by \$780,404 in 2015. The predominant cause of the increase was the increased output of the physician practice groups. Ancillary increases can also be attributable to wage rate increases and increased staffing levels.
- The total cost of Employee Benefits increased by \$1,016,320 in 2015, primarily due to increased numbers claims against both the Hospital's self-insured health insurance and workers compensation plans. Secondary reasons of the increase are due to physician practice expansions and acquisitions and generally higher staffing levels in some areas of the hospital.
- Drug and IV usage also had significant increases in 2015 with a 10.23% or \$150,390 increase. This increase was similar to the increase in 2014. These increases are a direct result of higher pricing resulting primarily from national shortages of a majority of drugs. Ambulatory services saw the greatest increase in drug costs. Good news for hospitals in general is that drug shortages are beginning to trend downward.

The Hospital Assessment Fee (HAF) continued its decreasing trend with a 2015 decrease of \$361,772 or 32.4%. This trend is a result of the Hospital successfully applying for and meeting the requirements for a 25% reduction in the assessment rate for 2014 and future years.

Total operating expenses increased by \$2,166,218 (4.7%) in 2014. Highlights of this increase are as follows:

- Salary costs increased by \$1,300,870 in 2014. The predominant cause of the increase was having a full year of operations from the Hospital owned physician practices that were acquired or expanded in 2013.
- The total cost of employee benefits increased \$374,056 in 2014, which was primarily caused by the increased number of employees participating in the Hospital's health insurance plan.
- Medical supplies increased \$518,154 in 2014, primarily related to an increase in volumes of 9% in 2014.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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### Non-operating Expenses

Non-operating expenses decreased by \$308,890. A significant portion of this decline (approximately \$204,000) is due to gains on the valuation of the interest rate SWAP valuations during 2015.

### Net Patient Service Revenue and Volume Trends

For the year ended December 31, 2015, discharges decreased by 4.7% from 2014. While observation days increased by nearly 31%, admissions and surgical visits declined by 4.7% and 6.3%, respectively. The decline in surgical visits was attributed to a decline orthopedic and pain procedures. Physician office visits experienced a significant increase during 2015 yielding a 10.8% increase over 2014. Increases in physician office visits demonstrate a move to deliver healthcare services in an outpatient setting, however, the primary driver of the increase was the addition of the second location of the Kids First Pediatric Office in Georgetown, Indiana. The increase resulted in practice revenue growing by approximately \$1,030,000.

The following table reflects certain patient volume information and key performance indicators, on a consolidated basis, for the year ended December 31, 2015 and 2014.

	<u>2015</u>	<u>2014</u>	<u>2013</u>
<u>Volume Trends</u>			
Discharges (including OP volume)	7,242	7,601	6,512
Total admissions	2,028	2,127	1,949
Acute average length of stay (days)	3.40	3.20	3.30
Observation days	1,337	1,021	962
Emergency room visits	14,944	14,499	13,799
Surgical visits	1,740	1,856	1,921
Physician office visits	56,756	51,201	42,521
<u>Key Performance Indicators</u>			
Operating margin	-3.9 %	-2.5 %	-4.7 %
Operating EBIDA margin	-4.5 %	6.2 %	5.4 %

### Cash Flow

The cash position of the Hospital decreased by approximately \$1,625,000 during 2015. This decrease is a result of capital, financing, and investing activities outpacing operational increases. The Hospital's 2015 cash inflows from operations (\$1,900,566) decreased by approximately \$397,000 from 2014 inflows. This decrease was attributable to larger self-insurance claims and salary costs despite overall net increases in cash received from patient service and other revenue sources. Capital and related financing activities created net outflows of approximately \$2.6 million primarily for capital purchases and debt obligations. This was a \$331,000 increase in outflows from 2014 amounts. The remaining decline (approximately \$900,000) in cash and cash equivalents came from the release of temporarily restricted cash reserves and the subsequent use of this

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2015 AND 2014

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cash for operating expenses of the Hospital. This release on restricted cash reserves was a result of the Hospital's creditor imposed cash reserve requirements for its interest rate swap obligation being reduced.

The cash position of the Hospital increased \$103,428 in 2014. This increase was primarily caused by a decrease in capital and related financing expenditures (\$529,670), an increase in cash resulting from a reclassification of Hospital funds pledged as collateral for the interest rate swap (\$3,320,270), and a decrease in EHR payments received in 2014 (\$1,361,107).

### LIQUIDITY AND OTHER PERFORMANCE MEASURES

The Hospital had net unrestricted cash and investments of \$15.50 million at December 31, 2015, compared to \$16.24 million at December 31, 2014. The decrease is primarily due to transfers for capital purchases and debt servicing obligations.

Days cash on hand increased by over 3 days from year over year. The debt service coverage and cash to debt ratios remained relatively static year over year. This correlates to similar operational results and similar annual debt obligations of the Hospital.

### Balance Sheet Ratios

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Current ratio	3.66	3.32	3.12
Days cash on hand	109.75	105.89	140.72
Net days in accounts receivable	44.94	43.70	36.40
Debt service coverage ratio	3.02	3.03	3.80
Cash-to-debt ratio	1.01	1.00	0.98

This report is designed to provide our citizens, customers, and creditors with a general overview of the Hospital's finances. This analysis should be read in conjunction with the consolidated financial statements of the Hospital. Separately-issued audited financial statements are available for the MOB. If you have questions about this report or need additional information, contact Jeff Davis, Chief Financial Officer at 812-738-425.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2015 AND 2014

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	<b>ASSETS</b>	
	<u>2015</u>	<u>2014</u>
<b>Current assets</b>		
Cash and cash equivalents	\$ 7,696,622	\$ 7,883,078
Patient accounts receivable, net of estimated uncollectibles of \$4,676,068 in 2015 and \$6,623,484 in 2014	6,044,579	5,712,804
Inventories	1,108,496	861,580
Prepaid expenses and other current assets	1,454,953	916,969
Estimated third-party payor settlements	100,387	225,000
Other assets, current portion	<u>25,000</u>	<u>15,385</u>
Total current assets	16,430,037	15,614,816
<b>Assets whose use is limited</b>	7,798,321	8,352,809
<b>Property and equipment, net</b>	33,947,300	37,173,051
<b>Other assets, net of current portion</b>	<u>43,313</u>	<u>46,097</u>
Total assets	58,218,971	61,186,773
<b>Deferred outflows - deferred loss on bond refunding</b>	<u>308,563</u>	<u>328,578</u>
Total assets and deferred outflows	<u>\$ 58,527,534</u>	<u>\$ 61,515,351</u>

