



# MARGARET MARY HEALTH

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2016 AND 2015**

*CPAs / ADVISORS*



# MARGARET MARY HEALTH

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors  
Margaret Mary Health  
Batesville, Indiana

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Margaret Mary Community Hospital, Inc. d/b/a Margaret Mary Health (the Hospital), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and 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 Consolidated Financial Statements

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

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We 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 consolidated 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.

To the Board of Directors  
Margaret Mary Health  
Batesville, Indiana

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2016 and 2015, and the results of its operations, 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.

### Change in Accounting Principles

As discussed in Note 2 to the consolidated financial statements, the Hospital adopted new accounting guidance during 2016. Accounting Standards Update (ASU) 2014-15, *Presentation of Financial Statements – Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, was adopted by the Hospital and requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year from the date the consolidated financial statements are issued. ASU 2015-03, *Interest – Imputation of Interest*, was adopted by the Hospital and simplifies the presentation of debt issue costs. ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share*, was early adopted by the Hospital and removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. Our opinion is not modified with respect to these matters.

### Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information identified in the accompanying table of contents is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual entities, and is not a required part of the consolidated 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 consolidated financial statements. The supplementary information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

**Blue & Co., LLC**

Indianapolis, Indiana  
April 3, 2017

# MARGARET MARY HEALTH

## CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2016 AND 2015

<b>ASSETS</b>		
	2016	2015
<b>Current assets</b>		
Cash and cash equivalents	\$ 5,446,014	\$ 6,192,901
Patient accounts receivable, net of allowance for uncollectible accounts of \$5,110,000 in 2016 and \$5,048,000 in 2015	10,935,461	11,840,873
Inventories and other current assets	2,915,582	2,988,583
Current portion of assets whose use is limited	1,759,928	1,700,167
Total current assets	21,056,985	22,722,524
<b>Assets whose use is limited</b>		
Board designated for capital improvements	75,808,130	71,592,041
Board designated for retirement plans	1,296,988	889,739
Held by Foundation	1,676,272	1,421,678
Donor restricted	954,033	817,154
Held by trustee for debt service	108,333	108,333
	79,843,756	74,828,945
Less current portion	1,759,928	1,700,167
Assets whose use is limited - noncurrent	78,083,828	73,128,778
<b>Property and equipment, net</b>	59,121,163	54,260,099
Total assets	\$ 158,261,976	\$ 150,111,401
<b>LIABILITIES AND NET ASSETS</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 2,014,860	\$ 3,047,315
Accrued wages and related liabilities	7,761,684	6,866,286
Estimated third-party settlements	2,931,049	3,098,502
Current portion of long-term debt	1,759,928	1,700,167
Total current liabilities	14,467,521	14,712,270
<b>Derivative liability</b>	1,898,894	2,300,607
<b>Long-term debt, less current portion</b>	24,464,223	26,209,039
Total liabilities	40,830,638	43,221,916
<b>Net assets</b>		
Unrestricted	116,477,305	106,072,331
Temporarily restricted	506,447	419,568
Permanently restricted	447,586	397,586
Total net assets	117,431,338	106,889,485
Total liabilities and net assets	\$ 158,261,976	\$ 150,111,401

See accompanying notes to consolidated financial statements.

## MARGARET MARY HEALTH

### CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
<b>Unrestricted revenue, gains and other support</b>		
Net patient service revenue	\$ 98,474,466	\$ 94,269,565
Less provision for bad debts	7,183,005	7,083,404
Net patient service revenue net of provision for bad debts	91,291,461	87,186,161
Other revenue	1,163,494	1,085,188
Total revenue, gains and other support	92,454,955	88,271,349
<b>Expenses</b>		
Salaries and wages	38,232,191	33,485,825
Employee benefits	11,290,905	11,683,149
Physician fees	3,358,585	2,739,107
Medical and surgical supplies	12,500,934	12,684,473
Other supplies	416,067	394,883
Purchased services	7,615,448	7,856,413
Equipment rentals	256,759	189,545
Food	587,026	470,027
Utilities	1,083,672	1,140,208
Insurance	724,091	701,314
Depreciation	6,863,375	6,587,073
Interest	1,112,217	1,177,038
Other	3,241,545	2,890,256
Total expenses	87,282,815	81,999,311
Operating income	5,172,140	6,272,038
<b>Nonoperating gain (loss)</b>		
Contributions	185,908	457,307
Gain on disposal of property and equipment	20,434	-0-
Investment return	3,524,167	1,117,422
Unrealized gain on derivative	401,713	138,955
Net assets released from restriction	93,262	33,855
Total nonoperating gain	4,225,484	1,747,539
Excess revenue over expenses	9,397,624	8,019,577
<b>Other changes in unrestricted net assets</b>		
Unrealized gain (loss) on investments	1,007,350	(3,717,343)
Change in unrestricted net assets	10,404,974	4,302,234
<b>Temporarily restricted net assets</b>		
Contributions, gifts and bequests	180,141	172,658
Net assets released from restriction	(93,262)	(33,855)
Change in temporarily restricted net assets	86,879	138,803
<b>Permanently restricted net assets</b>		
Contributions, gifts and bequests	50,000	153,286
Change in net assets	10,541,853	4,594,323
<b>Net assets</b>		
Beginning of year	106,889,485	102,295,162
End of year	\$ 117,431,338	\$ 106,889,485

See accompanying notes to consolidated financial statements.

# MARGARET MARY HEALTH

## CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
<b>Operating activities</b>		
Change in net assets	\$ 10,541,853	\$ 4,594,323
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	6,863,375	6,587,073
Amortization of debt issue costs	17,302	17,302
Provision for bad debts	7,183,005	7,083,404
Realized and unrealized (gain) loss on investments, net	(2,111,038)	4,678,352
Gain on disposal of property and equipment	(20,434)	-0-
Unrealized gain on derivative	(401,713)	(138,955)
Restricted contributions, gifts and bequests	(230,141)	(325,944)
Change in operating assets and liabilities		
Patient accounts receivable	(6,277,593)	(9,406,081)
Inventories and other current assets	73,001	(499,791)
Accounts payable	(1,091,426)	247,812
Accrued wages and related liabilities	895,398	250,327
Estimated third-party settlements	(167,453)	323,696
Net cash flows from operating activities	15,274,136	13,411,518
<b>Investing activities</b>		
Proceeds from sale of investments	41,934,668	10,852,140
Purchases of investments	(44,838,441)	(17,248,820)
Proceeds from disposal of property and equipment	20,434	-0-
Additions to property and equipment	(11,665,468)	(4,975,731)
Net cash flows from investing activities	(14,548,807)	(11,372,411)
<b>Financing activities</b>		
Principal payments on long-term debt	(1,702,357)	(1,653,230)
Restricted contributions, gifts and bequests	230,141	325,944
Net cash flows from financing activities	(1,472,216)	(1,327,286)
Net change in cash and cash equivalents	(746,887)	711,821
<b>Cash and cash equivalents</b>		
Beginning of year	6,192,901	5,481,080
End of year	\$ 5,446,014	\$ 6,192,901
<b>Noncash investing, capital and related financing activities</b>		
Property and equipment included in liabilities	\$ 58,971	\$ 1,460,720
<b>Supplemental disclosure of cash flows information</b>		
Cash paid for interest	\$ 1,170,946	\$ 1,170,671

