

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Independent Auditor's Report and Consolidated
Financial Statements
September 30, 2016 and 2015



DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
September 30, 2016 and 2015

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Independent Auditor's Report

Finance and Audit Committee
DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Auburn, Indiana

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health and its subsidiary (Hospital), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the 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 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital'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 Hospital'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 DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health and its subsidiary 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.

BKD, LLP

Fort Wayne, Indiana
November 23, 2016

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Balance Sheets September 30, 2016 and 2015

	2016	2015
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,049,131	\$ 29,899
Accounts receivable		
Patient services, net of allowance for uncollectible accounts; 2016 - \$2,730,970, 2015 - \$1,620,197	8,040,649	7,665,056
Other	85,646	375,502
Inventories	1,267,616	1,596,794
Prepaid expenses and other	610,417	721,293
Total current assets	11,053,459	10,388,544
Assets Limited as to Use		
Internally designated	15,957,764	17,575,039
Externally restricted by donor	-	37,166
Total assets limited as to use	15,957,764	17,612,205
Property and Equipment, net	38,691,458	40,831,186
Other Assets	68,074	133,011
Total assets	\$ 65,770,755	\$ 68,964,946
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	\$ 1,122,785	\$ 1,713,540
Accounts payable	2,338,779	1,858,585
Estimated amounts due to third-party payers	474,816	150,000
Accrued salaries, wages and related liabilities	2,712,936	3,334,369
Other accrued liabilities	746,885	850,682
Total current liabilities	7,396,201	7,907,176
Interest Rate Swap Agreement	680,509	565,161
Long-Term Debt, less current maturities	9,090,827	12,711,144
Total liabilities	17,167,537	21,183,481
Net Assets		
Unrestricted	48,603,218	47,294,299
Temporarily restricted	-	487,166
Total net assets	48,603,218	47,781,465
Total liabilities and net assets	\$ 65,770,755	\$ 68,964,946

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Operations
Years Ended September 30, 2016 and 2015

