MARION GENERAL HOSPITAL

FINANCIAL STATEMENTS

JUNE 30, 2016 AND 2015

CPAs / ADVISORS

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MARION GENERAL HOSPITAL, INC.

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Marion General Hospital, Inc.
Marion, Indiana

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of June 30, 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 Principle

As discussed in Note 2 to the financial statements, the Hospital early adopted Accounting Standards Update 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 per share practical expedient. Our opinion is not modified with respect to this matter.

Blue & Co., LLC

Indianapolis, Indiana
October 13, 2016

MARION GENERAL HOSPITAL, INC.

BALANCE SHEETS
JUNE 30, 2016 AND 2015

ASSETS

	2016	2015
Current assets		
Cash and cash equivalents	$ 26,259,446	$ 28,858,498
Current portion of assets limited as to use	3,900,911	2,450,350
Account receivable		
Patient services, less allowances for uncollectible accounts of $5,748,000 in 2016 and $4,591,000 in 2015	19,242,378	17,475,090
Physician services, less allowances for uncollectible accounts of $61,000 in 2016 and $60,000 in 2015	1,336,411	1,154,344
Other	355,017	7,032,460
Accrued interest	5,855	36
Inventories	1,505,584	1,716,593
Current portion of notes receivable	790,025	717,575
Prepaid expenses	2,194,280	1,969,468
Total current assets	55,589,907	61,374,414
Assets limited as to use		
Board designated funds	191,082,001	183,830,866
Trustee held	19,102,928	4,399,827
Donor restricted	10,155	10,155
Total assets limited as to use, net	210,195,084	188,240,848
Less current portion	3,900,911	2,450,350
Total assets limited as to use, net	206,294,173	185,790,498
Property and equipment, net	81,697,453	77,614,488
Other assets		
Investment in joint ventures	1,681,133	1,739,329
Unamortized bond issuance costs	717,670	663,795
Notes receivable, net	2,955,988	3,122,249
Goodwill and other intangible assets, net	2,069,810	2,136,418
Other	1,492,321	1,465,461
Total other assets	8,916,922	9,127,252
Total assets	$ 352,498,455	$ 333,906,652

See accompanying notes to financial statements.

MARION GENERAL HOSPITAL, INC.

BALANCE SHEETS
JUNE 30, 2016 AND 2015

LIABILITIES AND NET ASSETS

	2016	2015
Current liabilities		
Accounts payable	$ 4,676,289	$ 5,344,785
Accrued liabilities		
Salaries and related liabilities	8,618,051	10,137,126
Interest	769,541	747,781
Other	356,857	475,198
Estimated third-party settlements	1,929,093	471,299
Current portion of long-term debt	1,920,000	1,630,000
Total current liabilities	18,269,831	18,806,189
Long-term liabilities		
Long-term debt, less current portion	65,443,137	51,698,070
Pension liability	27,278,241	27,512,757
Other long-term liabilities	1,308,518	942,245
Total long-term liabilities	94,029,896	80,153,072
Total liabilities	112,299,727	98,959,261
Net assets		
Unrestricted	240,188,573	234,937,236
Permanently restricted	10,155	10,155
Total net assets	240,198,728	234,947,391
Total liabilities and net assets	$ 352,498,455	$ 333,906,652

See accompanying notes to financial statements.

MARION GENERAL HOSPITAL, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
Unrestricted revenue and other support		
Net patient service revenue	$ 178,322,191	$ 170,063,566
Less provision for bad debts	14,818,369	13,554,401
Net patient service revenue net of provision for bad debts	163,503,822	156,509,165
Other revenue	3,047,600	3,471,641
Total unrestricted revenue and other support	166,551,422	159,980,806
Expenses		
Salaries and wages	45,875,165	49,321,739
Employee benefits	18,038,008	15,884,985
Physician services	19,584,689	17,784,788
Professional services	10,526,483	9,525,095
Medical supplies	11,189,580	11,016,208
Drugs and IV solutions	8,490,554	7,240,182
Food	25,185	26,534
Purchased services	16,141,023	11,865,215
Rent	1,419,653	1,748,957
Plant and equipment maintenance	4,934,853	4,782,669
Utilities	2,123,223	2,178,138
Nonmedical supplies	2,311,980	2,355,395
Leased property	1,412,164	1,413,346
Other	2,296,917	1,624,700
Insurance	1,443,410	1,208,953
Hospital Assessment Fee Program	5,053,859	1,349,234
Interest	1,350,808	1,314,701
Depreciation and amortization	11,060,111	10,898,982
Total expenses	163,277,665	151,539,821
Income from operations	3,273,757	8,440,985
Nonoperating gain		
Investment income and other, net	5,522,129	7,052,706
Excess of revenue, support and gains over expenses	8,795,886	15,493,691
Other changes in unrestricted net assets		
Net unrealized loss on investments	(3,971,817)	(6,122,864)
Pension related changes other than net periodic pension cost	427,268	(9,176,162)
Change in net assets	5,251,337	194,665
Net assets		
Beginning of year	234,947,391	234,752,726
End of year	$ 240,198,728	$ 234,947,391

See accompanying notes to financial statements.

MARION GENERAL HOSPITAL, INC.