See accompanying notes to consolidated financial statements.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### 1. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by Margaret Mary Health (the Hospital) in the preparation of its consolidated financial statements are summarized below:

#### Organization

The Hospital, located in Batesville, Indiana, is a not-for-profit acute care hospital providing inpatient, outpatient, and other ancillary services to the residents of Ripley and surrounding counties. Admitting physicians are primarily practitioners in the local area. The Hospital is the sole corporate member of Margaret Mary Health Foundation, Inc. (the Foundation). The Foundation supports the efforts and activities of the Hospital in the furtherance of the Hospital's charitable purposes and benefits the community served by the Hospital.

#### Principles of Consolidation

The accompanying consolidated financial statements include accounts of the Hospital and the Foundation. Because the Hospital is the sole corporate member of the Foundation, the financial position, results of operations and cash flows of the Foundation are included with the Hospital for financial reporting purposes. All material intercompany balances and transactions have been eliminated in consolidation.

#### Use of Estimates

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

#### Cash and Cash Equivalents

The Hospital considers highly liquid investments available for operating purposes with an original maturity of 90 days or less to be cash and cash equivalents for the purposes of the consolidated statements of cash flows.

#### Patient Accounts Receivable

Patient service revenue and the related accounts receivable are recorded at the time services to patients are performed. 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

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# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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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.

### Allowance for Uncollectible Accounts

Patient accounts receivable are reduced by an allowance for uncollectible accounts based on the Hospital's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to its service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible 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 uncollectible accounts and a provision for bad debts, if necessary. For receivables associated with self-pay payments, 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) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

During 2016, the Hospital's allowance for uncollectible accounts increased \$62,000 from \$5,048,000 to \$5,110,000. The uncollectible allowance related to self-pay balances increased approximately \$376,000 as overall self-pay balances increased with changes in the population of individuals classified as self-pay. The uncollectible estimate remained stable at 98%. The uncollectible allowance for third-party payor accounts decreased approximately \$314,000 as the accounts receivable balance for third party decreased and the uncollectible estimate decreased to 2% from 4% at December 31, 2015. The Hospital's self-pay related write-offs increased by approximately \$447,000 to \$7,121,000 in 2016 from \$6,674,000 in 2015. The change was the result of trends related to shifts in payor mix due to health care reform and an increase in insurance coverage for patients who were previously uninsured or underinsured. The Hospital did not change its charity care or uninsured discount policies during 2016 or 2015.

As of December 31, 2016, the allowance for uncollectible accounts of \$5,110,000 was comprised of \$4,719,000 reserved for self-pay balances and \$391,000 reserved for third-party payor balances.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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During 2015, the Hospital's allowance for uncollectible accounts increased \$409,000 from \$4,639,000 to \$5,048,000. The uncollectible allowance related to self-pay balances increased approximately \$182,000 as overall self-pay balances increased with changes in the population of individuals classified as self-pay brought on by participation in the insurance marketplace plans. The uncollectible estimate increased to 98% of self-pay balances from 92% at December 31, 2014. The uncollectible allowance for third-party payor accounts increased approximately \$227,000 as the uncollectible estimate remained at 4%. In addition, the Hospital's self-pay related write-offs increased by approximately \$936,000 from \$5,738,000 in 2014 to \$6,674,000 in 2015. The increase was the result of trends related to shifts in payor mix due to health care reform and an increase in insurance coverage for patients who were previously uninsured or underinsured.

As of December 31, 2015, the allowance for uncollectible accounts of \$5,048,000 was comprised of \$4,343,000 reserved for self-pay balances and \$705,000 reserved for third-party payor balances.

### Patient Service Revenue

Patient service revenue and the related accounts receivable are recorded at the time services to patients are performed. A summary of the payment arrangements with major third-party payors follows:

#### *Medicare*

The Hospital is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The Hospital is classified as Critical Access Status by Medicare and is paid for Medicare services based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at an interim rate, with final settlement determined after submission of annual cost reports. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

#### *Medicaid and Hospital Assessment Fee Program*

The Hospital is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

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

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

During 2016 and 2015, the Hospital recognized HAF Program expense of approximately \$1,284,000 and \$1,083,000, respectively, which resulted in Medicaid rate increases. The HAF Program expense is included in other expenses in the consolidated statements of operations and changes in net assets. The Medicaid rate increases under the HAF Program are included in patient service revenue in the consolidated statements of operations and changes in net assets.

### *Other Payment Arrangements*

The Hospital also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge and discounts from established rates.

The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The year-end cost reports filed with the Medicare and Medicaid programs through December 31, 2014 have been audited by these programs and any resulting differences are reflected in the consolidated financial statements. During 2016, the Hospital recognized an increase of approximately \$548,000 and in 2015 a decrease of approximately \$231,000 to net patient service revenue due to the differences between original estimates and subsequent revisions for the final settlement of cost reports.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these program audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

A summary of patient service revenue for 2016 and 2015 follows:

	2016	2015
Gross patient service revenue		
Inpatient	\$ 31,093,072	\$ 28,316,077
Outpatient	156,184,355	146,319,484
Total gross patient service revenue	187,277,427	174,635,561
Less provisions for		
Contractual adjustments under		
third-party reimbursement programs	86,212,577	78,054,577
Charity care	2,590,384	2,311,419
	88,802,961	80,365,996
Net patient service revenue	98,474,466	94,269,565
Less provision for bad debts	7,183,005	7,083,404
Net patient service revenue		
net of provision for bad debts	\$ 91,291,461	\$ 87,186,161

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue.

Of the Hospital's total expenses reported, an estimated \$1,207,000 and \$1,085,000 arose from providing services to charity patients during 2016 and 2015, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses to gross patient service revenue.