	2016	2015
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	\$ 65,305,861	\$ 61,196,869
Provision for uncollectible accounts	<u>(6,508,801)</u>	<u>(5,403,094)</u>
Net patient service revenue less provision for uncollectible accounts	58,797,060	55,793,775
Other	6,933,128	5,769,548
Net assets released from restrictions used for operations	<u>11,184</u>	<u>54,448</u>
Total unrestricted revenue, gains and other support	<u>65,741,372</u>	<u>61,617,771</u>
Expenses		
Salaries and wages	27,319,581	26,860,597
Payroll taxes and employee benefits	7,609,299	7,345,861
Purchased medical services	3,641,720	3,346,087
Medical supplies and drugs	10,513,188	9,698,142
Insurance	775,541	819,157
Depreciation and amortization	4,937,376	4,693,464
Interest	541,801	383,481
Loss on disposal of property and equipment	278,534	-
Other	<u>10,600,627</u>	<u>9,518,734</u>
Total expenses	<u>66,217,667</u>	<u>62,665,523</u>
Operating Loss	<u>(476,295)</u>	<u>(1,047,752)</u>
Other Income (Expense)		
Investment return, dividends, interest and realized gains	399,729	738,438
Investment return, change in unrealized losses on trading securities	<u>1,024,851</u>	<u>(1,959,608)</u>
Total other income (expense)	<u>1,424,580</u>	<u>(1,221,170)</u>
Excess (Deficiency) of Revenue Over Expenses	948,285	(2,268,922)
Net assets released from restrictions used for purchase of property and equipment	475,982	1,530,360
Change in fair value of interest rate swap agreement	<u>(115,348)</u>	<u>(320,952)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ 1,308,919</u>	<u>\$ (1,059,514)</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Unrestricted Net Assets		
Excess (deficiency) of revenue over expenses	\$ 948,285	\$ (2,268,922)
Change in fair value of interest rate swap agreement	(115,348)	(320,952)
Net assets released from restrictions used for purchase of property and equipment	<u>475,982</u>	<u>1,530,360</u>
Increase (decrease) in unrestricted net assets	<u>1,308,919</u>	<u>(1,059,514)</u>
Temporarily Restricted Net Assets		
Contributions received	-	1,051,118
Net assets released from restrictions	<u>(487,166)</u>	<u>(1,584,808)</u>
Decrease in temporarily restricted net assets	<u>(487,166)</u>	<u>(533,690)</u>
Increase (Decrease) in Net Assets	821,753	(1,593,204)
Net Assets, Beginning of Year	<u>47,781,465</u>	<u>49,374,669</u>
Net Assets, End of Year	<u>\$ 48,603,218</u>	<u>\$ 47,781,465</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Cash Flows
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating Activities		
Change in net assets	\$ 821,753	\$ (1,593,204)
Items not requiring (providing) operating cash flows		
Depreciation and amortization	4,937,376	4,693,464
Loss on disposal of property and equipment	278,534	-
Net realized and unrealized (gains) losses on investments	(1,024,851)	1,560,651
Change in fair value of interest rate swap agreement	115,348	320,952
Restricted contributions	-	(1,051,118)
Changes in		
Patient accounts receivable, net	(375,593)	251,135
Other current assets and liabilities	647,263	(415,986)
Net cash provided by operating activities	<u>5,399,830</u>	<u>3,765,894</u>
Investing Activities		
Purchase of property and equipment	(2,170,936)	(7,903,677)
Purchase of investments	(857,874)	(3,111,011)
Net change in certificates of deposit	-	2,916,386
Proceeds from disposition of property and equipment	-	3,000
Proceeds from disposition of investments	3,537,166	2,770,400
Net cash provided by (used in) investing activities	<u>508,356</u>	<u>(5,324,902)</u>
Financing Activities		
Change in outstanding checks in excess of bank balance	-	(905,255)
Proceeds from issuance of long-term debt	-	3,502,020
Principal payments on long-term debt	(4,888,954)	(1,387,171)
Payments on line of credit borrowings	(115,160)	(5,731,975)
Proceeds from line of credit borrowings	115,160	5,045,489
Proceeds from restricted contributions	-	1,051,118
Net cash provided by (used in) financing activities	<u>(4,888,954)</u>	<u>1,574,226</u>
Increase in Cash and Cash Equivalents	1,019,232	15,218
Cash and Cash Equivalents, Beginning of Year	<u>29,899</u>	<u>14,681</u>
Cash and Cash Equivalents, End of Year	<u>\$ 1,049,131</u>	<u>\$ 29,899</u>
Supplemental Cash Flows Information		
Interest paid (net of amount capitalized)	\$ 541,801	\$ 383,481
Fixed asset additions in accounts payable	626,446	399,082
Capital lease obligations incurred for property and equipment	677,882	-

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health (Hospital), a not-for-profit organization, provides inpatient and outpatient health care services generally to residents of DeKalb County, Indiana and contiguous counties. Expenses relate to the provision of medical care and related general and administrative costs. The consolidated financial statements include the accounts of DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health and its wholly owned subsidiaries, DeKalb Memorial Pharmicare LLC (DMP), a single-member limited liability company which operates a retail pharmacy within the Hospital facility, and DeKalb Foundation (Foundation), a not-for-profit organization which raises funds on behalf of the Hospital and DeKalb County. The Hospital became the sole-member of the Foundation on August 10, 2016, and recognized a contribution from the Foundation of approximately \$461,000.

All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Cash and Cash Equivalents

The Hospital considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At September 30, 2016 and 2015, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

At September 30, 2016, the Hospital's cash accounts exceeded federally insured limits by approximately \$1,080,000.

Assets Limited as to Use and Investment Return

Assets limited as to use include (1) assets restricted by donors and (2) assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital, if any, are included in current assets.