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
Operating activities		
Change in net assets	$ 5,251,337	$ 194,665
Adjustments to reconcile change in net assets to net cash from operating activities:		
Depreciation and amortization	11,060,111	10,898,982
Amortization of bond issuance costs and bond premium	259,692	33,578
Amortization of notes receivable	1,329,461	1,179,078
Provision for bad debts - net patient service revenue	14,818,369	13,554,401
Provision for bad debts - other	343,375	(2,808)
Loss on disposal of property and equipment	363,138	14,205
Impairment loss on property and equipment	-0-	200,000
Change in unrealized loss on investments	3,971,817	6,122,864
Realized loss on sale of investments	212,766	1,136,004
Gain on equity in joint ventures	(464,968)	(149,316)
Loss on refunding of long-term debt	220,696	-0-
Changes in operating assets and liabilities:		
Accounts receivable	(16,767,724)	(13,179,855)
Accrued interest, inventories, prepaid expenses, and other current assets	6,657,821	(6,871,325)
Other long-term assets	31,336	134,379
Pension liability	(234,516)	10,970,293
Accounts payable and accrued liabilities	(3,205,399)	1,363,066
Estimated third-party settlements	1,457,794	222,551
Net cash flows from operating activities	25,305,106	25,820,762
Investing activities		
Additions to property and equipment	(14,152,088)	(9,980,717)
Proceeds from the sale or maturity of investments	76,291,987	94,382,502
Purchases of investments	(102,553,104)	(104,552,851)
Dividends received from joint ventures	366,570	301,449
Advances on notes receivable	(1,614,490)	(1,101,031)
Payments received on notes receivable	35,467	133,378
Net cash flows from investing activities	(41,625,658)	(20,817,270)
Financing activities		
Payments for bond issuance costs	(333,500)	-0-
Proceeds from issuance of long-term debt	33,000,000	-0-
Repayments of long-term debt	(18,945,000)	(1,585,000)
Net cash flows from financing activities	13,721,500	(1,585,000)
Net change in cash and cash equivalents	(2,599,052)	3,418,492
Cash and cash equivalents		
Beginning of year	28,858,498	25,440,006
End of year	$ 26,259,446	$ 28,858,498
Supplemental cash flows information		
Interest paid, net of amounts capitalized of approximately $239,000 and $90,000 in 2016 and 2015, respectively	$ 1,329,047	$ 1,320,449
Property and equipment included in accounts payable	$ 1,287,520	$ 1,360,178

See accompanying notes to financial statements.

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Marion General Hospital, Inc. (Hospital), a not-for-profit corporation, provides inpatient and outpatient services primarily to residents from the Grant County area. The Hospital operates an acute care general hospital with 97 acute care beds, 20 nursery beds, and 18 inpatient acute rehabilitation beds. The Hospital was formed in 1902 and is located in Marion, Indiana.

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, including the allowance for estimated uncollectible accounts, estimated third-party settlements, defined pension plan obligations and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period and could differ from actual results.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and demand deposit accounts, all with an original maturity of three months or less. 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 and believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Patient Accounts Receivable, Net Patient Service Revenue and Estimated Third-Party Payor Settlements

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 payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. These estimated retroactive adjustments under reimbursement agreements are included with estimated third-party payor settlements. 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 is 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 for patient and physician services increased approximately $1,158,000 from $4,651,000 to $5,809,000. The uncollectible allowance for self-pay balances increased approximately $40,000 during 2016. The uncollectible estimate was 95% and 94% of self-pay balances as of June 30, 2016 and 2015.

The uncollectible allowance for self-pay balances after third-party insurance increased approximately $1,118,000 during 2016. The uncollectible estimate for self-pay balances after third-party insurance was 53% and 46% as of June 30, 2016 and 2015. The change is the result of collections on self-pay after third-party insurance balances combined with aging of self-pay after third-party insurance balances from 2015 to 2016.

In addition, the Hospital's uncollectible write-offs decreased by approximately $277,000 to $13,660,000 in 2016 from $13,937,000 in 2015. The decrease was the result of trends experienced in the collection of amounts from self-pay and self-pay after third-party insurance patients during 2016.

As of June 30, 2016, the allowance for uncollectible accounts of approximately $5,809,000 was comprised of approximately $2,061,000 reserved for self-pay balances and approximately $3,748,000 reserved for self-pay after third-party payor balances. As of June 30, 2015, the allowance for uncollectible accounts of approximately $4,651,000 was comprised of $2,021,000 reserved for self-pay balances and $2,630,000 reserved for self-pay after third-party payor balances.

The Hospital changed its financial assistance policy during 2016 to allow for 100% assistance for qualified patients with income up to 300% of the federal poverty level. Previously, qualified patients whose income was between 200-300% of the federal poverty level only qualified for partial assistance. There were no changes to its financial assistance policy in 2015.

Investments

Investments are recorded at fair value in the balance sheets. Investment income and other, net (including realized gains and losses on investments, interest, and dividends) is included in the excess of revenue, support, and gains over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on other-than-trading investments are excluded from the excess of revenue, support, and gains over expenses unless the unrealized loss on investment security is considered other-than-temporary. Generally, the fair value of the alternative investments (fund of funds) is based on the fair value of the underlying marketable securities determined by the individual manager of the alternative investment. Although the manager uses its 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. Alternative investments totaled approximately $8,498,000 (4.4% of board designated funds) and $8,787,000 (4.8% of board designated funds) as of June 30, 2016 and 2015, respectively.

A decline in the market value of any other-than-trading security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to excess of revenue, support, and gains over expenses and a new cost basis for the security is established. Management continually reviews the investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary.

In 2016 and 2015, the Hospital did not record other-than-temporary declines in the fair value of its investments. While management uses available information to measure other-than-temporary impairment at the balance sheet date, future write-downs may be necessary based on extended duration of current unrealized losses and changing market conditions.

