

**Gibson General Hospital, Inc. and Affiliate
Combined Financial Statements**

*Years Ended September 30, 2016 and 2015
with Report of Independent Auditors*

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Report of Independent Auditors

Board of Trustees
Gibson General Hospital, Inc. and Affiliate
Princeton, Indiana

Report on the Financial Statements

We have audited the accompanying combined financial statements of Gibson General Hospital, Inc. and Affiliate (the Hospital) which comprise the combined balance sheets as of September 30, 2016 and 2015, and the related combined statements of operations and changes in net assets and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of 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 combined financial statements.

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

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Gibson General Hospital, Inc. and Affiliate as of September 30, 2016 and 2015, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Board of Trustees
Gibson General Hospital, Inc. and Affiliate
Report of Independent Auditors, continued

Other Matter

Supplementary Information

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

Emphasis of Matter

As described in Note 8, on March 21, 2016, the original purchaser (Old National Bank i.e. "the Bank") of the Series 2005, 2007 and 2008 Bonds and the Hospital agreed to a Forbearance Agreement (the Agreement) which outlines the terms and conditions under which the Bank will forbear from exercising its rights and remedies related to the default caused by the Hospital not meeting its debt service coverage covenants related to the bond issues. The original forbearance period was for the period beginning March 21, 2016 to the earlier of October 1, 2016 or the date of the occurrence of any new events of default as defined in the Agreement. During fiscal 2016, the Agreement was extended to April 1, 2017. During this period, the Hospital expects to refinance all of its debt via a \$8.4 million United States Department of Agriculture and bank financed refinancing project. Our opinion is not modified with respect to this matter.

Dean Dotson Allen Ford, PLLC

January 9, 2017
Louisville, Kentucky

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GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combined Balance Sheets

September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,458,493	\$ 637,616
Patient accounts receivable, net of allowance for uncollectible accounts of approximately \$2,350,000 and \$2,800,000 for 2016 and 2015, respectively.	3,399,288	3,679,146
Other receivables	456,596	456,751
Supplies	756,580	816,213
Prepaid and other	<u>316,709</u>	<u>174,946</u>
Total current assets	6,387,666	5,764,672
Assets limited as to use:		
Internally designated	2,147,978	3,221,927
Pledged as collateral (Notes 3 and 8)	<u>1,000,000</u>	<u>1,000,000</u>
Total assets limited as to use	3,147,978	4,221,927
Property and equipment, net	11,322,395	12,078,250
Beneficial interest in assets at Community Foundation Alliance	<u>57,419</u>	<u>63,490</u>
Total other assets	<u>14,527,792</u>	<u>16,363,667</u>
Total assets	<u>\$ 20,915,458</u>	<u>\$ 22,128,339</u>

	<u>2016</u>	<u>2015</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 542,106	\$ 831,607
Accrued expenses	1,360,541	1,445,020
Line of credit	-	600,000
Estimated Medicare-Medicaid cost report settlements payable	251,553	19,463
Accrued self-insurance liabilities	342,356	193,943
Deferred revenue	69,297	29,417
Current maturities of long-term debt	<u>8,041,375</u>	<u>901,132</u>
Total current liabilities	10,607,228	4,020,582
Long-term debt, net of current maturities	<u>-</u>	<u>7,808,700</u>
Total liabilities	10,607,228	11,829,282
Net assets:		
Hospital:		
Unrestricted	9,871,589	10,184,560
Temporarily restricted	50,742	51,007
Permanently restricted	<u>57,419</u>	<u>63,490</u>
Total hospital net assets	9,979,750	10,299,057
Joint venture equity - Pain Management	<u>328,480</u>	<u>-</u>
Total net assets	<u>10,308,230</u>	<u>10,299,057</u>
Total liabilities and net assets	<u>\$ 20,915,458</u>	<u>\$ 22,128,339</u>

See accompanying notes.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combined Statements of Operations and Changes in Net Assets

Years ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Unrestricted revenues, gains and other support:		
Patient service revenue (net of contractual allowances and discounts)	\$ 33,111,853	\$ 34,349,394
Provision for bad debts	<u>(2,889,599)</u>	<u>(3,943,699)</u>
Net patient service revenue less provision for bad debts	30,222,254	30,405,695
Other revenue	<u>378,348</u>	<u>467,338</u>
Total unrestricted revenues, gains and other support	30,600,602	30,873,033
Expenses and losses:		
Salaries and wages	14,257,088	14,482,267
Employee benefits	4,157,851	3,655,429
Contracted services	2,604,521	2,770,005
Supplies	2,600,348	2,813,428
Physician fees	2,108,447	2,268,074
Insurance	331,587	426,280
Lease expense	440,576	438,177
Utilities	666,422	653,327
Other expenses	576,745	622,097
Depreciation and amortization	1,257,649	1,215,995
Professional fees	120,746	147,784
Interest	464,251	230,643
Maintenance and repair	903,314	994,119
Advertising	203,540	285,183
Recruiting	186,865	88,562
Collection	184,750	162,255
Minor equipment	58,859	116,218
Provider hospital assessment fee	<u>445,673</u>	<u>312,860</u>
Total expenses and losses	<u>31,569,232</u>	<u>31,682,703</u>
Operating loss	(968,630)	(809,670)
Other income:		
Contributions received	191,131	188,222
Investment income	351,275	226,818
Assets released from restriction	<u>265</u>	<u>6,799</u>
Total other income	<u>542,671</u>	<u>421,839</u>
Deficit of revenues over expenses	(425,959)	(387,831)