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Certificates of deposit are stated at cost plus accrued interest, which approximates fair value. The Hospital has classified all of its investments in debt and equity securities as trading securities. Investment return includes dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the consolidated statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Patient Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer 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 coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients 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. The difference between the standard rates (or the discounted rates if negotiated or provided by policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Hospital's allowance for doubtful accounts for self-pay patients increased from \$1,620,197 at September 30, 2015, to \$2,730,970 at September 30, 2016. In addition, the Hospital's write-offs increased approximately \$1,106,000 from approximately \$5,403,000 for the year ended September 30, 2015, to approximately \$6,509,000 for the year ended September 30, 2016. The increase in the allowance for doubtful accounts is due to higher self-pay activity during the year. The increase in write-offs was the result of trends experienced in the collection of self-pay patients in fiscal year 2016.

Inventories

Supply inventories are stated at the lower of cost, determined using the first-in, first-out (FIFO) method or market.

Property and Equipment

Property and equipment are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

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 net assets when the donated asset is placed in service.

Long-Lived Asset Impairment

The Hospital evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended September 30, 2016 and 2015. Fair value was determined based on current and projected cash flows.

Patient Accounts Receivable Financing

Under a credit financing agreement, qualified self-pay patients can receive interest-bearing loans from an independent financial institution to pay their receivable balances to the Hospital. The transfer of these receivables is with full recourse to the Hospital. At September 30, 2016 and 2015, these receivables totaled \$4425,439 and \$298,208, respectively. The Hospital has recorded a liability for estimated required repayments of \$2,121 and \$19,729 on these loans at September 30, 2016 and 2015, respectively.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Temporarily restricted net assets at September 30, 2015, were available for the purchase of building improvements and equipment and operational expenses of various Hospital service lines. There were no temporarily restricted net assets at September 30, 2016.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as adjustments become known.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2016 and 2015

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. The Hospital's direct and indirect costs for services furnished under its charity care policy aggregated approximately \$695,000 and \$1,185,000 in 2016 and 2015, respectively.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted contributions and released from restriction.

Estimated Malpractice Costs

The Hospital participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the Hospital, with the balance paid by the State of Indiana Patient Compensation Fund. The Hospital carries a claims-made basis insurance policy covering the Hospital's \$250,000 of exposure per claim with a \$5,000,000 annual aggregate. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents, including an estimate for claims incurred, but not yet reported. Based upon the Hospital's claim experience, an accrual of \$75,000 has been made at September 30, 2016 and 2015, which is included in other accrued liabilities. It is reasonably possible that this estimate could change materially in the near term.

The Hospital has recorded a long-term asset and liability related to insurance claims and recoveries of approximately \$29,000 included in other current assets on the consolidated balance sheets as of September 30, 2016 and 2015, respectively.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified Electronic Health Records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2015, the Hospital completed the fourth-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately \$200,000, which is included in other revenue within operating revenues in the consolidated statements of operations.

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 to \$125,000 per covered employee and that limits its aggregate exposure to approximately \$5,463,000.

Income Taxes

The Hospital and the Foundation have been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Hospital and Foundation are subject to federal income tax on any unrelated business taxable income. The Hospital and Foundation file tax returns in the U.S. federal jurisdiction.

DMP is considered a disregarded entity for tax purposes and is included in the Hospital's 990.

Excess (Deficiency) of Revenue Over Expenses

The consolidated statements of operations include excess (deficiency) of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess (deficiency) of revenue over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets) and changes in interest rate swap value.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Note 2: Net Patient Service Revenue

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the consolidated statement of operations as a component of net patient service revenue.

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare: Inpatient acute care services and substantially all outpatient services provided to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment although determination of certain elements of the rates can occur after the current period and generate final settlement after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary.