### Inventories and Other Current Assets

Inventories, consisting of mainly medical supplies and pharmaceuticals, are valued at the lower of cost or market with cost being determined on an average cost method. Inventories and other current assets are comprised of the following as of December 31, 2016 and 2015:

	2016	2015
Other receivables	\$ 454,129	\$ 564,288
Inventories	1,104,045	1,075,747
Prepaid expenses	1,357,408	1,348,548
	<u>\$ 2,915,582</u>	<u>\$ 2,988,583</u>

### Property and Equipment and Provision for Depreciation

Property and equipment are recorded at historical cost except for donations, which are recorded at fair market value at the date of the donation. Property and equipment include expenditures for additions and repairs that substantially increase the useful lives of existing property and equipment. Maintenance, repairs and minor renewals are expensed as incurred.

The property and equipment of the Hospital are being depreciated over their estimated useful lives using the straight-line method. The ranges of useful lives used in computing depreciation are as follows:

Description	Range of Useful Lives
Land improvements	12-24 years
Buildings and improvements	10-40 years
Equipment	3-20 years

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# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor restrictions about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. During 2016 and 2015, there were no gifts of long-lived assets with restrictions.

### Assets Whose Use is Limited

Assets whose use is limited includes cash and cash equivalents and marketable securities. Marketable securities include mutual funds, private equity investments and common stock. Such securities are stated at fair market value. Donated securities are recorded at fair market value at the date of the donation.

Private equity funds consist of investments in limited liability companies which invest in the common stock of small and medium capitalization companies. Investments in those limited liability companies are reported at fair value as determined by the individual managers. Although the managers use their best judgment in estimating the fair value of the investments in the investment funds, there are inherent limitations in any estimation technique. Therefore, the values reported are not necessarily indicative of the amount that the investments funds could realize in a current transaction.

These estimated values may differ significantly from the values that would have been used had a ready market for the investments in the investment funds existed and the difference could be material. Private equity investments totaled approximately \$4,760,000 (6.0% of investment portfolio) and \$9,501,000 (12.7% of investment portfolio) as of December 31, 2016 and 2015, respectively.

Assets held by a trustee include cash and cash equivalents for debt service payments and/or capital improvements in compliance with the Indiana Health Facility Financing Authority bond issues described in the long-term debt note.

### Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by external sources for a specific time period or purpose. When a restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Contributions that are received and whose restrictions are satisfied within the same reporting period are reported as unrestricted contributions. As of December 31, 2016 and 2015, temporarily restricted net assets were approximately \$506,000 and \$420,000, respectively.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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A summary of temporarily restricted net assets as of December 31, 2016 and 2015 follows:

	2016	2015
Health and wellness	\$ 154,386	\$ 118,726
Education	37,487	34,557
Hospice	129,207	98,145
Oncology	155,900	120,782
Think Pink	6,885	11,353
Other	22,582	36,005
	<u>\$ 506,447</u>	<u>\$ 419,568</u>

### Permanently Restricted Net Assets

Permanently restricted net assets are contributed with donor restrictions requiring they be held in perpetuity with income used to support the Hospital's activities. Permanently restricted net assets as of December 31, 2016 and 2015 were approximately \$448,000 and \$398,000, respectively.

### Performance Indicator

The consolidated statements of operations and changes in net assets include a performance indicator, excess revenue over expenses. Changes in unrestricted net assets that are excluded from performance indicator include unrealized gain and loss on investments other than trading securities and contributions of long-lived assets.

### Federal and State Income Taxes

The Hospital and the Foundation are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code. As such, the Hospital and Foundation are generally exempt from income taxes. However, both are required to file Federal Form 990 – Return of Organization Exempt from Income Tax, which is an informational return only.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and the Foundation and recognize a tax liability if the Hospital and Foundation have taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Hospital and the Foundation, and has concluded that as of December 31, 2016 and 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Hospital and Foundation are subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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The Hospital and Foundation filed their federal and state income tax returns for periods through December 31, 2015. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

### Costs of Borrowing

Except for capital assets acquired through gifts, contributions or capital grants, interest cost on borrowed funds, as well as interest earned on those funds, during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets

### Advertising Costs

The Hospital's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were approximately \$459,000 and \$437,000 in 2016 and 2015, respectively.

### Volunteer Services

The Hospital receives donated services from a variety of unpaid volunteers. No amounts are recognized in the accompanying consolidated statements of operations and changes in net assets because the criteria for recognition of such services does not meet the guidelines under the Financial Accounting Standards Board Accounting Standards Codification. The estimated hours related to the donated services approximated 5,600 and 5,650 for 2016 and 2015, respectively.

### Electronic Health Records (EHR) Incentive Payments

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, the Hospital must meet "meaningful use" criteria that become more stringent over time. The Hospital periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Hospital's cost reports. For Critical Access Hospitals, the payment calculation is based upon the net book value of the qualifying assets multiplied by the Medicare utilization using Medicare to total inpatient days plus 20%, not to exceed 100%. The total days are multiplied by a factor of total charges excluding charity care to total charges. Critical Access Hospitals can be reimbursed over a four year period for additional qualifying assets not claimed in the first year. The transitional factor ranges from 100% in the first payment year and decreases by 25% each payment year until it is completely phased out in the fifth year.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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The Hospital recognizes EHR incentive payments as grant income when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the consolidated financial statement effects of the grants must be both recognizable and measurable. During 2016 and 2015, the Hospital recognized approximately \$396,000 and \$380,000, respectively, in EHR incentive payments as grant income using the ratable recognition method. Under the ratable recognition method, the Hospital recognizes income ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

EHR incentive income is included in other revenue in the consolidated statement of operations and changes in net assets. EHR incentive income recognized is based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

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

### Reclassification

Certain amounts in the 2015 consolidated financial statements have been reclassified to conform with the current year presentation. The reclassifications did not affect previously reported net assets or changes in net assets.

### Going Concern Evaluation

Management evaluates whether there are conditions or events that raise substantial doubt about the Hospital's ability to continue as a going concern for a period of one year from the date the consolidated financial statements are issued.

### Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is April 3, 2017.



# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### 2. CHANGE IN ACCOUNTING PRINCIPLES

During 2016, the Hospital adopted Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements – Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. ASU No. 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year from the date the consolidated financial statements are issued. When conditions or events that raise substantial doubt exist, additional disclosures will be required to enable financial statement users to understand those conditions or events, management's evaluation of them and management's plans that either alleviated substantial doubt or are intended to mitigate the conditions or events that raise substantial doubt. The adoption of ASU No. 2014-15 did not have a material effect on the accompanying consolidated financial statements.