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of the Hospital's investments could occur in the near term and that such changes could materially affect the amounts reflected in the financial statements. Critical factor in this evaluation is the length of time and extent to which the market value of the individual security has been less than cost. Other factors considered include recommendations of investment advisors and conditions specific to the issuer or industry in which the issuer operates.

Inventories

Inventories, consisting of medical supplies, are stated on the weighted average cost method, which approximates market value.

Assets Limited as to Use or Restricted

Assets limited as to use include assets set aside by the board of directors for future capital improvements and other purposes, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Assets held by trustees under indenture agreements are also included within this caption and are classified as current assets to the extent they are to be used to pay for current liabilities. Restricted assets include assets whose use by the Hospital has been limited by donors to a specific purpose.

Property and Equipment and Depreciation

Property and equipment acquisitions are recorded at cost. Property and equipment donated to the Hospital are recorded as additions to temporarily restricted net assets at their fair value at the date of receipt and as a transfer to unrestricted net assets when the assets are placed in service.

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method using a half-year convention in the year of acquisition and disposal. Estimated useful lives range from 2 to 40 years depending on asset classification.

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Hospital first compares undiscounted cash flows expected to be generated by that asset or group to its carrying value. If the carrying value of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

Unamortized Bond Issuance Costs and Original Issue Discounts

The costs incurred and capitalized in issuing Hospital Revenue Bonds are amortized into interest expense by the bonds outstanding method over the respective term of each bond series.

The premium and discount incurred in issuing the Hospital Revenue Bonds are classified with long-term debt and are amortized into interest expense using the effective-interest method over the respective term of the bond issues.

Notes Receivable

Notes receivable are comprised of loans and advances to certain physicians, tuition advances to various employees and prospective employees, and recruitment loan advances to various employees. The allowance for uncollectible notes receivable is approximately $5,000 and $49,000 as of June 30, 2016 and 2015, respectively. The provision for bad debts related to notes receivable and other non-patient receivables is recorded in operating expenses.

Business Combinations and Goodwill and Other Intangible Assets

The Hospital accounts for a business combination using the acquisition method of accounting, and accordingly, the net assets of the acquired entity are recorded at their estimated fair values at the date of acquisition. Goodwill represents the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. Other intangible assets are amortized on a straight-line basis over a period ranging from two to seven years. Goodwill and other intangible assets, at cost, approximated $9,209,000 and $9,951,000, respectively, as of June 30, 2016 and 2015 with accumulated amortization of approximately $7,139,000 and $7,814,000, respectively.

The Hospital's policy is to evaluate goodwill and intangible assets based on consideration of such factors as the occurrence of a significant adverse event or change in the environment in which the business operates or if the expected future cash flows (undiscounted and without interest) are less than the carrying amount of the asset.

Goodwill is assessed annually for impairment. No impairment was recognized in 2016 and 2015, as the Hospital does not believe that there are any factors or circumstances indicating impairment as of June 30, 2016 and 2015.

Temporarily Restricted and Permanently Restricted Net Assets

Restricted net assets, the use of which is restricted by donors or grantors, are used to differentiate from unrestricted net assets on which donors or grantors place no restrictions or that arise as a result of the operations of the Hospital for its stated purposes. Restricted gifts and other restricted resources are recorded as additions to the appropriate restricted net assets at fair market value at the date of donation.

Resources restricted by donors for property and equipment replacement or expansion are added to unrestricted net assets to the extent expended within the period.

Unrestricted donations totaled approximately $19,000 and $18,000 for 2016 and 2015, respectively, and are included in other revenue in the statements of operations and changes in net assets.

Excess of Revenue, Support, and Gains over Expenses

The statements of operations and changes in net assets include a performance indicator, excess of revenue, support, and gains over expenses. Transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue, support, and expenses. Transactions incidental to the provision of patient care services are reported as gains and losses. Changes in unrestricted net assets which are excluded from the performance indicator, consistent with industry practice, include unrealized gains and losses on investments in other-than-trading securities, pension related changes other than net periodic pension cost and contributions of long-lived assets (including assets acquired using contributions which, by donor restriction, were to be used for the purposes of acquiring such assets).

Financial Assistance, Community Benefit and Assistance to the Uninsured

The Hospital provides care to patients regardless of their ability to pay. A patient qualifies for financial assistance based on certain established policies of the Hospital. Essentially, these policies define financial assistance as those services for which no payment or reduced payment based upon a graduated scale, is anticipated, up to 300% of Federal Poverty Income Guidelines, published by the Department of Health and Human Services and where incurred charges are considered significant when compared to the income of the patient. Because collection of amounts determined to qualify as financial assistance is not pursued, such amounts are not reported as revenue.

Financial assistance provided during 2016 and 2015, measured at established rates, was approximately $8,271,000 and $15,666,000, respectively. Medicaid expansion was approved for the State of Indiana in February 2015. This combined with other health care reform initiatives, increased insurance coverage for patients who were previously uninsured. In addition, other programs and services for the benefit of the community are provided. The costs of these programs are included in operating expenses. The Hospital receives reimbursements from certain governmental payors to assist in the funding of financial assistance.

Of the Hospital's total expenses reported during 2016 and 2015, an estimated $3,254,000 and $6,255,000 arose from providing services to charity patients during 2016 and 2015, respectively. The estimated costs of providing financial assistance 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.