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*See accompanying notes to consolidated financial statements.*

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2015 AND 2014

### LIABILITIES AND NET POSITION

	<u>2015</u>	<u>2014</u>
<b>Current liabilities</b>		
Accounts payable	\$ 1,669,628	\$ 1,203,303
Accrued personnel costs	1,853,598	2,310,400
Accrued expenses	369,369	640,996
Current portion of obligations under capital leases	38,309	21,657
Current portion of long-term debt	<u>553,198</u>	<u>530,023</u>
Total current liabilities	4,484,102	4,706,379
<b>Long-term liabilities</b>		
Obligations under capital leases, net of current portion	136,904	84,464
Long-term debt, net of current portion	12,800,633	13,354,260
Interest rate swap	<u>1,865,393</u>	<u>2,198,172</u>
Total long-term liabilities	<u>14,802,930</u>	<u>15,636,896</u>
Total liabilities	19,287,032	20,343,275
<b>Net position</b>		
Controlling interest net position		
Net investment in capital assets	20,726,819	23,511,225
Restricted		
Expendable for interest rate swaps	1,683,185	3,422,136
Unrestricted	<u>16,924,898</u>	<u>14,392,858</u>
Total controlling interest net position	39,334,902	41,326,219
Restricted net position - non-expendable	<u>(94,400)</u>	<u>(154,143)</u>
Total net position	<u>39,240,502</u>	<u>41,172,076</u>
Total liabilities and net position	<u>\$ 58,527,534</u>	<u>\$ 61,515,351</u>

*See accompanying notes to consolidated financial statements.*



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
<b>Operating revenues</b>		
Net patient service revenue	\$ 47,222,791	\$ 45,704,393
Rent revenue	400,400	366,469
Other revenue	1,472,521	1,649,629
Total operating revenues	49,095,712	47,720,491
<b>Operating expenses</b>		
Salaries and wages	23,114,616	22,332,073
Employee benefits and payroll taxes	6,298,897	5,284,716
Professional medical fees	1,707,978	1,740,220
Medical supplies	2,939,827	3,057,048
Other supplies	1,010,931	1,044,971
Drugs	1,620,634	1,470,244
Purchased services	5,405,678	5,363,018
Utilities	1,212,106	1,066,268
Insurance	590,088	549,522
Depreciation and amortization	4,356,472	4,371,396
Hospital assessment fee	755,843	1,117,615
Other operating expenses	1,276,365	1,144,594
Total operating expenses	50,289,435	48,541,685
Income (loss) from operations	(1,193,723)	(821,194)
<b>Nonoperating revenues (expenses)</b>	(705,051)	(1,013,941)
Excess revenues (expenses)	(1,898,774)	(1,835,135)
<b>Member distributions</b>	(32,800)	(32,800)
Change in net position	(1,931,574)	(1,867,935)
<b>Net position, beginning of year</b>	41,172,076	43,040,011
<b>Net position, end of year</b>	\$ 39,240,502	\$ 41,172,076

*See accompanying notes to consolidated financial statements.*



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
<b>Operating activities</b>		
Cash received for patient services	\$ 47,015,629	\$ 45,117,118
Cash paid to/for employees	(29,870,315)	(27,682,861)
Cash paid to vendors and suppliers	(17,117,669)	(17,152,719)
Other receipts, net	1,872,921	2,016,098
Net cash flows from operating activities	1,900,566	2,297,636
<b>Noncapital financing activities</b>		
Noncapital contributions	4,483	31,955
<b>Capital and related financing activities</b>		
Principal payments on obligations under capital leases	(43,302)	(10,778)
Principal payments on long-term debt	(530,452)	(507,223)
Interest paid	(1,017,010)	(997,937)
Purchase of capital assets	(993,103)	(736,895)
Change in deferred outflows	20,015	20,015
Member distributions	(32,800)	(32,800)
Net cash flows from capital and related financing activities	(2,596,652)	(2,265,618)
<b>Investing activities</b>		
Investment income	39,834	41,346
Other nonoperating revenues (expenses)	(65,137)	(26,890)
Change in assets whose use is limited	(884,433)	3,320,270
Change in other assets	(24,038)	24,999
Net cash flows from investing activities	(933,774)	3,359,725
Net change in cash and cash equivalents	(1,625,377)	3,423,698
<b>Cash and cash equivalents, beginning of year</b>	16,235,887	12,812,189
<b>Cash and cash equivalents, end of year</b>	\$ 14,610,510	\$ 16,235,887
<b>Reconciliation of cash and cash equivalents to the balance sheets</b>		
Cash and cash equivalents in current assets	\$ 7,696,622	\$ 7,883,078
Cash and cash equivalents in assets whose use is limited	6,913,888	8,352,809
Total cash and cash equivalents	\$ 14,610,510	\$ 16,235,887

*See accompanying notes to consolidated financial statements.*

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2015 AND 2014

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	<u>2015</u>	<u>2014</u>
<b>Reconciliation of income from operations to net cash flows from operating activities</b>		
Income (loss) from operations	\$ (1,193,723)	\$ (821,194)
Adjustments to reconcile income (loss) from operations to net cash flows from operating activities		
Depreciation	4,339,265	4,354,188
Amortization	17,207	17,208
Provision for bad debts	4,547,236	6,367,456
Changes in operating assets and liabilities		
Patient accounts receivable	(4,879,011)	(7,454,731)
Inventories	(246,916)	15,840
Prepaid expenses and other current assets	(537,984)	250,929
Accounts payable	458,308	(1,011,091)
Accrued personnel costs	(456,802)	(66,072)
Accrued expenses	(271,627)	145,103
Estimated third-party payor settlements	124,613	500,000
Net cash flows from operating activities	<u>\$ 1,900,566</u>	<u>\$ 2,297,636</u>
<b>Supplemental disclosures of noncash activities</b>		
Property and equipment acquired included in accounts payable	\$ 8,017	\$ 52,564
Property and equipment acquired under capital lease obligations	\$ 112,394	\$ 116,899
Change in interest rate swap	\$ (332,779)	\$ 62,415

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See accompanying notes to consolidated financial statements.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by HCH and MOB (collectively the "Hospital") in the preparation of the consolidated financial statements are summarized below:

#### Nature of Operations

Harrison County Hospital ("HCH") is a not-for-profit, acute care hospital located in Corydon, Indiana. The Hospital is county owned and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital is organized for the purpose of providing healthcare services to the residents of Harrison County and the surrounding area. The Hospital's primary sources of support are from patient revenues and other ancillary income. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

Harrison MOB, LLC ("MOB") is a limited liability company that is 61% owned by the Hospital and 39% owned by individual physicians. MOB was organized to construct, own, and operate a medical office building adjacent to the Hospital in Corydon, Indiana. MOB's primary source of revenue is from rental income.

#### Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of HCH and MOB. The Board of County Commissioners of Harrison County appoints the Governing Board of HCH and a financial benefit/burden relationship exists between the County and HCH. For these reasons, the HCH is considered a component unit of Harrison County. Similarly, due to its organized purpose, MOB is considered a blended component unit of HCH. Intercompany transactions and balances have been eliminated in consolidation. The separate audited financial statements of MOB may be obtained by contacting HCH as follows:

Harrison County Hospital  
1141 Hospital Drive NW  
Corydon, IN 47112

#### Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### Proprietary Fund Accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis of accounting using the economic resources measurement focus. Substantially all revenues and expenses are subject to accrual.

When both restricted and unrestricted resources are available for use, the Hospital's policy is to use restricted resources first, then unrestricted resources as they are needed.

### Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Hospital is insured for medical malpractice claims and judgments.

### Cash and Cash Equivalents

Cash and cash equivalents as reported on the consolidated balance sheet include petty cash and other cash on hand amounts, checking accounts, and savings accounts that are readily available for use. Cash and cash equivalents as reported on the consolidated statement of cash flows include investments in highly liquid assets with maturity dates of 90 days or less when purchased.

### Investment Derivative Instrument - Interest Rate Swap

The Hospital uses interest rate swap agreements to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital accounts for the interest rate swap agreements as investment derivative instruments. As a result, the agreements are recorded at fair value on the consolidated balance sheet. The net cash payments or receipts under the interest rate swap agreements are recorded as an increase or decrease to interest expense, which is included in nonoperating revenues (expenses) on the consolidated statements of operations.

### Investments

Short-term investments are investments with remaining maturities of up to 90 days. Statutes authorize the Hospital to invest in interest-bearing deposit accounts, passbook savings accounts, certificates of deposit, money market deposit accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury, and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Nonparticipating certificates of deposit, demand deposits, and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### Patient Accounts Receivable and Net Patient Service Revenue

The Hospital recognizes net patient service revenues on the accrual basis of accounting in the reporting period in which services are performed based on the current gross charge structure, less actual adjustments and estimated discounts for contractual allowances, principally for patients covered by Medicare, Medicaid, managed care, and other health plans. Gross patient service revenue is recorded in the accounting records using the established rates for the types of service provided to the patient. The Hospital recognizes an estimated contractual allowance to reduce gross patient charges to the estimated net realizable amount for service rendered based upon previously agreed-to rates with a payor. The Hospital utilizes the patient accounting system to calculate contractual allowances on a payor-by-payor basis based on the rates in effect for each primary third-party payor. Another factor that is considered and could further influence the level of the contractual reserves includes the status of accounts receivable balances as inpatient or outpatient. The Hospital's management continually reviews the contractual estimation process to consider and incorporate updated laws and regulations and the frequent changes in managed care contractual terms that result from contract negotiations and renewals.

Payors include federal and state agencies, including Medicare and Medicaid, managed care health plans, commercial insurance companies, and patients. These third-party payors provide payments to the Hospital at amounts different from its established rates based on negotiated reimbursement agreements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

### Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts based on the Hospital's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to the service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party payor coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulty that make the realization of amounts due unlikely). For receivables associated with self-pay payments, which includes both patients without insurance and patient with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts. The December 31, 2015 and 2014 allowance for doubtful accounts balance was comprised of the following:

	<u>2015</u>	<u>2014</u>
Reserve for third-party payor balances	\$ 909,796	\$ 1,374,893
Reserve for self-pay balances	<u>3,766,272</u>	<u>5,248,591</u>
Total allowance for doubtful accounts	<u>\$ 4,676,068</u>	<u>\$ 6,623,484</u>

The decrease in the allowance for doubtful accounts is a result of changes in the payor mix from 2014 to 2015.

### Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or market, with cost being determined on the first-in, first-out (FIFO) method.

### Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the respective Boards for future capital improvements, over which the Boards retain control and may at their discretion subsequently use for other purposes; assets held by trustees under indenture agreements; assets that have been restricted by donors for specific purposes; and amounts that have been set aside as part of deferred compensation plans. Investment income or loss, including realized gains and losses on investments and assets whose use is limited, net change in the market value of assets whose use is limited, and interest, is included in nonoperating revenues (expenses) when earned.

### Capital Assets

The Hospital's capital assets are reported at historical cost and include expenditures for additions and repairs which substantially increase the useful lives of capital assets. Maintenance, repairs, and minor improvements are expensed as incurred. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land and construction in progress are depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association Guide for Estimated Useful Lives for Fixed Assets.

### Classification of Net Position

The net position of the Hospital is classified in four components. (1) *Net investment in capital assets* consists of capital assets net of accumulated depreciation plus deferred outflows related to losses

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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on bond refunding which are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. (2) *Restricted expendable net position* includes assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. (3) *Restricted nonexpendable net position* includes the principal portion of permanent endowments and non-controlling interests owned by external investors. (4) *Unrestricted net position* is the remaining net position that does not meet the definition of *net investment in capital assets or restricted*.

### Consolidated Statements of Operations

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from income from operations include investment income, contributions received, interest expense, restricted expenditures, and the net change in the market value of assets whose use is limited.

### Advertising and Marketing Costs

Advertising and marketing costs are charged to operations when incurred. Advertising and marketing costs charged to operations were \$301,438 and \$309,970 for the years ended December 31, 2015 and 2014, respectively, and are included within the line item purchased services on the consolidated statements of operations.

### Income Taxes

HCH has been granted exemption from taxation as a not-for-profit organization by the Internal Revenue Service under Section 115, and in 2005 was also granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code for purposes of maintaining a 403b deferred compensation plan. Therefore, no provision for income taxes has been provided in the consolidated statement of operations. The MOB has elected to be treated as a partnership for federal and state income tax purposes. Under existing provisions of the Internal Revenue Code, a partnership is not a taxpaying entity for federal or state income tax purposes. Accordingly, no income tax expense has been recorded in the consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by each entity comprising the Hospital and recognize a tax liability if any Hospital entity has taken an uncertain tax position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by each entity of the Hospital, and has concluded that as of December 31, 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. Each entity of the Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

### Grants and Contributions

From time to time, the Hospital receives grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues.

### Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is November 3, 2016.