Medicaid: The Hospital is reimbursed for Medicaid inpatient and outpatient services at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

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

Patient service revenue, net of contractual allowances and discounts (before the provision for uncollectible accounts), recognized for the years ended September 30, 2016 and 2015, respectively, was approximately:

	<u>2016</u>	<u>2015</u>
Medicare	\$ 16,349,980	\$ 18,254,061
Medicaid	5,791,934	3,680,812
Other third-party payers	35,315,957	38,035,059
Self-pay	<u>7,847,990</u>	<u>1,226,937</u>
Total	<u>\$ 65,305,861</u>	<u>\$ 61,196,869</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2016 and 2015

In 2011, the state of Indiana submitted certain Medicaid State Plan Amendments to the Centers for Medicare and Medicaid Services (CMS) to incorporate a Provider Assessment Fee, requesting retroactive approval to July 1, 2011, which was approved by CMS initially in 2012. The effect of the Provider Assessment Fee on reimbursement is to increase Medicaid base fee for service and diagnosis related group payment rates to Indiana hospitals and reduce the level of Medicaid lump sum payments made under the existing Medicaid Supplemental Payment programs. For the year ended September 30, 2016, the Hospital paid Provider Assessment Fees of approximately \$1,349,000 and received payments from the program of approximately \$2,047,000, yielding a net increase to 2016 excess of revenue over expenses of approximately \$698,000. For the year ended September 30, 2015, the Hospital paid Provider Assessment Fees of approximately \$1,187,000 and received payments from the program of approximately \$1,950,000, yielding a net increase to 2015 excess of revenue over expenses of approximately \$763,000. Provider Assessment Fee expense is included within other expenses and additional reimbursements received from the program are included within net patient service revenue on the 2016 and 2015 consolidated statements of operations.

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents and are generally insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2016 and 2015, was:

	<u>2016</u>	<u>2015</u>
Commercial insurance	41%	45%
Medicare	29	19
Medicaid	14	8
Self-pay	7	19
Other	9	9
	<u>100%</u>	<u>100%</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Note 4: Assets Limited as to Use and Investment Return

Assets limited as to use at September 30, include:

	2016	2015
Cash and money market funds	\$ 76,975	\$ 110,292
Common stocks	40,287	—
Mutual funds		
Equity mutual funds		
Large blend and growth funds	5,548,622	4,896,349
Intermediate term growth funds	2,438,828	2,067,544
Small blend and growth funds	1,060,302	900,474
International funds	3,100,158	3,946,850
Other funds	947,298	1,857,655
Fixed income mutual funds	2,745,294	3,833,041
	<u>\$ 15,957,764</u>	<u>\$ 17,612,205</u>
Internally designated	\$ 15,957,764	\$ 17,575,039
Externally restricted by donors or held by trustees under debt agreements	—	37,166
	<u>\$ 15,957,764</u>	<u>\$ 17,612,205</u>

Total investment return is comprised of the following:

	2016	2015
Interest and dividend income	\$ 565,452	\$ 339,481
Realized gains on sales of securities	(165,723)	398,957
Unrealized losses on trading securities	1,024,851	1,959,608
Total investment return	<u>\$ 1,424,580</u>	<u>\$ (1,221,170)</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2016 and 2015

Note 5: Property and Equipment

Property and equipment at September 30, consists of:

	<u>2016</u>	<u>2015</u>	Estimated Useful Life
Land	\$ 393,118	\$ 393,118	
Land improvements	1,830,710	1,781,970	5-15 years
Hospital buildings	51,623,465	50,850,949	5-40 years
Medical office buildings	9,443,718	9,443,706	5-40 years
Equipment	23,958,257	22,443,298	5-20 years
Medical office equipment	52,659	52,659	5-20 years
Construction in progress	<u>230,319</u>	<u>1,780,423</u>	
	87,532,246	86,746,123	
Less accumulated depreciation and amortization	<u>(48,840,788)</u>	<u>(45,914,937)</u>	
	<u>\$ 38,691,458</u>	<u>\$ 40,831,186</u>	

Note 6: Medical Office Buildings

The Hospital owns Medical Office Buildings (MOBs) adjacent to the Hospital and leases space in these MOBs to physicians under various operating leases. Other revenue for the years ended September 30, 2016 and 2015, includes gross rental income of approximately \$590,000 and \$596,000, respectively, from cancelable and noncancelable leases of the Medical Office Building.