The Hospital has a policy for uninsured patients with discounted rates similar to contractual payors. This policy did not change during 2016 or 2015. Uninsured self-pay discounts provided to patients were approximately $7,547,000 and $12,330,000 in 2016 and 2015, respectively.

Donor-Restricted Gifts

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

Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for the self-insured portion of both reported claims and claims incurred but not reported and is recorded in other long-term liabilities.

Income Taxes

The Hospital is a not-for-profit corporation and has been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. As such, the Hospital is generally exempt from income taxes. However, the Hospital is 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 recognize a tax liability if the Hospital has 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 has concluded that as of June 30, 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 financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

The Hospital filed its federal and state income tax returns for periods through June 30, 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).

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. The payment calculation is based upon an initial amount as adjusted for discharges, Medicare and Medicaid utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as grant income, under the ratable recognition method, when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2016 and 2015, the Hospital recognized approximately $1,395,000 and $1,861,000, respectively, in EHR incentive payments as grant income.

EHR incentive income is included in other revenue in the statements 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.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is October 13, 2016.

Recently Issued Accounting Standards

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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 fiscal year ending June 30, 2019, deal with the timing of reporting revenues from contracts with customers, and disclosures related thereto.

In April 2015, the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Topic 835)*, was issued to simplify the presentation of debt issuance costs. After the implementation of this ASU, debt issuance costs will be required to be presented as a direct deduction of the debt liability with the related amortization reported as interest expense. This treatment is similar to that of a bond discount or bond premium. This ASU is effective for the Hospital's year ending June 30, 2017.

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 fiscal year ending June 30, 2020, is intended to improve financial reporting about leasing transactions by requiring entities that lease assets to recognize on their statement of financial position 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 statement of financial position.

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 June 30, 2019, 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 financial statements, including related disclosures.

2. CHANGE IN ACCOUNTING PRINCIPLE

During 2016, the Hospital early adopted Accounting Standards Update 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 per share practical expedient. As such, certain investments that were measured at net asset value 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.

3. NET PATIENT SERVICES ACCOUNTS RECEIVABLE

Net patient services accounts receivable consists of the following as of June 30, 2016 and 2015:

	2016	2015
Gross patient services accounts receivable	$ 53,524,601	$ 45,563,515
Allowance for estimated contractual adjustments	(28,534,362)	(23,496,952)
Allowance for uncollectible accounts	(5,747,861)	(4,591,473)
Net patient services accounts receivable	$ 19,242,378	$ 17,475,090

4. NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payment to the Hospital at amounts different from its established rates. Estimated contractual adjustments under third-party payment programs represent the differences between the Hospital's billings at standard rates and amounts paid by third-party payors. They also include any differences between estimated third-party settlements for prior years and subsequent final settlements. A summary of the payment arrangements with major third-party payors follows:

Medicare

Under the Medicare program, the Hospital receives payment under a prospective payment system (PPS) for inpatient services. Under the hospital inpatient PPS, fixed payment amounts per inpatient discharge are established based on the patient's assigned diagnosis related group (DRG). When the estimated cost of treatment for certain patients is higher than the average cost, providers may receive additional "outlier" payments. A prospective outpatient system provides for payment for most outpatient services based on service groups called ambulatory payment classifications. Other procedures are paid on a fee schedule. The prospectively determined rates are not subject to retroactive adjustment. The Hospital's classification of patients under the prospective payment systems and the appropriateness of the patients' admissions are subject to validation reviews.

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.

During 2012, the State of Indiana implemented the Hospital Assessment Fee (HAF) Program. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana hospitals as reflected in the HAF Program expense reported in the statements of operations and changes in net assets. 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. During 2016 and 2015, the Hospital recognized HAF Program expense of approximately $5,054,000 and $1,349,000, respectively, which resulted in increased Medicaid reimbursement. The HAF Program expense is included in the consolidated statements of operations and changes in net assets as an operating expense. 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.

During 2016 and 2015, the net patient service revenue was increased by approximately $3,757,000 and $6,712,000, respectively, due to Medicaid DSH payments.

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.

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

	2016	2015
Patient service revenue		
Inpatient services	$ 111,909,149	$ 106,042,336
Outpatient services	286,608,525	263,606,711
Physician practice services	24,803,461	25,562,958
Financial assistance	(8,271,369)	(15,665,616)
	415,049,766	379,546,389
Less contractual allowances	236,727,570	209,482,823
Net patient service revenue	178,322,196	170,063,566
Less provision for bad debts	14,818,374	13,554,401
Net patient service revenue net of provision for bad debts	$ 163,503,822	$ 156,509,165

5. ESTIMATED THIRD-PARTY SETTLEMENTS

Estimated third-party settlements for the Medicare and Medicaid programs reflect the differences between interim reimbursement and reimbursement as determined by reports filed after the end of each year, and any differences owed to or by the Hospital after such reports have been audited. As of June 30, 2016, Medicare and Medicaid reports have been audited and final settled with the fiscal intermediary through June 30, 2014.

Changes to any previous year's estimated settlement are reflected in the period the intermediary finalizes its audit of cost reports, or when additional information becomes available. During 2016 and 2015, the differences between original estimates and subsequent revisions for the final settlement of cost reports was immaterial to the financial statements as a whole.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term.

6. CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are generally insured under third-party payor agreements. The mix of receivables and revenue from patients and third-party payors for 2016 and 2015 follows:

	Receivables		Revenue	
	2016	2015	2016	2015
Medicare	29%	30%	46%	44%
Medicaid	24%	18%	22%	18%
Blue Cross	10%	10%	17%	17%
Commercial	12%	14%	10%	12%
Self-pay, welfare, and contract	25%	28%	5%	9%
	100%	100%	100%	100%

7. ASSETS LIMITED AS TO USE OR RESTRICTED

Assets limited as to use include funds held by trustee subject to indenture agreements and assets set aside by the board of directors for future capital improvements and other purposes. All investments are considered other-than-trading securities by management. Assets limited as to use that are required for certain obligations classified as current liabilities are reported in current assets.

The funds held by trustee subject to indentures (investments are comprised of cash and cash equivalents) consist of the following as of June 30, 2016 and 2015:

	2016	2015
Indiana Financing Authority		
Hospital revenue bonds, Series 2012A, Project fund	$ 2,348,021	$ 3,043,257
Hospital revenue bonds, Series 2012A, Interest fund	1,365,466	1,356,568
Variable rate demand revenue bonds, Series 2008A, Project fund	2	2
Variable rate demand revenue bonds, Series 2015A, Project fund	15,389,439	-0-
	$ 19,102,928	$ 4,399,827

A description and the carrying value of the assets limited as to use by the board of directors is as follows as of June 30, 2016 and 2015:

	2016	2015
Cash and cash equivalents	$ 463,907	$ 700,405
Mutual funds	182,120,282	174,343,568
Alternative investments - fund of funds	8,497,812	8,786,893
	$ 191,082,001	$ 183,830,866

As of June 30, 2016 and 2015, assets limited as to use under indenture agreements and other restricted assets are invested in cash and cash equivalents. Investment return for cash, investments, and other investments are comprised of the following for 2016 and 2015:

	2016	2015
Other nonoperating gains		
Investment return		
Interest and dividends	$ 5,490,623	$ 8,039,394
Net realized loss on sale of investments	(212,766)	(1,136,004)
Other gain (loss)		
Gain on equity in joint ventures	464,968	149,316
Loss on refunding of long-term debt	(220,696)	-0-
	$ 5,522,129	$ 7,052,706
Unrealized loss on investments	$ (3,971,817)	$ (6,122,864)

The following schedule summarizes the fair value of securities included in investments that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of June 30, 2016 and 2015. The schedule further segregates the securities that have been in a gross unrealized position as of June 30, 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 several securities which industry experts expect recovery in the short-term future. These individual investments have projected recoveries in value in 2017. The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of June 30, 2016 and 2015.

	June 30, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	$ 14,205,418	$ 789,973	$ 14,989,428	$ 4,095,312	$ 29,194,846	$ 4,885,285

	June 30, 2015					
	Less Than 12 Months		12 Months or Longer		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mutual funds	$ 63,515,921	$ 3,920,121	$ 3,723,328	$ 498,430	$ 67,239,249	$ 4,418,551

8. FAIR VALUE MEASUREMENTS 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 June 30, 2016 and 2015:

- *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 net asset value (NAV) and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.

- *Alternative Investments:* 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 alternative investments consist of investments in a variety of domestic and foreign equity and debt securities, managed accounts and other investment vehicles that employ diversified styles and strategies. 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.

The following tables set forth by level, within the hierarchy, the Hospital's assets measured at fair value on a recurring basis as of June 30, 2016 and 2015:

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
Assets				
Assets limited as to use				
Mutual funds				
Fixed income	$ 99,854,662	$ 99,854,662	$ -0-	$ -0-
Global bond	24,684,973	24,684,973	-0-	-0-
International	24,993,456	24,993,456	-0-	-0-
Large cap	23,197,650	23,197,650	-0-	-0-
Small cap	3,033,740	3,033,740	-0-	-0-
Managed futures mutual funds	6,355,801	6,355,801	-0-	-0-
Total mutual funds	182,120,282	$ 182,120,282	$ -0-	$ -0-
Alternative investments (a)	8,497,812			
Cash	19,576,990			
	$ 210,195,084			

	June 30, 2015			
	Total	Level 1	Level 2	Level 3
Assets				
Assets limited as to use				
Mutual funds				
Fixed income	$ 79,783,781	$ 79,783,781	$ -0-	$ -0-
Global bond	30,787,065	30,787,065	-0-	-0-
International	22,103,772	22,103,772	-0-	-0-
Large cap	21,960,120	21,960,120	-0-	-0-
Mid cap	4,202,013	4,202,013	-0-	-0-
Small cap	4,310,862	4,310,862	-0-	-0-
Managed futures mutual funds	5,827,059	5,827,059	-0-	-0-
Long/Short equity mutual funds	5,368,896	5,368,896	-0-	-0-
Total mutual funds	174,343,568	$ 174,343,568	$ -0-	$ -0-
Alternative investments (a)	8,786,893			
Cash	5,110,387			
	$ 188,240,848			

(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 this table are intended to permit reconciliation of the fair value hierarchy to the line items presented at fair value in the balance sheets.

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 statements of operations and changes in net assets as a component of investment income. Realized losses of approximately $213,000 and $1,136,000 were recorded during 2016 and 2015, respectively.

The market value of investments exceeded the cost by approximately $7,100,000 and $11,072,000 as of June 30, 2016 and 2015, respectively. The unrealized gain and loss are included in earnings for the period attributable to the change in unrealized gain and loss relating to assets held as of June 30, 2016 and 2015 and are reported in the statements of operations and changes in net assets as net unrealized gain on investments. During 2016 and 2015, the Hospital recognized unrealized losses of approximately $3,972,000 and $6,123,000, respectively.