## 2. DEPOSITS AND INVESTMENTS

Deposits and investments are comprised of the following at December 31, 2015 and 2014:

	2015	2014
Carrying amount:		
Cash and cash equivalents	\$ 14,527,587	\$ 16,152,969
Money market mutual funds	82,923	82,918
Mutual funds	884,433	-0-
Total	<u>\$ 15,494,943</u>	<u>\$ 16,235,887</u>
Included in the consolidated balance sheet captions:		
Cash and cash equivalents	\$ 7,696,622	\$ 7,883,078
Assets whose use is limited	7,798,321	8,352,809
Total	<u>\$ 15,494,943</u>	<u>\$ 16,235,887</u>

### Custodial Credit Risk - Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. Deposits with financial institutions are insured by the Federal Deposit Insurance Corporation ("FDIC") up to FDIC limits or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories. This includes any deposit accounts issued or offered by a qualifying

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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institution. The Hospital maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Hospital has not experienced any losses on such accounts. The Hospital believes it is not exposed to any significant credit risk on cash.

### Interest Rate Risk

Interest risk rate is the risk that changes in market interest rates will adversely affect the fair value of an investment. The Hospital does not have a formal investment policy for interest rate risk for investments. The Hospital believes it is not exposed to any significant interest rate risk on investments.

### Credit Risk – Investments

Credit risk is the risk that, in the event of a failure of a financial institution, the Hospital would not be able to recover deposits, the value of its investments, or collateral securities that are in the possession of an outside party. The Hospital does not have a formal investment policy for credit risk for investments. The Hospital believes it is not exposed to any significant credit risk on investments.

### Concentration of Credit Risk

The Hospital places no limit on the amount it may invest in any one issuer. The Hospital maintains its investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments.

### Foreign Currency Risk

The Hospital does not have a formal policy in regards to foreign currency risk. The Hospital's investments did not have foreign currency risk.

### Fair Value Measurements and Disclosures

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active market for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.
  - Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or
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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value. There have been no changes in the methodologies used at December 31, 2015 and 2014:

- *Money market mutual funds*: Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.
- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Interest rate swap agreements*: Valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

The following table set forth by level, within the hierarchy, the Hospital's asset and liability measured at fair value on a recurring basis as of December 31, 2015 are as follows:

	Level 1	Level 2	Level 3	Total
<u>Assets</u>				
Money market mutual funds	\$ -0-	\$ 82,923	\$ -0-	\$ 82,923
Mutual funds				
Large cap value	71,064	-0-	-0-	71,064
Large cap growth	70,902	-0-	-0-	70,902
Mid cap blend	62,495	-0-	-0-	62,495
Mid cap growth	188,556	-0-	-0-	188,556
World allocation	491,416	-0-	-0-	491,416
	884,433	-0-	-0-	884,433
Total assets at fair value	\$ 884,433	\$ 82,923	\$ -0-	967,356
Cash				14,527,587
Total deposits and investments				\$ 15,494,943
<u>Liabilities</u>				
Interest rate swaps	\$ -0-	\$ 1,865,393	\$ -0-	\$ 1,865,393

The following table set forth by level, within the hierarchy, the Hospital's asset and liability measured at fair value on a recurring basis as of December 31, 2014 are as follows:

	Level 1	Level 2	Level 3	Total
<u>Assets</u>				
Money market mutual funds	\$ -0-	\$ 82,918	\$ -0-	\$ 82,918
Cash				16,152,969
Total deposits and investments				\$ 16,235,887
<u>Liabilities</u>				
Interest rate swaps	\$ -0-	\$ 2,198,172	\$ -0-	\$ 2,198,172

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

### 3. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable amounts are reported as current assets at December 31, 2015 and 2014 consist of the following:

	2015	2014
Medicare	\$ 6,121,260	\$ 5,716,046
Medicaid	4,533,225	3,591,808
Blue Cross	2,507,971	1,972,323
Other insurance carriers	4,999,987	4,258,603
Patients	4,240,796	5,655,132
Total patient accounts receivable	22,403,239	21,193,912
Less allowance for contractals	11,682,592	8,857,624
Less allowance for uncollectible amounts	4,676,068	6,623,484
 Patient accounts receivable, net	 \$ 6,044,579	 \$ 5,712,804

### 4. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. Assets whose use is limited are reported at market value and include the following at December 31, 2015 and 2014:

#### Investment Summary by Type

	2015	%	2014	%
Cash and cash equivalents	\$ 6,830,965	87.6 %	\$ 8,269,891	99.0 %
Money market mutual funds	82,923	1.1	82,918	1.0
Mutual funds	884,433	11.3	-0-	0.0
 Total assets whose use is limited	 \$ 7,798,321	 100.0 %	 \$ 8,352,809	 100.0 %

#### Investment Summary by Fund

Board-Designated Funds	\$ 6,115,136	78.4 %	\$ 4,930,673	59.0 %
Swap-Restricted Funds	1,683,185	21.6	3,422,136	41.0
 Total	 \$ 7,798,321	 100.0 %	 \$ 8,352,809	 100.0 %

#### Board-Designated Funds

The Hospital's Board of Trustees approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

items reducing the funded depreciation balance. Board-designated funds also include amounts intended for specific purposes, as established by the Hospital's Board. All income earned by the board-designated accounts is left to accumulate as additions to the funds. Board-designated funds remain under the control of the Board, which may at their discretion later use for other purposes. Therefore, all board-designated funds are included in unrestricted net position.

### Swap-Restricted Funds

Swap-restricted funds represent amounts that have been restricted by creditors for the potential payoff of the Hospital's interest rate swaps (see Note 11).