The following is a schedule, by year, of future minimum rental income to be received under operating leases which have initial or remaining noncancelable terms in excess of one year as of September 30, 2016:

2017	\$ 234,648
2018	223,358
2019	227,825
2020	232,381
2021	<u>117,341</u>
	<u>\$ 1,035,553</u>

Note 7: Line of Credit

The Hospital has a \$5,000,000 revolving bank line of credit expiring in January 2018. The line is collateralized by substantially all of the Hospital's assets. At September 30, 2016 and 2015, there were no borrowings against this line. The line is unsecured. Interest varies with the bank's prime rate and is payable monthly.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2016 and 2015

Note 8: Long-Term Debt

Long-term debt at September 30, consists of the following:

	2016	2015
Note payable to bank, maturity date of July 15, 2024 (A)	\$ 9,233,414	\$ 10,060,300
Note payable to bank, maturity date of July 10, 2025 (B)	—	3,502,020
Various miscellaneous notes payable to bank, collateralized by equipment, maturing through January 1, 2019, with interest payable at 3.02%	269,302	385,512
Capital lease obligations, at various imputed interest rates ranging from 1.37% to 3.02%	<u>710,896</u>	<u>476,852</u>
	10,213,612	14,424,684
Less current maturities	<u>(1,122,785)</u>	<u>(1,713,540)</u>
	<u>\$ 9,090,827</u>	<u>\$ 12,711,144</u>

- (A) In 2014, the Hospital entered into a \$11,025,000 term note maturing in 2024. At September 30, 2016 and 2015, there was \$9,233,414 and \$10,060,300, respectively, borrowed against this note. The note is secured by inventory, accounts receivable, equipment and certain other assets. Monthly principal payments of \$68,907 plus interest are due beginning August 2014. All outstanding principal and any accrued and unpaid interest is due July 2024. Interest rate is 1.75 percentage points over the One Month London Inter-Bank Offered Rate (LIBOR) and was 1.94% at September 30, 2016.
- (B) In 2015, the Hospital entered into a term note with a maximum borrowing amount of \$5,000,000 maturing in 2025. At September 30, 2015, there was \$3,502,020, borrowed against this line. The note was secured by certain equipment and inventory with monthly principal payments of \$55,609 plus interest due beginning February 2016. This term note was paid in full during the year ended September 30, 2016.

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2016, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2017	\$ 946,509	\$ 184,629
2018	950,174	140,352
2019	853,367	140,352
2020	826,886	140,498
2021	826,886	128,213
Thereafter	<u>5,098,894</u>	<u>—</u>
	<u>\$ 9,502,716</u>	734,044
Less amount representing interest		<u>(23,148)</u>
Present value of future minimum lease payments		710,896
Less current maturities		<u>(176,276)</u>
Noncurrent portion		<u>\$ 534,620</u>

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Property and equipment include the following property under capital leases:

	<u>2016</u>	<u>2015</u>
Equipment	\$ 677,882	\$ 1,987,213
Less accumulated depreciation	<u>(67,788)</u>	<u>(1,331,679)</u>
	<u>\$ 610,094</u>	<u>\$ 655,534</u>

Note 9: Interest Rate Swap Agreement

Variable-to-Fixed Interest Rate Swap

During 2014, as a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the Hospital entered into an interest rate swap agreement related to its floating rate debt. The agreement provides for the Hospital to receive interest from the counterparty at LIBOR and to pay interest to the counterparty at a fixed rate of 4.28 percent on the notional amounts of \$9,233,414 and \$10,060,300 at September 30, 2016 and 2015, respectively. Under the agreement, the Hospital pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

The table below presents certain information regarding the Hospital's interest rate swap agreement:

	<u>2016</u>	<u>2015</u>
Fair value of interest rate swap agreement	\$ (680,509)	\$ (565,161)
Balance sheet location of fair value amount	Other Liabilities	Other liabilities
Change in fair value of interest rate swap agreement recognized in change in net assets	(115,348)	(320,952)
Location of amount recognized in change in net assets	Excess (deficiency) of revenue over expenses	Excess (deficiency) of revenue over expenses