During 2016, the Hospital adopted ASU 2015-03, *Interest – Imputation of Interest*, which simplifies the presentation of debt issue costs by presenting them as direct deduction from face amount of the related debt obligations. Previously, debt issue costs were aggregated and presented as a deferred charge on the consolidated balance sheet. Debt issue costs will continue to be amortized over the terms of the related debt obligations, but are now are presented as a component of interest expense in the consolidated operations and changes in net assets.

The 2015 consolidated financial statements have been retroactively restated to adopt this new guidance as detailed in the following table.

	As previously reported	Effects of implementation	As restated
Consolidated balance sheet:			
Debt issue costs, net	\$ 255,969	\$ (255,969)	\$ -0-
Long-term debt, net of current portion	\$ 26,465,008	\$ (255,969)	\$ 26,209,039
Consolidated statement of operations and changes in net assets:			
Depreciation and amortization	\$ 6,604,375	\$ (17,302)	\$ 6,587,073
Interest	\$ 1,159,736	\$ 17,302	\$ 1,177,038
Consolidated statement of cash flows:			
Depreciation and amortization	\$ 6,604,375	\$ (17,302)	\$ 6,587,073
Amortization of debt issue costs	\$ -0-	\$ 17,302	\$ 17,302

During 2016, the Hospital early adopted ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value Per Share*, which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value (NAV) per share practical expedient. As such, certain investments that were measured at NAV per share practical expedient have not been classified in the fair value hierarchy table. The 2015 fair value measurement disclosures have been restated for this change.

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## MARGARET MARY HEALTH

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

#### 3. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited consist of the following as of December 31:

	2016	2015
Cash and cash equivalents	\$ 3,539,170	\$ 1,625,195
Mutual funds	70,751,282	63,023,361
Private equity funds	4,760,158	9,501,397
Common stocks	793,146	678,992
	\$ 79,843,756	\$ 74,828,945

The following is a reconciliation of investment return for 2016 and 2015:

	2016	2015
Interest and dividend income (net of fees of \$164,500 in 2016 and \$159,200 in 2015)	\$ 2,420,479	\$ 2,078,431
Realized gain (loss) on investments	1,103,688	(961,009)
Investment return	\$ 3,524,167	\$ 1,117,422
Unrealized gain (loss) on investments	\$ 1,007,350	\$ (3,717,343)

The following schedules summarize the fair value of securities included in assets whose use is limited that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of December 31, 2016 and 2015. The schedules further segregate the securities that have been in a gross unrealized position as of December 31, 2016 and 2015, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary. The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to securities which industry experts expect recovery in the short-term future. The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of December 31, 2016 and 2015:

Description of securities	December 31, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	\$ 9,171,444	\$ 146,226	\$ 11,832,656	\$ 854,162	\$ 21,004,100	\$ 1,000,388

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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Description of securities	December 31, 2015					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	\$ 15,690,711	\$ 1,557,051	\$ 19,644,643	\$ 2,696,353	\$ 35,335,354	\$ 4,253,404

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The Hospital's investments are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying consolidated financial statements.

#### 4. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of December 31, 2016 and 2015:

- *Money market mutual funds*: Valued based at the subscription and redemption activity at a \$1 stable net asset value (NAV). However, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of securities.

## MARGARET MARY HEALTH

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily NAV and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Private equity funds*: Valued at the NAV of units of the fund. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the net asset value of the fund and, consequently, the fair value of the Hospital's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the Hospital were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.
- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Derivative (Interest rate swap agreement)*: Valued using pricing models that are derived principally from observable market data based on discounted cash flows and interest rate yield curves at quoted intervals for the full term of the swap. See the note disclosure "Derivatives Financial Instruments – Interest Rate Swaps" for additional information related to derivatives.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The following table sets forth by level, within the hierarchy, the Hospital's assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Assets whose use is limited				
Cash and cash equivalents				
Money market mutual funds	\$ 2,036,332	\$ -0-	\$2,036,332	\$ -0-
Mutual funds				
Corporate Bond	731,878	731,878	-0-	-0-
Diversified Emerging Mkts	4,756,498	4,756,498	-0-	-0-
Energy Limited Partnership	2,936,348	2,936,348	-0-	-0-
Foreign Large Blend	5,116,710	5,116,710	-0-	-0-
Foreign Large Value	5,528,101	5,528,101	-0-	-0-
Foreign Small/Mid Value	1,127,949	1,127,949	-0-	-0-
Inflation-Protectec Bond	1,676,614	1,676,614	-0-	-0-
Intermediate-Term Bond	10,860,869	10,860,869	-0-	-0-
Large Blend	8,945,153	8,945,153	-0-	-0-
Large Value	9,772,333	9,772,333	-0-	-0-
Long Government	1,511,213	1,511,213	-0-	-0-
Long-Short Equity	2,743,065	2,743,065	-0-	-0-
Mid-Cap Blend	735,763	735,763	-0-	-0-
Nontraditional Bond	898,080	898,080	-0-	-0-
Option Writing	2,764,445	2,764,445	-0-	-0-
Real Estate	3,788,334	3,788,334	-0-	-0-
Short-Term Bond	1,069,511	1,069,511	-0-	-0-
World Stock	3,349,585	3,349,585	-0-	-0-
Other	2,438,833	2,438,833	-0-	-0-
Total mutual funds	70,751,282	70,751,282	-0-	-0-
Common stocks				
Healthcare	793,146	793,146	-0-	-0-
	73,580,760	\$ 71,544,428	\$ 2,036,332	\$ -0-
Private equity funds (a)				
Cash	4,760,158			
	1,502,838			
	<u>\$ 79,843,756</u>			
<b>Liabilities</b>				
Derivative	\$ 1,898,894	\$ -0-	\$ 1,898,894	\$ -0-