## 5. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2015, was as follows:

	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 3,001,138	\$ -0-	\$ -0-	\$ 3,001,138
Land improvements	3,331,118	8,800	-0-	3,339,918
Leasehold improvements	3,595,332	9,803	-0-	3,605,135
Buildings	40,834,597	42,058	(2,482)	40,874,173
Fixed equipment	24,426,574	1,010,168	-0-	25,436,742
Construction in progress	<u>64,691</u>	<u>42,685</u>	<u>(5,869)</u>	<u>101,507</u>
Total historical cost	75,253,450	1,113,514	(8,351)	76,358,613
Less accumulated depreciation for				
Land improvements	(1,715,394)	(235,530)	-0-	(1,950,924)
Leasehold improvements	(1,254,113)	(239,025)	-0-	(1,493,138)
Buildings	(14,313,799)	(2,053,655)	8,351	(16,359,103)
Fixed equipment	<u>(20,797,093)</u>	<u>(1,811,055)</u>	<u>-0-</u>	<u>(22,608,148)</u>
Total accumulated depreciation	<u>(38,080,399)</u>	<u>(4,339,265)</u>	<u>8,351</u>	<u>(42,411,313)</u>
Capital assets, net	<u>\$ 37,173,051</u>	<u>\$ (3,225,751)</u>	<u>\$ -0-</u>	<u>\$ 33,947,300</u>

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Capital asset activity for the year ended December 31, 2014, was as follows:

	Beginning Balance	Additions	Retirements/ Transfers	Ending Balance
Land	\$ 3,001,138	\$ -0-	\$ -0-	\$ 3,001,138
Land improvements	3,331,118	-0-	-0-	3,331,118
Leasehold improvements	3,553,580	41,752	-0-	3,595,332
Buildings	40,651,778	15,665	167,154	40,834,597
Fixed equipment	23,797,773	531,611	97,190	24,426,574
Construction in progress	81,521	317,330	(334,160)	64,691
Total historical cost	<u>74,416,908</u>	<u>906,358</u>	<u>(69,816)</u>	<u>75,253,450</u>
Less accumulated depreciation for				
Land improvements	(1,464,096)	(251,298)	-0-	(1,715,394)
Leasehold improvements	(1,025,401)	(228,713)	1	(1,254,113)
Buildings	(12,274,461)	(2,039,740)	402	(14,313,799)
Fixed equipment	<u>(19,032,069)</u>	<u>(1,834,437)</u>	<u>69,413</u>	<u>(20,797,093)</u>
Total accumulated depreciation	<u>(33,796,027)</u>	<u>(4,354,188)</u>	<u>69,816</u>	<u>(38,080,399)</u>
Capital assets, net	<u>\$ 40,620,881</u>	<u>\$ (3,447,830)</u>	<u>\$ -0-</u>	<u>\$ 37,173,051</u>

### 6. OTHER ASSETS

At December 31, 2015 and 2014, other assets consist of the following:

	2015	2014
Physician notes receivable	\$ 39,423	\$ 15,385
Intangible assets	<u>28,890</u>	<u>46,097</u>
Total other assets	68,313	61,482
Other assets, current portion	<u>(25,000)</u>	<u>(15,385)</u>
Other assets, net of current portion	<u>\$ 43,313</u>	<u>\$ 46,097</u>

Physician notes receivable are in varying amounts maturing through July 2017. If the physicians meet the period of service requirement, the Hospital will forgive these notes. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Interest rates are prime rate + 1 percent (4.25 percent at both December 31, 2015 and 2014).

The Hospital has intangible assets that are being amortized over their remaining estimated useful life using the straight line method.



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 7. COMPENSATED ABSENCES

The Hospital's policy on paid days off (which includes vacation, sick leave, personal leave, and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 60 days.

Paid days off are accrued when incurred and reported as a liability. The paid days off accrual at December 31, 2015 and 2014 was \$952,424 and \$892,399, respectively, and is reported in accrued personnel costs in the consolidated financial statements.

### 8. EMPLOYEE HEALTH BENEFIT PLAN

The Hospital operates a self-funded health plan covering substantially all employees. The Hospital has an annual stop loss limit on the plan of \$60,000 per insured per year. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of pay out, and other economic and social factors. The accrued liability for claims liabilities is recorded in accrued expenses on the consolidated balance sheets.

Changes in the balance of claims liabilities during the years ended December 31, 2015 and 2014 were as follows:

	2015	2014
	<u>                    </u>	<u>                    </u>
Accrued liability, beginning of year	\$ 239,474	\$ 269,396
Incurred claims, changes in estimates, and fees/premiums	3,048,704	2,511,779
Claim payments	<u>(3,245,178)</u>	<u>(2,541,701)</u>
Accrued liability, end of year	<u>\$ 43,000</u>	<u>\$ 239,474</u>

### 9. DEFINED CONTRIBUTION PENSION PLAN

#### Plan Description

The Hospital has a defined contribution pension plan administered by MetLife as authorized by Indiana Code 16-22-3-11. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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financial report that includes financial statements and required supplementary information of the plan. That report may be obtained by contacting:

MetLife  
c/o FasCare, LLC  
P.O. Box 173768  
Denver, Colorado 80217-3768  
Ph. (800) 543-2520

### Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members are voluntary and are established by written authorization for payroll deduction into an annuity savings account. The current rate is 5 percent of annual covered payroll. Employer contributions to the plan were \$874,968 and \$766,219 for the years ended December 31, 2015 and 2014, respectively.

## **10. OBLIGATIONS UNDER CAPITAL LEASES**

The Hospital is the lessee of certain equipment under interest bearing capital leases that expire in various years through 2020. The assets and liabilities under capital leases are initially recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Amortization of assets held under capital leases is included in depreciation expense and was \$24,312 and \$11,485 for the years ended December 31, 2015 and 2014, respectively.

Following is a summary of property held under capital leases:

	<u>2015</u>	<u>2014</u>
Equipment	\$ 240,015	\$ 110,646
Less accumulated depreciation	<u>(31,942)</u>	<u>(11,485)</u>
Other assets, net of current portion	<u>\$ 208,073</u>	<u>\$ 99,161</u>

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

### 11. LONG-TERM DEBT

At December 31, 2015 and 2014, the Hospital was obligated for long-term debt agreements as follows:

	2015	2014
Harrison County, Indiana Economic Development Revenue Refunding Bonds, Series 2011 (Harrison County Hospital Project) dated June 2011, payable in annual principal installments commencing July 2011 through June 2031, in amounts ranging from \$347,495 to \$676,531. Variable interest rate is 71% of the Wall Street Journal Prime rate with a floor of 3.55%. Interest rate was 3.55% at both December 31, 2015 and 2014. Secured by gross revenues.	\$ 8,325,664	\$ 8,719,997
Mortgage note payable to bank, due July 2017; payable in annual principal installments, in amounts ranging from \$70,698 to \$134,206; variable interest rate at one month LIBOR plus 1.25% (1.61% and 1.41% at December 31, 2015 and 2014, respectively). Secured by substantially all assets.	4,735,002	4,861,029
Mortgage note payable to bank, due September 2017; monthly payments, including interest of \$2,103; Fixed interest at 5.00%. Secured by substantially all assets.	<u>293,165</u>	<u>303,257</u>
	13,353,831	13,884,283
Less current portion	<u>(553,198)</u>	<u>(530,023)</u>
Long-term debt, net of current portion	<u><u>\$ 12,800,633</u></u>	<u><u>\$ 13,354,260</u></u>

In June 2011, the Hospital defeased the 2005 bonds with proceeds from the issuance of the 2011 bonds, a contribution from Harrison County, and current cash. However, the swap agreement associated with the 2005 bonds was not terminated as part of the defeasance. The 2011 bonds require that the Hospital establish and maintain a separate deposit account (cash reserve), so long as the swap agreement is in full force and effect. The Hospital shall maintain a cash reserve in an amount equal to any payment that may be due by the Hospital under the swap master agreement due to the termination of the swap agreement. The amount of the cash reserve shall be determined as of the date of the 2011 bond agreement and upon the receipt from time to time of the Hospital's annual financial statements as though the swap agreement was terminated as of such date. The purchaser of the 2011 bonds may consent to release the funds from the cash reserve in the event the amount of the funds then on deposit in the cash reserve exceeds the termination payment on such date. The Hospital must maintain the reserve while the swap agreement is in effect.