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combined Statements of Operations and Changes in Net Assets, continued

Years ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Unrestricted net assets:		
Deficit of revenues over expenses	(425,959)	(387,831)
Change in unrealized gains (losses) on investments	1,081	(310,873)
Pain Management minority interest	<u>(111,907)</u>	<u>-</u>
Decrease in unrestricted net assets	(312,971)	(698,704)
Temporarily restricted net assets:		
Assets released from restriction	(265)	(6,799)
Permanently restricted net assets:		
Change in beneficial interest in assets at Community Foundation Alliance	<u>(6,071)</u>	<u>-</u>
Decrease in net assets	(319,307)	(705,503)
Net assets, beginning of year	10,299,057	11,004,560
Net assets, end of year:		
Hospital	9,979,750	10,299,057
Pain Management	<u>328,480</u>	<u>-</u>
Total	<u>\$ 10,308,230</u>	<u>\$ 10,299,057</u>

See accompanying notes.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combined Statements of Cash Flows

Years ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (319,307)	\$ (705,503)
Adjustment to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,257,649	1,215,995
Net realized and unrealized (gain) loss on investments	(215,103)	310,873
Change in beneficial interest in assets at Community Foundation Alliance	6,071	-
Provision for uncollectible accounts	2,889,599	3,943,699
Change in joint venture equity	328,480	-
Increase (decrease) in cash due to changes in:		
Patient accounts receivable	(2,609,741)	(4,370,534)
Other receivables	155	(113,807)
Supplies	59,633	(148,236)
Prepaid and other	(141,763)	285,037
Accounts payable	(289,501)	90,327
Accrued expenses	63,934	72,564
Estimated Medicare - Medicaid cost settlements payable	232,090	(480,465)
Deferred revenue	<u>39,880</u>	<u>29,417</u>
Net cash provided by operating activities	<u>1,302,076</u>	<u>129,367</u>
Cash flows from investing activities:		
Purchase of property and equipment	(497,941)	(608,706)
Decrease in assets limited as to use, net	<u>1,289,052</u>	<u>89,732</u>
Net cash provided by (used in) investing activities	<u>791,111</u>	<u>(518,974)</u>
Cash flows from financing activities:		
Repayment of debt	(972,310)	(946,779)
Change in line of credit, net	(600,000)	600,000
Proceeds from issuance of debt	<u>300,000</u>	<u>-</u>
Net cash used in financing activities	<u>(1,272,310)</u>	<u>(346,779)</u>
Net increase (decrease) in cash	820,877	(736,386)
Cash and cash equivalents, beginning of year	<u>637,616</u>	<u>1,374,002</u>
Cash and cash equivalents, end of year	<u>\$ 1,458,493</u>	<u>\$ 637,616</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 240,437	\$ 230,643

See accompanying notes.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements

1. Description of the Organization

Gibson General Hospital, Inc. (the Hospital) primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Gibson County, Indiana. It also operates a home health agency in the same geographic area.

Additionally, the financial statements of the Hospital include a joint-venture, Gibson General Hospital Pain Management, LLC (Pain Management), in which the Hospital maintains a controlling interest. The financial statements do not show the minority owners' interests in the entity as "noncontrolling interest" in the net assets of the Hospital (\$160,956 at September 30, 2016). See "Joint venture equity - Pain Management" in the net assets section of the Hospital's combined balance sheets.

Gibson General Health Foundation, Inc. (the Foundation) is affiliated with the Hospital through individuals holding common memberships of their respective governing bodies and through the dedication of fundraising efforts by the Foundation for the benefit of the Hospital.

2. Summary of Significant Accounting Policies

The combined financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Hospital in the preparation of its financial statements:

Principles of Combination

The accompanying combined financial statements include financial statements of Gibson General Hospital, Inc. and its affiliate, Gibson General Health Foundation, Inc. Material intercompany transactions and balances have been eliminated.