The Hospital holds investments which 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.

Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments (rounded to nearest thousand) measured at fair value based on net asset value per share as of June 30, 2016 and 2015, respectively.

June 30, 2016

Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Alternative investments	$ 4,015,000	None	First day of January, April, July, & October	75 days
Alternative investments	4,483,000	None	First day of January, April, July, & October	70 days
	$ 8,498,000			

June 30, 2015

Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Alternative investments	$ 4,304,000	None	First day of January, April, July, & October	75 days
Alternative investments	4,483,000	None	First day of January, April, July, & October	70 days
	$ 8,787,000			

As the restrictions lapse within six months of year-end, the Hospital does not believe that the redemptive restrictions have a significant impact on the fair value of the investments.

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, salaries and related liabilities, other current liabilities and estimated third-party settlements: The carrying amount reported in the balance sheets for cash and cash equivalents, accounts payable, salaries and related liabilities, other current liabilities and estimated third-party settlements approximate fair value based on short-term maturity.

Long-term debt: Fair value of the Hospital's long-term debt, based on current quoted market value of similar debt instruments, has an approximate fair value of $69,750,000 and $54,256,000 as of June 30, 2016 and 2015, respectively.

The Hospital did not hold any assets measured at fair value on a non-recurring basis as of June 30, 2016 and 2015. During 2016 and 2015, long-lived assets held for sale were written down to fair value less estimated costs to sell, which resulted in an impairment loss of approximately $-0- and $200,000 respectively.

9. PROPERTY AND EQUIPMENT

Property and equipment and their estimated useful lives are as follows as of June 30, 2016 and 2015:

	2016	2015	Range of estimated useful lives
Land	$ 4,646,548	$ 4,422,248	
Land improvements	3,353,531	3,341,756	10-20 years
Buildings	56,987,621	54,035,919	5-40 years
Medical office buildings	17,797,103	17,059,885	5-40 years
Building service equipment	39,122,657	37,114,075	5-25 years
Leasehold improvements	2,473,673	871,326	15-20 years
Fixed equipment	1,005,608	1,005,608	10-20 years
Leased equipment	142,740	142,740	4 years
Major movable equipment	77,480,138	76,613,538	2-20 years
Vehicles	1,070,672	1,102,002	4 years
	204,080,291	195,709,097	
Less accumulated depreciation	(131,047,841)	(123,052,155)	
Construction in progress	8,665,003	4,957,546	
	$ 81,697,453	$ 77,614,488	

Construction in progress as of June 30, 2016 primarily relates to inpatient room renovation and various facility improvement projects. The estimated cost to complete these projects as of June 30, 2016 is approximately $18,000,000 of which $17,100,000 has been contractually committed.

The Hospital capitalizes interest cost as a component cost of significant construction and renovation projects. Interest cost capitalized was approximately $239,000 and $90,000 in 2016 and 2015, respectively. Investment income earned on unexpended bond proceeds administered by a trustee for specific projects is offset against the amount of interest cost capitalized. Such amounts were immaterial to the financial statements as a whole during 2016 and 2015, respectively.

10. INVESTMENT IN JOINT VENTURES

In 2003, the Hospital invested $3,000,000 to purchase 50% ownership in a joint venture to operate a cancer care center (Progressive Cancer Center, LLC) in Marion, Indiana. Since 2003, the number of outstanding shares in Progressive Cancer Center, LLC decreased thereby increasing the Hospital's ownership to approximately 51% as of June 30, 2016. The Hospital accounts for the investment under the equity method of accounting, as the governance structure is such that the Hospital cannot exercise control. The Hospital recognized a gain of approximately $308,000 and $160,000 related to its investment in Progressive Cancer Center, LLC for 2016 and 2015, respectively. The Hospital received dividend distributions during 2016 and 2015 of approximately $367,000 and $301,000 respectively. The gain is included in investment income, net in the statements of operations and changes in net assets.

The following is the unaudited condensed financial information of Progressive Cancer Care, LLC as of and for the years ended June 30, 2016 and 2015:

	2016	2015
Total assets	$ 4,476,014	$ 4,376,954
Total liabilities	$ 1,189,406	$ 976,573
Total equity	$ 3,286,608	$ 3,400,381
Total revenue	$ 2,603,006	$ 1,612,512
Net income	$ 602,880	$ 313,349

11. LONG-TERM DEBT

Long-term debt consists of the following as of June 30, 2016 and 2015:

	2016	2015
Indiana Finance Authority		
Hospital revenue bonds, Series 2015A		
Variable rate securities, payable through June 2040 variable rate interest of 1.06% at June 30, 2016	$ 33,000,000	$ -0-
Hospital revenue bonds, Series 2012A		
Serial bonds payable through July 1, 2029, interest from 2.000% to 4.125%	17,390,000	18,000,000
Term bonds with final redemption on July 1, 2032, interest at 4.375%	8,820,000	8,820,000
Term bonds with final redemption on July 1, 2036, interest at 5.000%	7,900,000	7,900,000
Variable rate demand revenue bonds, Series 2008A		
Variable rate securities, refunded in 2016	-0-	18,335,000
	67,110,000	53,055,000
Unamortized bond premium	253,137	273,070
Less current portion	(1,920,000)	(1,630,000)
	$ 65,443,137	$ 51,698,070

In July 2015, the Hospital issued $33,000,000 of Series 2015A revenue bonds through the Indiana Finance Authority (the Authority). The proceeds were used to refund the Series 2008A revenue bonds, ($17,315,000 outstanding at time of refunding) in addition to making upgrades and renovations to the Hospital's main facility, and are due in varying principal amounts through 2040.