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Assets whose use is limited				
Cash and cash equivalents				
Money market mutual funds	\$ 548,204	\$ -0-	\$ 548,204	\$ -0-
Mutual funds				
Corporate Bond	1,237,401	1,237,401	-0-	-0-
Diversified Emerging Mkts	5,688,094	5,688,094	-0-	-0-
Energy Limited Partnership	2,174,058	2,174,058	-0-	-0-
Foreign Large Blend	5,002,955	5,002,955	-0-	-0-
Foreign Large Growth	3,140,941	3,140,941	-0-	-0-
Foreign Large Value	2,686,909	2,686,909	-0-	-0-
Foreign Small/Mid Value	2,616,444	2,616,444	-0-	-0-
Inflation-Protectec Bond	1,583,780	1,583,780	-0-	-0-
Intermediate-Term Bond	7,381,600	7,381,600	-0-	-0-
Large Blend	2,923,495	2,923,495	-0-	-0-
Large Growth	3,022,504	3,022,504	-0-	-0-
Large Value	8,274,418	8,274,418	-0-	-0-
Long-Short Equity	2,068,081	2,068,081	-0-	-0-
Mid-Cap Blend	2,973,027	2,973,027	-0-	-0-
Mid-Cap Growth	1,218,886	1,218,886	-0-	-0-
Multisector Bond	2,649,092	2,649,092	-0-	-0-
Real Estate	1,842,433	1,842,433	-0-	-0-
Small Value	3,023,884	3,023,884	-0-	-0-
Other	3,515,359	3,515,359	-0-	-0-
Total mutual funds	63,023,361	63,023,361	-0-	-0-
Common stocks				
Healthcare	678,992	678,992	-0-	-0-
	64,250,557	\$ 63,702,353	\$ 548,204	\$ -0-
Private equity funds (a)	9,501,397			
Cash	1,076,991			
Total assets whose use is limited	\$ 74,828,945			
<b>Liabilities</b>				
Derivative	\$ 2,300,607	\$ -0-	\$ 2,300,607	\$ -0-

(a) In accordance with Subtopic 820-10, certain investments that were measured at NAV per share or its equivalent have not been classified in the fair value hierarchy. The fair value amounts presented in these tables are intended to permit reconciliation of the fair value hierarchy to the line items presented at fair value in the consolidated balance sheets.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments measured at fair value based on net asset value per share as of December 31, 2016 and 2015, respectively.

		December 31, 2016		
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity funds	\$ 4,760,158	None	January 1 & July 1	95 days

  

		December 31, 2015		
Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity funds	\$ 9,501,397	None	January 1 & July 1	95 days

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2016 and 2015.

Realized gains and losses are reported in the consolidated statements of operations and changes in net assets as a component of investment return. Net realized gains of approximately \$1,104,000 for 2016 and net realized losses of approximately \$961,000 for 2015 were recorded.

The market value of investments exceeded the cost by approximately \$2,073,000 and \$1,066,000 as of December 31, 2016 and 2015, respectively. The unrealized gain or loss is included in earnings for the period attributable to the change in unrealized gain or loss relating to assets held as of December 31, 2016 and 2015 and is reported in the consolidated statements of operations and changes in net assets as net unrealized gain or loss on investments. The Hospital recognized unrealized gains of approximately \$1,007,000 during 2016 and unrealized losses of approximately \$3,717,000 during 2015.

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

Cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts payable, accrued expenses and estimated third-party settlements approximate fair value based on short-term maturity.

Long-term debt: Fair value of the Hospital's revenue bonds approximates its carrying value based on incremental borrowing rates available to similar entities with similar credit ratings.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### 5. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31:

	2016	2015
Land and improvements	\$ 3,022,022	\$ 2,795,059
Buildings and improvements	76,061,360	71,745,114
Fixed equipment	6,341,285	6,341,285
Movable and minor equipment	46,682,518	43,955,783
	<u>132,107,185</u>	<u>124,837,241</u>
Less accumulated depreciation	78,364,388	71,983,089
	<u>53,742,797</u>	<u>52,854,152</u>
Construction in progress	5,378,366	1,405,947
	<u>\$ 59,121,163</u>	<u>\$ 54,260,099</u>

Depreciation expense for 2016 and 2015 was approximately \$6,863,000 and \$6,587,000 respectively. The Hospital did not have any significant property and equipment commitments as of December 31, 2016.

### 6. DERIVATIVE FINANCIAL INSTRUMENTS – INTEREST RATE SWAPS

#### Objectives and Strategies for Using Derivatives

The Hospital makes limited use of derivative financial instruments for the purpose of managing interest rate risk. In particular, forward interest rate swaps (which are designated as cash flow hedges) are used to manage the risk associated with interest rates on variable-rate borrowings and to lower its overall borrowing costs.

As of December 31, 2016, the Hospital had outstanding an interest rate swap agreement with a financial institution, having a notional amount of \$13,755,000. The agreement effectively changes the Hospital's interest rate exposure on its Variable Rate Demand Revenue Bonds Series 2004A-1 due 2029 to a fixed 3.48%. The interest rate swap agreement matures at the time the related long-term debt matures. The Hospital is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the Hospital does not anticipate nonperformance by the counterparties.

The derivative is not designated as a hedging instrument, and is marked-to-market on the consolidated balance sheet at fair value. The related gains and losses are included in excess revenue and gains over expenses and losses, the performance indicator, for the reporting period. Cash flows from interest rate swap contracts are classified as an operating activity on the consolidated statements of cash flows.



# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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The asset derivatives are reported in the consolidated balance sheets as other assets and liability derivatives are reported as derivative liabilities. As of December 31, 2016 and 2015, the fair values of derivatives recorded in the consolidated balance sheets are as follows:

	<u>2016</u>	<u>2015</u>
Derivative liability	\$ 1,898,894	\$ 2,300,607

During 2016 and 2015, the amount of gain or loss recognized in the consolidated statements of operations and changes in net assets and reported as a component of nonoperating gain (loss) is as follows:

	<u>2016</u>	<u>2015</u>
Unrealized gain on derivative	\$ 401,713	\$ 138,955

Additional information regarding fair value measurements of the interest rate swap agreements is disclosed in Fair Value of Financial Instruments note.

### 7. LONG-TERM DEBT

The following is the summary of long-term debt as of December 31:

	<u>2016</u>	<u>2015</u>
Indiana Finance Authority Health Facility Variable Rate Demand Revenue Bonds Series 2004A-1; dated March 1, 2004, due 2029	\$ 13,755,000	\$ 14,575,000
Indiana Finance Authority Health Facility Revenue Bonds Series 2010; dated December 1, 2010, due 2035	12,707,818	13,590,175
	<u>26,462,818</u>	<u>28,165,175</u>
Less unamortized debt issue costs	238,667	255,969
Less current portion	1,759,928	1,700,167
	<u>\$ 24,464,223</u>	<u>\$ 26,209,039</u>

In 2004, the Hospital borrowed from the Indiana Finance Authority (the Authority) \$22,000,000 for the addition and improvement of the Hospital facilities. The Authority, created under Indiana Code 5-1-16, provides funds to eligible health facilities for financing capital expenditures.