Cash and Cash Equivalents

Cash and cash equivalents consist of bank deposits and investments with an original maturity of three months or less. At times, balances in the Hospital's cash accounts 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 and cash equivalents.

Patient Accounts Receivable

Patient accounts receivable consist of amounts due from government programs (e.g., Medicare and Medicaid) and non-government payors (e.g., self-pay and commercial payors). Management believes there are minimal credit risks associated with the receivables from government programs. Non-government receivables are from various payors that are subject to differing economic conditions. Management continually monitors and adjusts the allowance for uncollectible accounts associated with credit risk of patient accounts receivable.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Supplies

Supplies (primarily pharmaceuticals and medical supplies) are stated at the lower of cost (first-in, first-out method) or market.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Beneficial Interest in Assets of Community Foundation Alliance

Community Foundation Alliance (Alliance) and the Hospital are financially interrelated organizations as defined by GAAP. The Alliance seeks private support for and holds net assets on behalf of the Hospital. The Hospital accounts for its interest in the net assets of the Alliance in a manner similar to the equity method. The interest is stated at fair value, and changes in the interest are included in change in net assets. Transfers of assets between the Alliance and the Hospital are recognized as increases or decreases in the interest.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the combined statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. The expense and the related liability for benefits are recognized when earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the employee's regular pay and termination pay rates in effect at the balance sheet dates, plus an additional amount for compensation-related payments, such as Social Security and Medicare taxes computed using rates in effect at that date.

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 other than medical malpractice.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported and claims incurred but not yet reported.

Self-Insurance

The Hospital has elected to self-insure certain costs related to employee health programs. Costs resulting from noninsured losses are charged to income when incurred. The Hospital has purchased insurance that limits its exposure for individual claims in excess of \$75,000 and its aggregate exposure to \$1,000,000. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are amortized on a straight-line basis over the term of the respective debt.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital and the Foundation have been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital and the Foundation in perpetuity.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care

The Hospital accepts patients regardless of their ability to pay. A patient is classified as a charity patient based on certain established policies. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the Hospital includes certain cases where incurred charges are significant when compared to the patient's income. Charity care provided, measured at charges was \$755,923 and \$756,030 for September 30, 2016 and 2015, respectively. These charges are not included in net patient service revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Excess (Deficit) of Expenses Over Revenues

The combined statements of operations and changes in net assets include excess (deficit) of expenses over revenues. Changes in unrestricted net assets, which are excluded from excess (deficit) of expenses over revenues, consistent with industry practice, include unrealized gains and losses on investments other than trading securities and contributions of long-lived assets.

Income Taxes

The Hospital and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. However, the Hospital is subject to federal income tax on any unrelated business taxable income. Management believes they do not have any unrelated business taxable income.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

New Accounting Pronouncement

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases*, requiring all leases to be recognized on the Hospital's balance sheet as a right-of-use asset and a lease liability, unless the lease is a short term lease (generally a lease with a term of twelve months or less). At the commencement date of the lease, the Hospital will recognize: 1) a lease liability for Hospital's obligation to make payments under the lease agreement, measured on a discounted basis; and 2) a right-of-use asset that represents the Hospital's right to use, or control the use of, the specified asset for the lease term. Upon adopting the ASU, the Hospital will be required to recognize and measure its leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02 will be effective for the Hospital for the year ending September 30, 2021, with early adoption permitted. The Hospital is currently evaluating the effect that the new standard will have on its combined financial statements.

In August 2016, FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, that changes how a not-for-profit organization classifies its net assets, as well as the information it presents in the financial statements and notes about its liquidity, financial performance, and cash flows. The ASU includes a reduction in the number of net asset categories from three to two, conforming requirements on releases of capital restrictions, several new requirements related to expense presentation and disclosure (including investment expenses), and new required disclosures communicating information useful in assessing liquidity. This ASU will be effective for the Hospital for fiscal years beginning after December 15, 2017. Early adoption is permitted. The Hospital is currently evaluating the effects adoption of this guidance will have on the financial statements.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through January 9, 2017, the date that the combined financial statements were available to be issued. Except as disclosed in Notes 8 and 18, there were no events during the evaluation period that require recognition or disclosure in the combined financial statements.

3. Assets Limited as to Use and Investment Return

Assets limited as to use consist of the following as of September 30:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 3,147,978	\$ 1,047,721
Equities	-	1,002,709
Mutual funds	-	1,656,338
Municipal bonds	<u>-</u>	<u>515,159</u>
	<u>\$ 3,147,978</u>	<u>\$ 4,221,927</u>

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

3. Assets Limited as to Use and Investment Return, continued

Investment income and gains for assets limited as to use and cash equivalents are comprised of the following for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Investment (loss) income:		
Interest and dividends	\$ 137,253	\$ 226,818
Realized gains	214,022	-
Unrealized gains (losses)	<u>1,081</u>	<u>(310,873)</u>
	<u>\$ 352,356</u>	<u>\$ (84,055)</u>

See also "Waiver of Loan Covenant Violation and Amendment" at Note 8.