The Hospital, the Authority, and BMO Harris Bank (BMO) then entered into a Bond Purchase Agreement (the Agreement) where BMO purchased from the Authority all of the Series 2015A Bonds in a private placement. The Agreement provided that BMO would hold the Series 2015A Bonds until the initial purchase date which runs through July 2025. Until the initial purchase date, the Series 2015A Bonds would bear interest at the Libor Index rate (.738% plus 68% of 1M BBA LIBOR), reset monthly, with principal and interest payments determined using a 25-year amortization schedule.

At the end of the initial purchase date, the Series 2015A bonds may be converted to another interest rate mode, remarketed to another bondholder or holders or renewed for another term period with BMO. The Series 2015A Bonds could be converted to another interest rate mode to accommodate market conditions at that time. If the Series 2015A Bonds could not be remarketed at initial purchase date, the Hospital would be subject to payment of the remaining principal of approximately $19,780,000.

In April 2012, the Hospital issued $35,910,000 of revenue bonds, Series 2012A, through the Indiana Finance Authority, at a premium of approximately $339,000 to finance inpatient room renovations, purchase equipment, and to refinance and retire the Series 2002 bonds. All of the Series 2012A bonds are dated and bear interest from April 26, 2012, with interest payable semiannually on January 1 and July 1.

In June 2008, the Hospital issued $24,000,000 of variable rate demand revenue bonds, Series 2008A, through the Indiana Finance Authority. The funds were used to refinance and retire the outstanding Series 2005 Bonds in the amount of $6,750,000, and to finance routine capital expenditures at the Hospital facilities, including but not limited to remodeling of the radiology department in the Hospital, upgrading the current CT scanners, MRIs, ultrasounds, and other radiology equipment, upgrading and improvement of other equipment in the Hospital, and replacement of IV pumps throughout the Hospital. The bonds are dated and bear interest from June 10, 2008, with interest payable monthly. The Series 2008A bonds were secured by an irrevocable letter of credit which expired September 9, 2016. As noted above, the Series 2008A bonds were refunded with proceeds from the 2015A issuance.

The Hospital granted a security interest in its gross revenue (as defined) as collateral for the Series 2015A, 2012A and 2008A bonds. In addition to various financial covenants, the Hospital covenants that it will not permit any lien or security interest on the Hospital's property and equipment other than certain permitted encumbrances. The Hospital believes it was in compliance with the financial covenants as of June 30, 2016.

Below is the debt maturity schedule for the Hospital’s long-term debt.

Year Ending June 30,	
2017	$ 1,920,000
2018	1,975,000
2019	2,040,000
2020	2,110,000
2021	2,175,000
Thereafter	56,890,000
	$ 67,110,000

The refunding of the Series 2008A revenue bonds resulted in a loss of approximately $221,000 for 2016 which is included in investment income and other, net on the statements of operations and changes in net assets.

12. PENSION PLANS

Defined Benefit Plan

The Hospital has a noncontributory defined benefit pension plan (Pension Plan) covering substantially all employees of the Hospital hired before July 1, 2005. The funding policy is to contribute annually at least the minimum contribution required to comply with ERISA regulations.

Effective July 1, 2009, the Pension Plan was amended to comply with the Pension Protection Act of 2006 (PPA) and the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART).

Effective December 31, 2009, the Pension Plan was amended to calculate frozen benefits accrued under all prior benefit formulas as of December 31, 2009 (based on monthly plan compensation and service prior to December 31, 2009) and to add a new benefit formula for service after December 31, 2009 equal to 0.5% of monthly plan compensation per year of service earned after December 31, 2009.

Effective December 31, 2010, the Hospital and the Board of Directors froze the Pension Plan. Furthermore, the Pension Plan was amended to cease all further benefit accruals under the Plan for participants with 5 or more years of vesting service as of December 31, 2006. (Accruals for participants with less than 5 years of vesting service as of December 31, 2006 were frozen as of December 31, 2006.)

The following tables set forth the Pension Plan change in benefit obligation, change in plan assets, and weighted average assumptions as of June 30, 2016 and 2015 (Measurement Date):

	2016	2015
Change in benefit obligation		
Benefit obligation, beginning of year	$ 98,367,418	$ 92,491,863
Interest cost	3,983,022	3,610,118
Actuarial loss	7,493,628	8,219,549
Benefit payments	(4,318,891)	(5,954,112)
Projected benefit obligation, end of year	105,525,177	98,367,418
Changes in plan assets		
Fair value of plan assets, beginning of year	70,854,661	75,949,399
Actual return on plan assets	7,941,246	859,374
Employer contributions	3,769,920	-0-
Benefit payments	(4,318,891)	(5,954,112)
Fair value of plan assets, end of year	78,246,936	70,854,661
Unfunded status		
Unfunded status of the plan, end of year	$ (27,278,241)	$ (27,512,757)
Amounts recorded in the balance sheet consist of		
Pension liability	$ (27,278,241)	$ (27,512,757)

The Hospital recognizes the cost related to employee service using the projected unit credit actuarial cost method and funds at least the minimum as calculated under ERISA.

The discount rate was selected by applying the benefit payout stream to the Citigroup Pension Discount curve spot rates.