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# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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In 2009, the Hospital, the Authority and Branch Banking and Trust Company, Inc. (BB&T) entered into a Bond Purchase Agreement (Agreement) whereby BB&T purchased from the Authority all of the Series 2004A Bonds in a private placement. During 2013, the interest rate on the Series 2004A Bonds was converted from the Initial Long Mode to Successive Long Mode which is 68% of one month LIBOR plus .95% with no floor. The rate as of December 31, 2016 and 2015 was 1.31% and 1.13%, respectively. The Successive Long Mode period runs through 2029. Additionally, BB&T agreed to hold the Series 2004A Bonds through the maturity date in 2029.

In 2010, the Hospital borrowed \$16,625,235 from the Authority the Health Facility Revenue Bonds, Series 2010 to provide for future capital projects. The Series 2010 Bonds bear interest at rates as determined by daily, weekly, flexible, semiannual or long modes. The Hospital, the Authority and Key Government Finance, Inc. (Key) entered into an Agreement whereby Key purchased from the Authority all of the Series 2010 Bonds in a private placement. During 2013, the interest rate on the Series 2010 Bonds was converted from the Initial Long Mode to a new Long Mode with a fixed interest rate of 3.36%. The new Long Mode period runs through 2028. Additionally, Key agreed to hold the Series 2010 Bonds through 2028 compared to the Series 2010 Bond maturity date in 2035. At the end of the Long Mode period in 2028, the Series 2010 Bonds could be converted to another interest rate mode and remarketed to another bondholder or holders or renewed for another Long Mode Period with Key. If the Series 2010 Bonds could not be remarketed at the end of the Long Mode Period in 2028, the Hospital would be subject to payment of the remaining principal balance at that time.

Both the Series 2004A and 2010 Bonds are covered under a Master Trust Indenture and are secured by an interest in the gross revenues of the Hospital.

Annual maturities of long-term debt for the years succeeding December 31, 2016 are as follows:

Year Ending December 31,	
2017	\$ 1,759,928
2018	1,825,989
2019	1,888,111
2020	1,956,329
2021	2,020,681
Thereafter	17,011,780
	<u>\$ 26,462,818</u>

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### 8. RETIREMENT PLANS

The Hospital has a defined contribution pension plan, which covers all eligible employees. Hospital contributions are based on the earnings of qualified employees. Contribution percentages are at the discretion of the Hospital and were 3% for 2016 and 2015. The Hospital also offers a 403(b) tax deferred annuity retirement plan for the benefit of its eligible employees. During 2016, the Hospital modified the 403(b) plan to allow for discretionary Hospital matching contributions based on employee deferrals to the plan. The maximum matching contribution is up to \$1,500 per employee. The Hospital also has a 457(b) deferred compensation plan that provides for non-elective employer deferrals covering a select group of management or highly compensated individuals. Total pension expense under all retirement plans was approximately \$1,255,000 and \$994,000 for 2016 and 2015, respectively.

### 9. CONCENTRATIONS OF CREDIT RISK

The Hospital is located in Batesville, Indiana. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Accounts receivable and revenues from self-pay and third-party payors were as follows:

	Receivables		Revenues	
	2016	2015	2016	2015
Medicare	33%	35%	43%	43%
Medicaid	10%	9%	9%	8%
Blue Cross	12%	14%	22%	23%
Other third-party payors	19%	18%	23%	23%
Self pay	26%	24%	3%	3%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

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

### 10. COMMITMENTS AND CONTINGENCIES

#### Self-Funded Health Plan

The Hospital is committed to pay for employees' health care costs. A third-party administrator has been retained to process and present all benefit claims to the Hospital for payment. Under a stop loss agreement, the Hospital is responsible for the funding of all claims and related administrative costs up to \$200,000 per individual per policy year. There is no aggregate limit for the Plan under the stop loss agreement. Group health insurance expense for 2016 and 2015 totaled approximately \$6,801,000 and \$7,843,000, respectively.

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# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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### Litigation

The Hospital is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without adverse effect on the Hospital's future position, results from operations or cash flows.

### **11. RISK MANAGEMENT**

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation). The Hospital has purchased commercial insurance for malpractice, general liability, and employee medical claims. The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding \$250,000 or aggregate claims exceeding \$5,000,000, for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on the occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital is not aware of any medical malpractice claims, either asserted or unasserted, that would exceed the policy limits. No claims have been settled during the past three years that have exceeded policy coverage limits. The cost of this insurance policy represents the Hospital's cost for such claims for the year, and it has been charged to operations as a current expense.

The Hospital has a \$250,000 letter of credit available with a local financial institution to cover unfunded workers' compensation claims. The letter of credit expires in April 2017. There was no outstanding balance on the letter of credit as of December 31, 2016 and 2015.

### **12. FUNCTIONAL EXPENSES**

The Hospital, located in Batesville, Indiana, is a not-for-profit acute care hospital providing inpatient, outpatient, and other ancillary services to the residents of Ripley and surrounding counties. Expenses related to providing these services for 2016 and 2015 are as follows:

	2016	2015
Health care services	\$ 73,783,261	\$ 69,750,227
General and administrative	13,243,357	11,998,770
Fundraising	256,197	250,314
	<u>\$ 87,282,815</u>	<u>\$ 81,999,311</u>

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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Certain costs have been allocated among the health care services, general and administrative and fundraising categories based on the actual direct expenditures and cost allocations based upon time spent by the Hospital's personnel. Although the methods used were appropriate, alternative methods may provide different results.

### 13. FEDERAL, STATE AND LOCAL AWARDS

Guidelines for Examination of Entities Receiving Financial Assistance from Government Sources, issued by the Indiana State Board of Accounts, requires Indiana not-for-profit entities to disclose Federal, state and local awards expended during the entities' annual reporting period. During 2016, the Hospital expended the following awards:

Federal	
Dept of Health & Human Services through	
Indiana State Dept of Health	
Small Rural Hospital Improvement Grant	
Program - CFDA 93.301	\$ 5,700
Dept of Health & Human Services	
Hospital Preparedness Program - CFDA 93.074	2,565
	<hr/>
	\$ 8,265
	<hr/>

The Hospital did not expend any State or local awards during 2016.

### 14. RECENTLY ISSUED ACCOUNTING STANDARDS

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of this new guidance is that "an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services". On August 12, 2015, the FASB further amended this guidance and issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)*, which deferred the effective date for all entities by one year. These new standards, which the Hospital is not required to adopt until its year ending December 31, 2018, deal with the timing of reporting revenues from contracts with customers, and disclosures related thereto.