4. Fair Value Measurements

The Hospital has determined the fair value of certain assets as follows:

<u>Fair Value Measurement at Reporting Date Using</u>				
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>September 30, 2016</u>				
Money market funds	\$ <u>3,147,978</u>	\$ <u>3,147,978</u>	\$ <u>-</u>	\$ <u>-</u>

<u>Fair Value Measurement at Reporting Date Using</u>				
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>September 30, 2015</u>				
Money market funds	\$ 1,047,721	\$ 1,047,721	\$ -	\$ -
Equities	1,002,709	1,002,709	-	-
Mutual funds	1,656,338	1,656,338	-	-
Municipal bonds	<u>515,159</u>	<u>-</u>	<u>515,159</u>	<u>-</u>
Total assets	<u>\$ 4,221,927</u>	<u>\$ 3,706,768</u>	<u>\$ 515,159</u>	<u>\$ -</u>

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

4. Fair Value Measurements, continued

Financial assets valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets valued using Level 2 inputs are based primarily on quoted prices for similar assets in active or inactive markets. Financial assets valued using Level 3 inputs are based primarily on assumptions that management believes market participants would utilize in pricing the asset. Valuation techniques utilized to determine fair value are consistently applied.

The following methods and assumptions were used by the Hospital in estimating the fair value of its financial instruments. There were no changes in the methodologies used at September 30, 2016 and 2015.

Money market funds: Valued at cost which approximates fair value.

Equity securities and mutual funds: Valued at the closing price reported on the active market on which the individual securities are traded.

Municipal bonds: Fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing modules, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows.

5. Property and Equipment

Property and equipment consists of the following as of September 30:

	<u>2016</u>	<u>2015</u>
Land and improvements	\$ 684,803	\$ 684,803
Buildings and improvements	19,903,820	19,332,050
Equipment	<u>14,241,500</u>	<u>13,826,301</u>
	34,830,123	33,843,154
Less accumulated depreciation and amortization	<u>(23,507,728)</u>	<u>(22,253,932)</u>
	11,322,395	11,589,222
Construction in progress	<u>-</u>	<u>489,028</u>
Property and equipment, net	<u>\$ 11,322,395</u>	<u>\$ 12,078,250</u>

Depreciation expense for the years ended September 30, 2016 and 2015, amounted to \$1,253,796 and \$1,212,141, respectively.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

6. Beneficial Interest in Assets at Community Foundation Alliance

The Hospital and the Foundation transferred assets to the Community Foundation Alliance (Foundation Alliance) and retained a beneficial interest in those assets. The Hospital and the Foundation are to receive interest annually, but none of the principal. Variance power was granted to the Foundation Alliance; however, the Foundation Alliance will consult with the Hospital and the Foundation at such times as reasonably requested concerning the investment of the fund and allow input concerning the investment of the fund.

7. Line of Credit

The Hospital had a line of credit arrangement with a financial institution in the amount of \$1,000,000 that was renewed in October 2015 for a one-year term. During 2016, the line was paid off by using investments and thus was not renewed and expired. As of September 30, 2016 and 2015, the outstanding balance on this line was \$0 and \$600,000, respectively.

8. Debt

A summary of debt as of September 30:

	<u>2016</u>		<u>2015</u>
City of Princeton, Indiana Economic Development Revenue Bonds (Series 2005 Bonds)	\$ 4,158,759	\$	4,598,409
City of Princeton, Indiana Economic Development Revenue Bonds (Series 2008 Bonds)	1,495,297		1,658,039
City of Princeton, Indiana Economic Development Revenue Bonds (Series 2007 Bonds)	1,060,038		1,213,532
 Promissory note with a financial institution in the amount of \$1,125,000 to purchase the surgery center building. This note bears interest at 3.75% and is secured by the building purchased. Principal and interest payments are made monthly. This note expires in December 2027.	 903,086		 963,680
 Promissory note with a financial institution in the amount of \$300,000 to complete updates on building A at the Hospital. This note bears interest at 4.25% and is secured by the mortgage on the property. Principal and interest payments are made monthly. This note is set to expire in November 2020.	 255,521		 -
 Promissory note with a financial institution in the amount of \$425,000 to purchase radiology equipment. This note bears interest at 2.78%. Principal and interest payments are made monthly. This note expires in August 2018.	 168,651		 254,392

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

8. Debt, continued

Promissory note with a financial institution in the amount of \$126,000 to purchase equipment for the surgery center. This note bears interest at 2.60% and is secured by a the equipment purchased. Principal and interest payments are made monthly. This note expires in December 2017.