The amount of cash and investments set aside in assets whose use is limited was \$1,683,185 and \$3,422,136 at December 31, 2015 and 2014, respectively.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

Long-term debt activity for the years ended December 31, 2015 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2011	\$ 8,719,997	\$ -0-	\$ 394,333	\$ 8,325,664	\$ 408,277
Mortgage note payable	4,861,029	-0-	126,027	4,735,002	134,206
Mortgage note payable	<u>303,257</u>	<u>-0-</u>	<u>10,092</u>	<u>293,165</u>	<u>10,715</u>
Total long-term debt	<u>\$ 13,884,283</u>	<u>\$ -0-</u>	<u>\$ 530,452</u>	<u>\$ 13,353,831</u>	<u>\$ 553,198</u>

Long-term debt activity for the years ended December 31, 2014 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Current Portion
Revenue bonds, series 2011	\$ 9,100,351	\$ -0-	\$ 380,354	\$ 8,719,997	\$ 394,672
Mortgage note payable	4,978,293	-0-	117,264	4,861,029	125,158
Mortgage note payable	<u>312,862</u>	<u>-0-</u>	<u>9,605</u>	<u>303,257</u>	<u>10,193</u>
Total long-term debt	<u>\$ 14,391,506</u>	<u>\$ -0-</u>	<u>\$ 507,223</u>	<u>\$ 13,884,283</u>	<u>\$ 530,023</u>

Debt service requirements on long-term debt at December 31, 2015 are based on the interest rate modes in effect and are as follows:

Year Ending December 31,	Principal	Interest
2016	\$ 553,198	\$ 1,129,217
2017	5,307,300	927,461
2018	439,571	729,211
2019	455,656	678,227
2020	471,669	626,095
2021 - 2025	2,633,305	2,266,794
2026 - 2030	3,151,915	676,507
2031	<u>341,217</u>	<u>3,648</u>
Total	<u>\$ 13,353,831</u>	<u>\$ 7,037,160</u>

The Hospital's debt agreements contain various restrictive covenants, including debt service coverage ratio and audited financial statement submission requirements. The Hospital is in violation of the audit submission requirements and has obtained a covenant waiver for the violation.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 12. DERIVATIVE INSTRUMENTS - INTEREST RATE SWAPS

In accordance with GASB Codification Section D40, governmental entities are required to evaluate each derivative instrument to determine whether the instrument is an effective hedge.

For those instruments deemed to be an effective hedge, governmental entities are required to practice hedge accounting and the instrument continues to be reevaluated at the end of each future reporting period. Under hedge accounting, the fair value of the instrument is recorded on the consolidated balance sheets with the offsetting entry to deferred outflows or deferred inflows, which is reported on the consolidated balance sheets.

For those instruments deemed to be an ineffective hedge, governmental entities are required to practice investment accounting and the instruments are not evaluated in future reporting periods. Once deemed ineffective, the instrument is considered ineffective for the remainder of its term. Under investment accounting, the fair value of the instrument is recorded on the consolidated balance sheets with the offsetting entry posted to investment income within nonoperating revenues (expenses) on the consolidated statements of operations.

During 2011, the Hospital's interest rate swap on the 2011 revenue bonds (previously 2005 revenue bonds refinanced with 2011 revenue bonds) was determined to be an ineffective hedge. During 2013, the Hospital's interest rate swap on the mortgage note payable was determined to be an ineffective hedge. Therefore, the interest rate swap agreements are ineffective through the remainder of their terms. As a result, the fair value of the instruments have been recorded as liabilities on the consolidated balance sheets with the offsetting entries recorded under nonoperating revenues (expenses) in the consolidated statements of operations.

#### Contracts

The Hospital has two interest rate swap agreements in effect as of December 31, 2015 and 2014, respectively, for the 2011 revenue bonds and the mortgage note payable.

#### Objectives and Strategies for Using Derivatives

As a means to manage the risk associated with interest rate risk on its variable rate debt, the Hospital entered into interest rate swap agreements in connection with its 2011 revenue bonds and mortgage note payable. The intention of the swap agreements was to effectively change the Hospital's variable interest rate on the Series 2011 Bonds to a fixed rate of 3.81% and change the Hospital's variable interest rate on the mortgage note payable to a fixed rate of 5.97% plus an additional 1.25% credit spread as noted in Note 10.

#### Terms, Fair Values, and Credit Risk

The swap agreements relate to the 2011 revenue bonds and mortgage note payable with original notional amounts of \$25,000,000 and \$5,600,000, respectively. The counter party to the swap

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

agreements is U.S. Bank for the 2011 revenue bonds and Regions Bank for the mortgage note payable.

The terms and fair values of the outstanding swaps as of December 31, 2015 are as follows:

	2011 Revenue Bonds	Mortgage note payable
Original notional amount	\$ 25,000,000	\$ 5,600,000
Current notional amount	\$ 7,986,000	\$ 4,895,002
Effective date	December 1, 2005	February 15, 2009
Fixed rate	3.81%	5.97%
	70% of USD-LIBOR-	
Variable rate	BBA	USD-LIBOR-BBA
Fair value	\$ (1,480,475)	\$ (384,918)
Termination date	October 1, 2030	July 1, 2017
Counterparty credit rating (1)	AA-	BBB
(1) As rated by Fitch		

The terms and fair values of the outstanding swaps as of December 31, 2014 are as follows:

	2011 Revenue Bonds	Mortgage note payable
Original notional amount	\$ 25,000,000	\$ 5,600,000
Current notional amount	\$ 8,391,000	\$ 5,021,028
Effective date	December 1, 2005	February 15, 2009
Fixed rate	3.81%	5.97%
	70% of USD-LIBOR-	
Variable rate	BBA	USD-LIBOR-BBA
Fair value	\$ (1,573,169)	\$ (625,003)
Termination date	October 1, 2030	July 1, 2017
Counterparty credit rating (1)	AA-	BBB
(1) As rated by Fitch		

As of December 31, 2015, the negative fair values of the agreements may be countered by reductions in total interest payments under the swap agreements should the variable rates on the 2011 revenue bonds and mortgage note payable increase.