Note 10: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

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Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Recurring Measurements

The following tables present the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2016 and 2015:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2016				
Investments				
Common stock	\$ 40,287	\$ 40,287	\$ —	\$ —
Equity mutual funds				
Large blend and growth funds	5,548,622	5,548,622	—	—
Intermediate term growth funds	2,483,828	2,483,828	—	—
Small blend and growth funds	1,060,302	1,060,302	—	—
International funds	3,100,158	3,100,158	—	—
Other funds	947,298	947,298	—	—
Fixed income mutual funds	2,745,294	2,745,294	—	—
Interest rate swap agreement	(680,509)	—	(680,509)	—

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	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2015				
Investments				
Equity mutual funds				
Large blend and growth funds	\$ 4,896,349	\$ 4,896,349	\$ —	\$ —
Intermediate term growth funds	2,067,544	2,067,544	—	—
Small blend and growth funds	900,474	900,474	—	—
International funds	3,946,850	3,946,850	—	—
Other funds	1,857,655	1,857,655	—	—
Fixed income mutual funds	3,833,041	3,833,041	—	—
Interest rate swap agreement	(565,161)	—	(565,161)	—

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. The Hospital has no assets or liabilities measured at fair value on a nonrecurring basis. There have been no significant changes in the valuation of techniques during the year ended September 30, 2016.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, 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. The Hospital has no Level 2 securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Hospital has no Level 3 securities.

Interest Rate Swap Agreement

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or can be corroborated by observable market data and, therefore, is classified within Level 2 of the valuation hierarchy.

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Fair Value of Financial Instruments

The following table presents estimated fair value of the Hospital's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2016 and 2015:

	2016		2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 1,049,131	\$ 1,049,131	\$ 29,899	\$ 29,899
Assets limited as to use	15,957,764	15,957,764	17,612,205	17,612,205
Financial liabilities				
Interest rate swap agreement	(680,509)	(680,509)	(565,161)	(565,161)
Long-term debt	(10,213,612)	(10,213,612)	(14,424,684)	(14,424,684)

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents

The carrying amount approximates fair value.

Long-Term Debt

Fair value is estimated based on the borrowing rates currently available to the Hospital for bank loans with similar terms and maturities.

Note 11: Pension Plan

The Hospital has a noncontributory defined contribution pension plan covering all eligible employees. The Hospital's cost each year is determined by the plan as a specific percentage of each participating employee's salary. It is the Hospital's policy to fund pension costs as accrued. Pension expense was approximately \$102,000 and \$525,000 in 2016 and 2015, respectively.

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Note 12: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Note 1.

Regulatory Investigations

The U.S. Department of Justice, the Internal Revenue Service and other federal agencies routinely conduct regulatory investigations and compliance audits of health care providers. The Hospital is subject to these regulatory efforts. Management is currently unaware of any regulatory matters which may have a material adverse effect on the Hospital's financial position or results of operations.

Investments

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated balance sheets.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. At September 30, 2016 and 2015, no accrual of potential losses from litigation was recorded other than in relation to the Hospital's estimated malpractice insurance costs as discussed in Note 1. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

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Note 13: Related Party Transactions

Prior to August 10, 2016, the Hospital and DeKalb County Community Memorial Hospital Foundation, Inc. (Foundation) were related parties that were not financially interrelated organizations. The Foundation was established to receive and administer funds and to apply them for the acquisition, construction, establishment and operation of a Community Memorial Hospital for DeKalb County, Indiana. In the absence of donor restrictions, funds were distributed as determined by the Foundation's Board of Directors, which were separately appointed from that of the Hospital.

The Hospital received \$900,000 in donations from the Foundation for the year ended September 30, 2015.

Note 14: Functional Expenses

The Hospital provides health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	2016	2015
Health care services	\$ 58,933,724	\$ 55,772,315
General and administrative	7,283,943	6,893,208
	\$ 66,217,667	\$ 62,665,523

Note 15: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were available to be issued.