33,148 58,758

Financing costs capitalized, net of accumulated amortization of \$42,392 in 2016 and \$38,539 in 2015, respectively.

(33,125) (36,978)

Total long-term debt

8,041,375 8,709,832

Less current portion

(8,041,375) (901,132)

Long-term debt, net of current portion

\$ - \$ 7,808,700

Series 2005 Bonds

The City of Princeton, Indiana Economic Development Revenue Bonds, Series 2005 were issued in the original amount of \$7,100,000 dated June 2005. The bonds bear a variable interest rate based on LIBOR and is adjusted every five years. The interest rates at September 2016 and 2015 were 4.00% and 2.18%, respectively. Principal and interest payments are made on the 1st day of each month. The bonds are secured by substantially all of the assets of the Hospital and are set to expire in June 2025. Under these terms, the Hospital has agreed to certain covenants, including maintaining a historical debt-service coverage ratio of at least 1.5 to 1. For the year ended September 30, 2016, the Hospital did not meet its debt service coverage covenant. See "Forbearance Agreement" paragraph as follows.

Series 2007 Bonds

The City of Princeton, Indiana Economic Development Revenue Bonds, Series 2007 were issued in the original amount of \$2,096,000 dated October 2007 and were utilized by the Hospital for an energy conservation project. The bonds bear a variable interest rate based on LIBOR and is adjusted every five years. The interest rates at September 2016 and 2015 were 4.00% and 1.42%, respectively. Principal and interest payments are made on the 1st day of each month. The bonds are secured by substantially all of the assets of the Hospital and are set to expire in June 2023. Under these terms, the Hospital has agreed to certain covenants, including maintaining a historical debt-service coverage ratio of at least 1.5 to 1. For the year ended September 30, 2016, the Hospital did not meet its debt service coverage covenant. See "Forbearance Agreement" paragraph as follows.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

8. Debt, continued

Series 2008 Bonds

The City of Princeton, Indiana Economic Development Revenue Bonds, Series 2008 were issued in the original amount of \$2,500,000 dated December 2008 and were utilized by the Hospital for renovations to the emergency department. The bonds bear a variable interest rate based on LIBOR and is adjusted every five years. The interest rates at September 2016 and 2015 were 4.00% and 2.43%, respectively. Principal and interest payments are made on the 1st day of each month. The bonds are secured by substantially all of the assets of the Hospital and are set to expire in November 2024. Under these terms, the Hospital has agreed to certain covenants, including maintaining a historical debt-service coverage ratio of at least 1.5 to 1. For the year ended September 30, 2016, the Hospital did not meet its debt service coverage covenant. See "Forbearance Agreement" paragraph as follows.

Waiver of Loan Covenant Violation and Amendment

In an agreement dated September 4, 2014 and September 18, 2015, respectively, the original purchaser (Old National Bank i.e. "the Bank") of the Series 2005, 2007 and 2008 Bonds and the Hospital agreed to a waiver of loan covenant violation and amendment agreement that waived default (measured as of December 31, 2014) from violation of a compensating balance covenant and amended the covenant for the measurement period ending September 30, 2015 and subsequent quarters in exchange for the Hospital pledging as collateral \$1 mil. of its assets limited as to use (see Note 3).

Forbearance Agreement

On March 21, 2016, the Bank and the Hospital agreed to a Forbearance Agreement (the Agreement) which outlines the terms and conditions under which the Bank will forbear from exercising its rights and remedies related to the default caused by the Hospital not meeting its debt-service coverage covenants related to the bond issues. The original forbearance period was for the period beginning March 21, 2016 to the earlier of October 1, 2016 or the date of the occurrence of any new events of default as defined in the Agreement. During fiscal 2016, the Agreement was extended so that, on or before December 31, 2016 (amended to February 15, 2017), the Hospital shall deliver to the Bank a binding loan commitment from the United States Department of Agriculture (USDA) (or an alternative lender acceptable to the Bank) evidencing a binding commitment to loan funds to the Hospital sufficient to pay the outstanding debt related to the bond issues on or before April 1, 2017. As such, debt related to the Agreement is shown in current maturities in the 2016 balance sheet. During this period, the Hospital expects to refinance all of its debt via a \$8.4 million USDA and bank financed refinancing project.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

9. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	<u>2016</u>	<u>2015</u>
Purchase of equipment and emergency department expansion	\$ 2,645	\$ 4,635
Other programs	<u>48,097</u>	<u>46,372</u>
	<u>\$ 50,742</u>	<u>\$ 51,007</u>

Permanently restricted net assets are restricted to:

	<u>2016</u>	<u>2015</u>
Investments to be held in perpetuity, the income of which is unrestricted	<u>\$ 57,419</u>	<u>\$ 63,490</u>