### Basis Risk

The swaps variable rates are pegged to USD-LIBOR-BBA index. The 2011 Bonds and mortgage note payable variable rates are determined based on the Wall Street Journal Prime Rate and LIBOR, respectively. Therefore basis risk relating to the swaps could be significant.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

### Termination Risk

The Hospital or the counter party may terminate the swaps if the other party fails to perform under the terms of the contracts. If at the time of termination, the swaps have a negative fair value, the Hospital could be liable to the counter party for a payment equal to the swaps' fair values. As of December 31, 2015 and 2014, the Hospital was in compliance with the terms of the swap contracts.

### Swap Payments and Associated Debt

Using rates as of December 31, 2015, debt service requirements of the variable rate debt and net swap payments of the Series 2011 Bonds and mortgage note payable, assuming current interest rates remain the same for the term of the bonds are disclosed in the Long Term Debt note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

The Hospital has determined the swaps to be ineffective hedges. Accordingly, the fair value of the swaps have been recorded and subsequent changes in fair value will be recorded in the consolidated balance sheets with the offsetting entry recorded under nonoperating revenues (expenses) in the consolidated statements of operations.

Following is an analysis of the recording of the interest rate swap agreements as of, and for the year ended December 31, 2015:

Swap agreement	Change in market value	Interest rate swap liability
2011 Revenue Bonds	\$ 92,693	\$ 1,480,475
Mortgage note payable	240,086	384,918
	\$ 332,779	\$ 1,865,393

Following is an analysis of the recording of the interest rate swap agreements as of, and for the year ended December 31, 2014:

Swap agreement	Change in market value	Interest rate swap liability
2011 Revenue Bonds	\$ (310,936)	\$ 1,573,169
Mortgage note payable	248,521	625,003
	\$ (62,415)	\$ 2,198,172

See the Fair Value Measurements and Long Term Debt footnotes for additional information.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

### 13. NET PATIENT SERVICE REVENUE

For the years ended December 31, 2015 and 2014, net patient service revenue was as follows:

	2015	2014
Gross patient service revenue		
Inpatient services	\$ 29,485,452	\$ 27,479,383
Outpatient services	105,140,488	95,981,264
Total gross patient service revenue	134,625,940	123,460,647
Deductions from revenue		
Contractual allowances	83,659,842	71,467,378
Charity care	2,019,352	3,121,886
Bad debts	4,547,236	6,367,456
Medicaid DSH payments recognized	(2,823,281)	(3,200,466)
Total deductions from revenue	87,403,149	77,756,254
Total net patient service revenue	\$ 47,222,791	\$ 45,704,393

The Hospital grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements.

The mix of gross revenues and receivables from patients and third-party payors at December 31, 2015 and 2014 was as follows:

	2015				2014			
	Revenues	%	Receivables	%	Revenues	%	Receivables	%
Medicare	41	%	27	%	41	%	27	%
Medicaid	21		20		17		17	
Blue Cross	16		11		15		9	
Other third-party payors	19		22		18		20	
Patients	3		20		9		27	
	100	%	100	%	100	%	100	%

The Hospital has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** The Hospital is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Hospital is classified as Critical Access Status by Medicare and is paid for Medicare services based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at an interim rate, with



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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final settlement determined after submission of annual cost reports. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. As of December 31, 2015, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2013.

- **Medicaid**. The Hospital is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Hospital is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.
- **Charity Care**. The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue. The estimated costs of providing charity 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 the Hospital's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2015 and 2014, the Hospital incurred estimated costs of \$769,534 and \$1,254,010, respectively.
- **Other**. The Hospital has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these agreements includes discounts from established charges, fee schedules, as well as inpatient diagnosis-related group reimbursement methodologies.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes that it is in compliance with all applicable laws and regulations.

### 13. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for EHR incentive payments, the Hospital must meet "meaningful use" criteria that become more stringent over time. The Hospital periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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generally include performance measures for each annual EHR reporting period (Federal fiscal year ending on September 30<sup>th</sup>). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Hospital's cost reports. For Critical Access Hospitals, the payment calculation is based upon the net book value of the qualifying assets, multiplied by the Medicare utilization using Medicare to total inpatient days plus 20%, not to exceed 100%. The total days are multiplied by a factor of total charges excluding charity care to total charges. Critical Access Hospitals can be reimbursed over a four year period for additional qualifying assets not claimed in the first year. The transitional factor ranges from 100% in first payment year and decreases by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as grant income when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During the years ended December 31, 2015 and 2014, the Hospital recognized \$81,111 and \$288,788, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the Hospital records income at the end of EHR reporting period in which compliance is achieved. EHR incentive income is included in other revenue on the consolidated statements of operations. EHR incentive income is recognized based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

Receipt of these funds is subject to the fulfillment of certain obligations by the Hospital as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

### **14. HOSPITAL ASSESSMENT FEE**

In 2012, Hospital Assessment Fee (HAF) Program was approved by Centers for Medicare and Medicaid Services (CMS). The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share payments for Indiana hospitals. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced claims are designed to follow patients and result in increased Medicaid rates.

During the years ended December 31, 2015 and 2014, the Hospital recognized HAF program expense of \$755,843 and \$1,117,615, respectively, which resulted in Medicaid rate increases. The Medicaid rate increases under the HAF Program are included in net patient service revenue in the consolidated statements of operations. The HAF Program was approved for extension through June 30, 2017.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 15. NONOPERATING REVENUES (EXPENSES)

For the years ended December 31, 2015 and 2014, nonoperating revenues (expenses) were as follows:

	<u>2015</u>	<u>2014</u>
Investment income	\$ 39,834	\$ 41,346
Interest expense	(1,013,761)	(1,050,427)
Contributions and grants	4,483	31,955
Change in market value of interest rate swaps	332,779	(62,415)
Miscellaneous	<u>(68,386)</u>	<u>25,600</u>
Total nonoperating revenues (expenses)	<u>\$ (705,051)</u>	<u>\$ (1,013,941)</u>

GASB requires interest expense to be reported as nonoperating expense while FASB requires interest expense to be reported as an operating expense.