On January 5, 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This new standard, which the Hospital is not required to adopt until its year ending December 31, 2019, is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The primary impact on the Hospital will be that changes in the fair value of equity investments will be recognized in excess revenue over expenses, rather than in other changes as currently required.

# MARGARET MARY HEALTH

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

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On February 25, 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842). This new standard, which the Hospital is not required to adopt until its year ending December 31, 2019, is intended to improve financial reporting about leasing transactions by requiring entities that lease assets to recognize on their balance sheet the assets and liabilities for the rights and obligations created by those leases, and to provide additional disclosures regarding the leases. Leases with terms (as defined in the ASU) of twelve months or less are not required to be reflected on an entity's balance sheet.

On August 18, 2016, the FASB issued ASU No. 2016-14 *Presentation of Financial Statements of Not-for-Profit Entities* (Topic 958) that amends how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. This new standard, which the Hospital is not required to adopt until its year ending December 31, 2018, requires improved presentation and disclosures to help not-for-profits provide more relevant information about their resources (and the changes in those resources) to donors, grantors, creditors, and other users. This ASU completes the first phase of a two phase project to amend not-for-profit financial reporting requirements.

The Hospital is presently evaluating the effects that these ASUs will have on its future consolidated financial statements, including related disclosures.

**SUPPLEMENTARY INFORMATION**

# MARGARET MARY HEALTH

## CONSOLIDATING BALANCE SHEET DECEMBER 31, 2016

ASSETS	Hospital	Foundation	Eliminations	Total
<b>Current assets</b>				
Cash and cash equivalents	\$ 5,283,380	\$ 162,634	\$ -0-	\$ 5,446,014
Patient accounts receivable, net	10,935,461	-0-	-0-	10,935,461
Inventories and other current assets	2,842,587	151,183	(78,188)	2,915,582
Current portion of assets whose use is limited	1,759,928	-0-	-0-	1,759,928
Total current assets	20,821,356	313,817	(78,188)	21,056,985
<b>Assets whose use is limited</b>				
Board designated for capital improvements	75,808,130	-0-	-0-	75,808,130
Board designated for retirement plan	1,296,988	-0-	-0-	1,296,988
Held by Foundation	-0-	1,676,272	-0-	1,676,272
Donor restricted	57,619	896,414	-0-	954,033
Held by trustee for debt service	108,333	-0-	-0-	108,333
	77,271,070	2,572,686	-0-	79,843,756
Less current portion	1,759,928	-0-	-0-	1,759,928
Assets whose use is limited - noncurrent	75,511,142	2,572,686	-0-	78,083,828
<b>Property and equipment, net</b>	59,121,163	-0-	-0-	59,121,163
Total assets	<u>\$ 155,453,661</u>	<u>\$ 2,886,503</u>	<u>\$ (78,188)</u>	<u>\$ 158,261,976</u>
<b>LIABILITIES AND NET ASSETS</b>				
<b>Current liabilities</b>				
Accounts payable	\$ 2,014,860	\$ 78,188	\$ (78,188)	\$ 2,014,860
Accrued wages and related liabilities	7,761,684	-0-	-0-	7,761,684
Estimated third-party settlements	2,931,049	-0-	-0-	2,931,049
Current portion of long-term debt	1,759,928	-0-	-0-	1,759,928
Total current liabilities	14,467,521	78,188	(78,188)	14,467,521
<b>Derivative liability</b>	1,898,894	-0-	-0-	1,898,894
<b>Long-term debt, less current portion</b>	24,464,223	-0-	-0-	24,464,223
Total liabilities	40,830,638	78,188	(78,188)	40,830,638
<b>Net assets</b>				
Unrestricted	114,565,404	1,911,901	-0-	116,477,305
Temporarily restricted	57,619	448,828	-0-	506,447
Permanently restricted	-0-	447,586	-0-	447,586
Total net assets	114,623,023	2,808,315	-0-	117,431,338
Total liabilities and net assets	<u>\$ 155,453,661</u>	<u>\$ 2,886,503</u>	<u>\$ (78,188)</u>	<u>\$ 158,261,976</u>

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# MARGARET MARY HEALTH

## CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2016

	Hospital	Foundation	Eliminations	Total
<b>Unrestricted revenue, gains and other support</b>				
Net patient service revenue	\$ 98,474,466	\$ -0-	\$ -0-	\$ 98,474,466
Less provision for bad debts	7,183,005	-0-	-0-	7,183,005
Net patient service revenue net of provision for bad debts	91,291,461	-0-	-0-	91,291,461
Other revenue	1,163,494	-0-	-0-	1,163,494
Total revenue, gains and other support	92,454,955	-0-	-0-	92,454,955
<b>Expenses</b>				
Salaries and wages	38,232,191	-0-	-0-	38,232,191
Employee benefits	11,290,905	-0-	-0-	11,290,905
Physician fees	3,358,585	-0-	-0-	3,358,585
Medical and surgical supplies	12,500,934	-0-	-0-	12,500,934
Other supplies	416,067	-0-	-0-	416,067
Purchased services	7,615,448	-0-	-0-	7,615,448
Equipment rentals	256,759	-0-	-0-	256,759
Food	587,026	-0-	-0-	587,026
Utilities	1,083,672	-0-	-0-	1,083,672
Insurance	724,091	-0-	-0-	724,091
Depreciation	6,863,375	-0-	-0-	6,863,375
Interest	1,112,217	-0-	-0-	1,112,217
Other	3,241,545	-0-	-0-	3,241,545
Total expenses	87,282,815	-0-	-0-	87,282,815
Operating income	5,172,140	-0-	-0-	5,172,140
<b>Nonoperating gain (loss)</b>				
Contributions	83,219	180,876	(78,187)	185,908
Gain on disposal of property and equipment	20,434	-0-	-0-	20,434
Program expenses	-0-	(78,187)	78,187	-0-
In-kind revenue	-0-	256,197	(256,197)	-0-
In-kind expense	-0-	(256,197)	256,197	-0-
Investment return	3,446,808	77,359	-0-	3,524,167
Unrealized gain on derivative	401,713	-0-	-0-	401,713
Net assets released from restriction	21,796	71,466	-0-	93,262
Total nonoperating gain	3,973,970	251,514	-0-	4,225,484
Excess revenue over expenses	9,146,110	251,514	-0-	9,397,624
<b>Other changes in unrestricted net assets</b>				
Unrealized gain on investments	966,899	40,451	-0-	1,007,350
Change in unrestricted net assets	10,113,009	291,965	-0-	10,404,974
<b>Temporarily restricted net assets</b>				
Contributions, gifts and bequests	31,767	148,374	-0-	180,141
Net assets released from restriction	(21,796)	(71,466)	-0-	(93,262)
Change in temporarily restricted net assets	9,971	76,908	-0-	86,879
<b>Permanently restricted net assets</b>				
Contributions, gifts and bequests	-0-	50,000	-0-	50,000
Change in net assets	10,122,980	418,873	-0-	10,541,853
<b>Net assets</b>				
Beginning of year	104,500,043	2,389,442	-0-	106,889,485
End of year	\$ 114,623,023	\$ 2,808,315	\$ -0-	\$ 117,431,338

See report of independent auditors on pages 1 and 2.