10. Net Patient Service Revenue

The Hospital has agreements with federal, state and third-party payors that provide for reimbursement at amounts different from their established rates. Contractual adjustments under third-party reimbursement programs represent the difference between billings at established rates and amounts reimbursed by third-party payors. The Hospital participates in the Medicare and Medicaid programs. Approximately 44% and 42% of the Hospital's net patient service revenues in 2016 and 2015, respectively, were derived from services to patients covered by these programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

The Hospital has elected critical access hospital status for Medicare and Medicaid reimbursement purposes. The election allows the Hospital to receive cost-based reimbursement for services rendered to Medicare and Medicaid beneficiaries. The Hospital receives interim payments from Medicare and Medicaid. Final settlements are determined after the submission of annual cost reports filed by the Hospital and the audit or desk review thereof by Medicare and Medicaid. Management feels that adequate provision has been made for the effects, if any, for audits or desk reviews by either program.

The Hospital received approximately \$991,000 and \$1,156,000 during 2016 and 2015, respectively, due to the enactment of a state provider assessment program to increase Medicaid payments to hospitals. This revenue is recorded within net patient service revenue in the combined statements of operations and changes in net assets for 2016 and 2015. The Hospital paid approximately \$446,000 and \$313,000 into the Medicaid program for 2016 and 2015, which is recorded as an operating expense in the combined statements of operations and changes in net assets. This program is scheduled to end on June 30, 2017.

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

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

10. Net Patient Service Revenue, continued

Following is a summary of gross and net patient service revenue for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Gross patient service revenue	\$ 60,274,454	\$ 59,178,638
Deductions from revenue:		
Contractual allowances	26,406,678	24,073,214
Charity care	755,923	756,030
Provision for bad debts	<u>2,889,599</u>	<u>3,943,699</u>
Net patient service revenue	<u>\$ 30,222,254</u>	<u>\$ 30,405,695</u>

11. Long - Term Care Operating Lease and Management Agreement

Effective June 1, 2014, the Hospital entered into an agreement to lease its skilled nursing facility and equipment to another hospital partner. Along with the lease agreement, the Hospital also entered into a management agreement where it continues to operate the facility. The agreements expire May 30, 2016 and include two optional two year extensions. The management agreement includes an optional termination clause by either party if material changes in circumstances, as defined in the agreement, occur. The lease agreement also includes optional termination clauses by either party with a written 90 day notice.

The agreements call for various rental, management, incentive, royalty and other fees. Fees paid to the Hospital in 2016 and 2015 were \$169,614 and \$205,334, respectively. As of September 30, 2016 and 2015, amounts due to the Hospital were \$84,759 and \$236,593, respectively.

12. Operating Leases

The Hospital leases space and equipment under several non-cancelable operating leases that expire in various years through 2021.

Future minimum lease payments are as follows:

<u>Year Ending September 30:</u>	
2017	\$ 311,777
2018	271,884
2019	250,608
2020	220,453
2021	<u>202,871</u>
	<u>\$ 1,257,593</u>

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

12. Operating Leases, continued

Rental expense related to all operating leases was \$440,576 and \$438,177 in 2016 and 2015, respectively.

13. Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended September 30 are as follows:

	<u>2016</u>	<u>2015</u>
Health care services	\$ 26,424,153	\$ 26,518,293
General and administrative	<u>4,921,265</u>	<u>5,164,410</u>
	<u>\$ 31,345,418</u>	<u>\$ 31,682,703</u>

14. Pension Plan

The Hospital has a defined contribution pension plan covering substantially all employees of the Hospital. Under the terms of the plan, covered employees may contribute a percentage of gross pay, with matching contributions by the Hospital at 50% of employee contributions up to 4% of employee eligible compensation. For the years ended September 30, 2016 and 2015, the amount of retirement expense was \$171,970 and \$193,629, respectively.

15. Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2016 was as follows:

Medicare	24 %
Medicaid	9
Other third-party payors	26
Patients	<u>41</u>
	<u>100 %</u>

16. Contingencies

The Hospital insures for medical malpractice losses through a claims-made policy and provides an estimated reserve for deductibles for outstanding claims, which in the opinion of management, is adequate to cover losses, if any. Should the current claims-made policy not be renewed or replaced with equivalent insurance, claims based upon occurrences during their terms but reported subsequently will be uninsured. The Hospital intends to continue carrying such insurance.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

16. Contingencies, continued

The Hospital is currently, and from time to time, subject to claims and suits arising in the ordinary course of its business, including claims for medical malpractice and damages for personal injuries. In the opinion of the Hospital's management, the ultimate resolution of any of these pending claims and legal proceedings will not have a material effect on the Hospital's financial position or results of operations.