### 16. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18, provides a maximum recovery of \$250,000 for an occurrence of malpractice and \$1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of \$250,000 per occurrence and \$5,000,000 in the annual aggregate for hospitals with fewer than 100 occupied beds. The Act also requires the Hospital to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

Liabilities for incurred but not reported losses at December 31, 2015 and 2014, respectively, are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Hospital's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Hospital intends to continue carrying such insurance.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 17. OPERATING LEASES – LESSEE

The Hospital leases certain equipment under non-cancelable operating leases. Future payments under these non-cancelable operating leases at December 31, 2015 was as follows:

Year Ending December 31,	Amount
2016	\$ 267,881
2017	259,142
2018	245,779
2019	117,504
2020	70,872
2021-2025	70,800
Total minimum payments	<u>\$ 1,031,978</u>

The Hospital leases certain building space under cancelable operating leases. The Hospital incurred \$234,368 and \$177,107 in total rent expense for the years ended December 31, 2015 and 2014, respectively, under its cancelable and non-cancelable operating leases.

### 18. OPERATING LEASES – LESSOR

The Hospital leases certain space of the medical office building (with a net book value of \$3,874,077) to tenants under operating leases expiring within the next five years. The leases contain annual escalation provisions which increase rentals relative to increases in the Consumer Price Index. The leases also contain provisions which require tenants to pay their proportionate share of certain expenses and costs in connection with the Hospital's ownership and operation of the building and common area.

Following is a schedule by years of future minimum rentals to be received under the operating leases with remaining non-cancelable lease terms in excess of one year as of December 31, 2015:

Year ended December 31:	Amount
2016	\$ 199,368
2017	199,368
2018	104,024
Total minimum future rentals	<u>\$ 502,760</u>

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# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 19. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

#### Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value based on the short maturities of those items.

#### Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

#### Accounts Payable, Accrued Personnel Costs, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued personnel costs, and accrued expenses approximate their fair value based on the short maturities of those items.

#### Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value because they are expected to be settled in the near future.

#### Long-Term Debt

The carrying amount reported in the consolidated balance sheets for long-term debt approximates its fair value because the vast majority of the outstanding debt carries variable interest rates.

#### Interest Rate Swap Agreements

Interest rate swap agreements are reported in the consolidated balance sheets at fair value. Interest rate swap agreements are valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap.

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 20. CONTINGENCIES

There are a variety of legal proceedings and claims by others against the Hospital in a variety of matters arising out of the conduct of the Hospital's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the consolidated financial statements.

### 21. COMMITMENTS

As of December 31, 2015, the Hospital has construction and renovation project commitments as follows:

<u>Project</u>	<u>Expected Date of Completion</u>	<u>Estimated Total Cost of Project</u>	<u>Costs Incurred as of 12/31/2015</u>
Batch Scanning - Cerner	6/30/2016	\$ 73,490	\$ 70,490
Chart Maxx	6/30/2016	22,500	22,500
CMA/Dr. Sauer Phone System	5/31/2016	15,000	8,517
		<u>\$ 110,990</u>	<u>\$ 101,507</u>

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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### 22. CONDENSED FINANCIAL INFORMATION

The Hospital includes one blended component unit, the MOB, in its reporting entity. Condensed component unit information for its blended component unit as of and for the years ended December 31, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
<b>Balance sheet</b>		
Assets		
Current assets	\$ 135,656	\$ 113,406
Capital assets, net	5,691,748	5,966,369
Other assets	<u>28,890</u>	<u>46,097</u>
Total assets	<u>\$ 5,856,294</u>	<u>\$ 6,125,872</u>
Liabilities		
Current liabilities	\$ 229,183	\$ 217,575
Long-term liabilities	<u>5,288,769</u>	<u>5,727,713</u>
Total liabilities	5,517,952	5,945,288
Net position		
Net investment in capital assets	592,207	684,454
Unrestricted	<u>(253,865)</u>	<u>(503,870)</u>
Total net position	<u>338,342</u>	<u>180,584</u>
Total liabilities and net position	<u>\$ 5,856,294</u>	<u>\$ 6,125,872</u>

# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

	2015	2014
<b>Statement of operations and changes in net position</b>		
Operating revenues		
Other operating revenue	\$ 925,851	\$ 899,598
Operating expenses		
Depreciation and amortization	291,828	291,827
Other operating expenses	251,932	224,286
Total operating expenses	<u>543,760</u>	<u>516,113</u>
Income from operations	382,091	383,485
Nonoperating revenues (expenses)	<u>(140,333)</u>	<u>(143,222)</u>
Change in net position	241,758	240,263
Member distributions	(84,000)	(84,000)
Net position - beginning of year	180,584	24,321
Net position - end of year	<u>\$ 338,342</u>	<u>\$ 180,584</u>
<b>Statement of cash flows</b>		
Cash provided by		
Operating activities	\$ 317,037	\$ 263,937
Capital and related financing activities	<u>(266,374)</u>	<u>(258,861)</u>
Total	50,663	5,076
Cash - beginning of year	62,124	57,048
Cash - end of year	<u>\$ 112,787</u>	<u>\$ 62,124</u>

### 23. RECENT GASB PRONOUNCEMENTS

Management has not currently determined what effects, if any, the implementation of the following recently enacted statements may have on its future financial statements:

**GASB Statement No. 72**, *Fair Value Measurement and Application*, issued February 2015, will be effective for periods beginning after June 15, 2015. This Statement will enhance the comparability of financial statements among governments by requiring the measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statements users about the impact of fair value measurements on a government's financial position.



# HARRISON COUNTY HOSPITAL AND AFFILIATED ORGANIZATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2015 AND 2014

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**GASB Statement No. 76**, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, issued June, 2015, will be effective for periods beginning after June 15, 2015. The objective of this Statement is to identify – in the context of the current governmental financial reporting environment – the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

**GASB Statement No. 80**, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*, issued January 2016, will be effective for periods beginning after June 15, 2016. The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity*, as amended. The Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

### 24. SUBSEQUENT EVENT

On September 13, 2016, the Hospital issued Harrison County, Indiana Economic Development Revenue Refunding Bonds, series 2016 (2016 bonds) in the amount of \$7,500,000 to refinance the 2011 revenue bonds. The 2016 bonds bear interest at 2.61% and require monthly principal and interest payments commencing October 1, 2016 through maturity, which is October 1, 2026. In conjunction with the refunding of the 2011 bonds, the Hospital terminated the interest rate swap associated with the 2011 bonds. The termination payment was made on September 13, 2016 in the amount of \$1,555,200.