# MARGARET MARY HEALTH

## CONSOLIDATING BALANCE SHEET DECEMBER 31, 2015

ASSETS	Hospital	Foundation	Eliminations	Total
<b>Current assets</b>				
Cash and cash equivalents	\$ 6,114,396	\$ 78,505	\$ -0-	\$ 6,192,901
Patient accounts receivable, net	11,840,873	-0-	-0-	11,840,873
Inventories and other current assets	2,868,830	190,000	(70,247)	2,988,583
Current portion of assets whose use is limited	1,700,167	-0-	-0-	1,700,167
Total current assets	22,524,266	268,505	(70,247)	22,722,524
<b>Assets whose use is limited</b>				
Board designated for capital improvements	71,592,041	-0-	-0-	71,592,041
Board designated for retirement plan	889,739	-0-	-0-	889,739
Held by Foundation	-0-	1,421,678	-0-	1,421,678
Donor restricted	47,648	769,506	-0-	817,154
Held by trustee for debt service	108,333	-0-	-0-	108,333
	72,637,761	2,191,184	-0-	74,828,945
Less current portion	1,700,167	-0-	-0-	1,700,167
Assets whose use is limited - noncurrent	70,937,594	2,191,184	-0-	73,128,778
<b>Property and equipment, net</b>	54,260,099	-0-	-0-	54,260,099
Total assets	<u>\$ 147,721,959</u>	<u>\$ 2,459,689</u>	<u>\$ (70,247)</u>	<u>\$ 150,111,401</u>
<b>LIABILITIES AND NET ASSETS</b>				
<b>Current liabilities</b>				
Accounts payable	\$ 3,047,315	\$ 70,247	\$ (70,247)	\$ 3,047,315
Accrued wages and related liabilities	6,866,286	-0-	-0-	6,866,286
Estimated third-party settlements	3,098,502	-0-	-0-	3,098,502
Current portion of long-term debt	1,700,167	-0-	-0-	1,700,167
Total current liabilities	14,712,270	70,247	(70,247)	14,712,270
<b>Derivative liability</b>	2,300,607	-0-	-0-	2,300,607
<b>Long-term debt, less current portion</b>	26,209,039	-0-	-0-	26,209,039
Total liabilities	43,221,916	70,247	(70,247)	43,221,916
<b>Net assets</b>				
Unrestricted	104,452,395	1,619,936	-0-	106,072,331
Temporarily restricted	47,648	371,920	-0-	419,568
Permanently restricted	-0-	397,586	-0-	397,586
Total net assets	104,500,043	2,389,442	-0-	106,889,485
Total liabilities and net assets	<u>\$ 147,721,959</u>	<u>\$ 2,459,689</u>	<u>\$ (70,247)</u>	<u>\$ 150,111,401</u>

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# MARGARET MARY HEALTH

## CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2015

	Hospital	Foundation	Eliminations	Total
<b>Unrestricted revenue, gains and other support</b>				
Net patient service revenue	\$ 94,269,565	\$ -0-	\$ -0-	\$ 94,269,565
Less provision for bad debts	7,083,404	-0-	-0-	7,083,404
Net patient service revenue				
net of provision for bad debts	87,186,161	-0-	-0-	87,186,161
Other revenue	1,085,188	-0-	-0-	1,085,188
Total revenue, gains and other support	88,271,349	-0-	-0-	88,271,349
<b>Expenses</b>				
Salaries and wages	33,485,825	-0-	-0-	33,485,825
Employee benefits	11,683,149	-0-	-0-	11,683,149
Physician fees	2,739,107	-0-	-0-	2,739,107
Medical and surgical supplies	12,684,473	-0-	-0-	12,684,473
Other supplies	394,883	-0-	-0-	394,883
Purchased services	7,856,413	-0-	-0-	7,856,413
Equipment rentals	189,545	-0-	-0-	189,545
Food	470,027	-0-	-0-	470,027
Utilities	1,140,208	-0-	-0-	1,140,208
Insurance	701,314	-0-	-0-	701,314
Depreciation	6,587,073	-0-	-0-	6,587,073
Interest	1,177,038	-0-	-0-	1,177,038
Other	2,890,256	-0-	-0-	2,890,256
Total expenses	81,999,311	-0-	-0-	81,999,311
Operating income	6,272,038	-0-	-0-	6,272,038
<b>Nonoperating gain (loss)</b>				
Contributions	243,721	283,833	(70,247)	457,307
Program expense	-0-	(70,247)	70,247	-0-
In-kind revenue	-0-	250,314	(250,314)	-0-
In-kind expense	-0-	(250,314)	250,314	-0-
Investment return	1,066,435	50,987	-0-	1,117,422
Unrealized gain on derivative	138,955	-0-	-0-	138,955
Net assets released from restriction	12,454	21,401	-0-	33,855
Total nonoperating gain	1,461,565	285,974	-0-	1,747,539
Excess revenue over expenses	7,733,603	285,974	-0-	8,019,577
<b>Other changes in unrestricted net assets</b>				
Unrealized loss on investments	(3,604,002)	(113,341)	-0-	(3,717,343)
Change in unrestricted net assets	4,129,601	172,633	-0-	4,302,234
<b>Temporarily restricted net assets</b>				
Contributions, gifts and bequests	13,867	158,791	-0-	172,658
Net assets released from restriction	(12,454)	(21,401)	-0-	(33,855)
Change in temporarily restricted net assets	1,413	137,390	-0-	138,803
<b>Permanently restricted net assets</b>				
Contributions, gifts and bequests	-0-	153,286	-0-	153,286
Change in net assets	4,131,014	463,309	-0-	4,594,323
<b>Net assets</b>				
Beginning of year	100,369,029	1,926,133	-0-	102,295,162
End of year	\$ 104,500,043	\$ 2,389,442	\$ -0-	\$ 106,889,485

See report of independent auditors on pages 1 and 2.