17. Healthcare Reform

Patient Protection and Affordable Care Act

On March 23, 2010, *The Patient Protection and Affordable Care Act* (the Act) was signed into law. The Act materially changed the requirements that hospitals must meet to obtain or maintain tax-exempt status under 501(c)(3). The Act created Section 501(r) in the IRC, which requires each tax-exempt hospital facility to:

1. Conduct a community health needs assessment (CHNA) every three years.
2. Adopt an implementation strategy to meet the community health needs identified through the CHNA.
3. Establish written financial assistance policy (FAP) that includes eligibility criteria and the method for applying for financial assistance, among other provisions.
4. Establish a written emergency medical care policy (EMCP) that requires the provision of care to individuals for emergency medical conditions regardless of their eligibility for financial assistance.
5. Limit amounts charged for emergency or other medically necessary care provided to individuals eligible for financial assistance to not more than amounts generally billed (AGB) to insured patients.
6. Refrain from engaging in extraordinary collection actions (ECAs) before making "reasonable efforts" to determine whether individuals are eligible for financial assistance.

The Act left the meaning of important terms such as AGB, ECA, and reasonable efforts to be clarified through regulations. Proposed regulations were published in 2012 and 2013. The Internal Revenue Service published final regulations on December 29, 2014.

To preserve tax-exempt status and avoid certain excise taxes, 501(c)(3) hospitals must comply with the final regulations by the start of the tax year that begins on or after December 29, 2015. For the Hospital, that is by September 30, 2017.

The Hospital believes it is in compliance with the Act.

18. Subsequent Event

On December 16, 2016, the Hospital entered into Contribution and Management Services agreements with Deaconess Hospital, Inc. (Deaconess). In exchange for a \$1,050,000 contribution, the Hospital's articles and by-laws were amended so that Deaconess could appoint three of the Hospital's sixteen voting Trustees.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Notes to the Financial Statements, continued

18. Subsequent Event, continued

The Management Services agreement is for an initial term of five years. Unless terminated by either party, the initial term will automatically renew for additional five year terms. The base management fee will be \$120,000 per year.

SUPPLEMENTAL SCHEDULES

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combining Schedule - Balance Sheet

September 30, 2016

	Gibson General Hospital, Inc.	Gibson General Health Foundation, Inc.	Combining Total
Assets			
Current assets:			
Cash and cash equivalents	\$ 1,112,783	\$ 345,710	\$ 1,458,493
Patient accounts receivable, net	3,399,288	-	3,399,288
Other receivables	453,251	3,345	456,596
Supplies	756,580	-	756,580
Prepaid and other	316,709	-	316,709
Total current assets	6,038,611	349,055	6,387,666
Other assets:			
Assets limited as to use:			
Internally designated	2,147,978	-	2,147,978
Pledged as collateral (Notes 3 and 8)	1,000,000	-	1,000,000
Total assets limited as to use	3,147,978	-	3,147,978
Property and equipment, net	11,322,395	-	11,322,395
Beneficial interest in assets at Community Foundation Alliance	46,941	10,478	57,419
Total assets	\$ 20,555,925	\$ 349,055	\$ 20,915,458
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	\$ 533,891	\$ 8,215	\$ 542,106
Accrued expenses	1,360,541	-	1,360,541
Estimated Medicare-Medicaid cost report settlements payable	251,553	-	251,553
Accrued self-insurance liabilities	342,356	-	342,356
Deferred revenue	69,297	-	69,297
Current maturities of long-term debt	8,041,375	-	8,041,375
Total liabilities	10,599,013	8,215	10,607,228
Net assets			
Hospital:			
Unrestricted	9,581,491	290,098	9,871,589
Temporarily restricted	-	50,742	50,742
Permanently restricted	46,941	10,478	57,419
Total hospital net assets	9,628,432	351,318	9,979,750
Joint venture equity - Pain Management	328,480	-	328,480
Total liabilities and net assets	\$ 20,555,925	\$ 359,533	\$ 20,915,458

See accompanying notes and report of independent auditors.

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combining Schedule - Statement of Operations and Changes in Net Assets
Year ended September 30, 2016

	Gibson General Hospital, Inc.	Pain Management	Eliminations	Gibson General Hospital, Inc. Total	Gibson General Health Foundation, Inc.	Combining Total
Unrestricted revenues, rains and other support:						
Patient service revenue (net of contractual allowances and discounts)	\$ 33,111,853	\$ 991,119	\$ (991,119)	\$ 33,111,853	\$ -	\$ 33,111,853
Provision for bad debts	<u>(2,889,599)</u>	<u>(47,795)</u>	<u>47,795</u>	<u>(2,889,599)</u>	<u>-</u>	<u>(2,889,599)</u>
Net patient service revenue less provision for bad debts	30,222,254	943,324	(943,324)	30,222,254	-	30,222,254
Other revenue	<u>378,348</u>	<u>-</u>	<u>-</u>	<u>378,348</u>	<u>-</u>	<u>378,348</u>
Total unrestricted revenues, gains and other support	30,600,602	943,324	(943,324)	30,600,602	-	30,600,602
Expenses and losses:						
Salaries and wages	14,257,088	321,647	(321,647)	14,257,088	-	14,257,088
Employee benefits	4,157,851	85,534	(85,534)	4,157,851	-	4,157,851
Contracted services	2,604,521	187,811	(187,811)	2,604,521	-	2,604,521
Supplies	2,599,134	45,867	(45,867)	2,599,134	1,214	2,600,348
Physician fees	2,108,447	-	-	2,108,447	-	2,108,447
Insurance	331,587	2,103	(2,103)	331,587	-	331,587
Lease expense	438,410	46,902	(46,902)	438,410	2,166	440,576
Utilities	666,412	-	-	666,412	10	666,422
Other expenses	437,162	11,473	(11,473)	437,162	139,583	576,745
Depreciation and amortization	1,257,649	-	-	1,257,649	-	1,257,649
Professional fees	120,746	-	-	120,746	-	120,746
Interest	240,437	-	-	240,437	-	240,437
Maintenance and repair	903,314	-	-	903,314	-	903,314
Advertising	203,540	8,736	(8,736)	203,540	-	203,540
Recruiting	186,865	-	-	186,865	-	186,865
Collection	184,750	-	-	184,750	-	184,750
Minor equipment	58,859	-	-	58,859	-	58,859
Provider hospital assessment fee	<u>445,673</u>	<u>-</u>	<u>-</u>	<u>445,673</u>	<u>-</u>	<u>445,673</u>
Total expenses and losses	<u>31,202,445</u>	<u>710,073</u>	<u>(710,073)</u>	<u>31,202,445</u>	<u>142,973</u>	<u>31,345,418</u>
Operating loss	(601,843)	233,251	(233,251)	(601,843)	(142,973)	(744,816)
Other income:						
Contributions received	75,823	-	-	75,823	115,308	191,131
Investment return	351,120	-	-	351,120	155	351,275
Assets released from restriction	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>265</u>	<u>265</u>
Total other income	<u>426,943</u>	<u>-</u>	<u>-</u>	<u>426,943</u>	<u>115,728</u>	<u>542,671</u>
Excess (deficit) of revenue over expenses	(174,900)	233,251	(233,251)	(174,900)	(27,245)	(202,145)

GIBSON GENERAL HOSPITAL, INC. AND AFFILIATE

Combining Schedule - Statement of Operations and Changes in Net Assets, continued

Year ended September 30, 2016

	<u>Gibson General Hospital, Inc.</u>	<u>Pain Management</u>	<u>Eliminations</u>	<u>Gibson General Hospital, Inc. Total</u>	<u>Gibson General Health Foundation, Inc.</u>	<u>Combining Total</u>
Unrestricted net assets:						
Excess (deficit) of revenues over expenses	(174,900)	233,251	(233,251)	(174,900)	(27,245)	(202,145)
Change in unrealized gains on investments	-	-	-	-	1,081	1,081
Pain Management minority interest	<u>(111,907)</u>	<u>-</u>	<u>-</u>	<u>(111,907)</u>	<u>-</u>	<u>(111,907)</u>
Increase (decrease) in unrestricted net assets	(286,807)	233,251	(233,251)	(286,807)	(26,164)	(312,971)
Temporarily restricted net assets:						
Assets released from restriction	-	-	-	-	(265)	(265)
Permanently restricted net assets						
Change in beneficial interest in assets at Community Foundation Alliance	<u>(4,990)</u>	<u>-</u>	<u>-</u>	<u>(4,990)</u>	<u>(1,081)</u>	<u>(6,071)</u>
Increase (decrease) in net assets	(291,797)	233,251	(233,251)	(291,797)	(27,510)	(319,307)
Net assets, beginning of year	9,920,229	-	-	9,920,229	378,828	10,299,057
Paid-in capital, net	<u>-</u>	<u>95,229</u>	<u>(95,229)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net assets, end of year:						
Hospital	9,628,432	-	(328,480)	9,628,432	351,318	9,979,750
Pain Management	<u>-</u>	<u>328,480</u>	<u>-</u>	<u>328,480</u>	<u>-</u>	<u>328,480</u>
Total	<u>\$ 9,628,432</u>	<u>\$ 328,480</u>	<u>\$ (328,480)</u>	<u>\$ 9,956,912</u>	<u>\$ 351,318</u>	<u>\$ 10,308,230</u>

See accompanying notes and report of independent auditors.