The Hospital's overall expected long-term rate of return on assets is 5.60% for determining net periodic pension cost and 5.20% for determining benefit obligation cost for fiscal year 2016. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The following table sets forth the components of net periodic benefit cost for the 2016 and 2015 for the Pension Plan:

	2016	2015
Amounts not yet reflected in net periodic benefit cost and included in other changes in unrestricted net assets		
Actuarial loss	$ 36,550,982	$ 36,978,250
Components of net periodic benefit cost		
Interest cost	3,983,022	3,610,118
Expected return on plan assets	(3,833,966)	(4,238,353)
Amortization of loss	3,813,616	2,422,366
Net periodic benefit cost	$ 3,962,672	$ 1,794,131
Weighted-average actuarial assumptions to determine net periodic pension cost of June 30		
Discount rate	4.15%	4.00%
Expected long-term rate of return on assets	5.60%	5.75%
Weighted-average actuarial assumptions to determine benefit obligation cost of June 30		
Discount rate	3.26%	4.15%
Expected long-term rate of return on assets	5.20%	5.60%

The Pension Plan asset target allocation for 2016, as well as the allocation as of June 30, 2016 and 2015, by asset category are as follows:

Asset category	Target Allocation 2017	Percentage of Plan assets June 30, 2016	June 30, 2015
Debt securities and cash equivalents	100%	100%	100%

See the Fair Value Measurement of Financial Instruments Note for the valuation methodologies for mutual funds related to the Pension Plan. The valuation methodology for fixed income securities is based on pricing models maximizing the use of observable inputs for similar securities. The following is a breakdown of assets held by the Plan as of June 30, 2016 and 2015:

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
Mutual funds				
Bonds	$ 1,640,868	$ 1,640,868	$ -0-	$ -0-
Foreign	4,974,218	4,974,218	-0-	-0-
Total mutual funds	6,615,086	6,615,086	-0-	-0-
Fixed income obligations				
Government obligations	13,518,801	-0-	13,518,801	-0-
Municipal obligations	2,449,550	-0-	2,449,550	-0-
Corporate obligations	51,929,407	-0-	51,929,407	-0-
Total fixed income obligations	67,897,758	-0-	67,897,758	-0-
	74,512,844	$ 6,615,086	$ 67,897,758	$ -0-
Cash	3,734,092			
	$ 78,246,936			

	June 30, 2015			
	Total	Level 1	Level 2	Level 3
Mutual funds				
Bonds	$ 4,874,422	$ 4,874,422	$ -0-	$ -0-
Foreign	3,413,405	3,413,405	-0-	-0-
Total mutual funds	8,287,827	8,287,827	-0-	-0-
Fixed income obligations				
Government obligations	13,385,145	-0-	13,385,145	-0-
Municipal obligations	2,712,994	-0-	2,712,994	-0-
Corporate obligations	36,466,857	-0-	36,466,857	-0-
Foreign obligations	6,892,739	-0-	6,892,739	-0-
Total fixed income obligations	59,457,735	-0-	59,457,735	-0-
	67,745,562	$ 8,287,827	$ 59,457,735	$ -0-
Cash	3,109,099			
	$ 70,854,661			

The investment policy covering pension assets is approved by the Finance Committee of the Board of Directors for the Hospital. This Committee meets on a bimonthly basis and makes periodic changes to the policy. The approved investment structure reflects a movement to a "liability driven" investment strategy due to the freeze of the Pension Plan. Investment managers are reviewed on an ongoing basis.

The Hospital expects to contribute approximately $2,000,000 to the Pension Plan in 2017.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the Pension Plan:

Year Ending June 30,	
2017	$ 4,549,000
2018	4,818,000
2019	5,055,000
2020	5,283,000
2021	5,514,000
2022-2026	29,333,000
	$ 54,552,000

Defined Contribution Plan

The Hospital established a 403(b) Employer Contributory Plan (the Plan) on January 1, 2007, which permits employees of the Hospital to contribute to the Plan, on a pretax basis, up to the applicable limitations under Section 402(g)(l) of the Code. The contributions made by each employee are fully vested immediately and are not subject to forfeiture. The Hospital matches contributions of 50% of the employee's contribution up to 6% of qualifying wages for all benefit eligible employees. Additionally, the Hospital can elect to make discretionary contributions to the Plan. Contributions made by the Hospital for 2016 and 2015 approximated $1,028,000 and $994,000, respectively. Employees are fully vested immediately on the employer match and discretionary contributions.

13. MEDICAL OFFICE BUILDINGS - OPERATING LEASES

The Hospital owns medical office buildings in Marion, Gas City, Fairmount, and Swayzee, Indiana, and leases the buildings to physicians, physician groups, and others under various operating leases which expire through 2020. Lease rental income of approximately $339,000 and $402,000 is included in other revenue in the statements of operations and changes in net assets for 2016 and 2015, respectively.

The Hospital is scheduled to receive future minimum rental payments under these lease agreements as follows:

Year Ending June 30,		
2017	$	198,000
2018		139,000
2019		55,000
2020		2,000
	$	394,000

14. LEASE OBLIGATIONS

The Hospital leases space under noncancelable operating leases expiring in various years through 2025. Total rental expense under noncancelable leases amounted to approximately $1,100,000 and $1,300,000 for 2016 and 2015, respectively. Future minimum payments under the operating leases with initial terms in excess of one year are as follows:

Year Ending June 30,		
2017	$	1,300,000
2018		1,132,000
2019		1,032,000
2020		754,000
2021		486,000
Thereafter		1,369,000
	$	6,073,000

15. MALPRACTICE INSURANCE

The Hospital participates in the Indiana Medical Malpractice Act (the Act), which limits the maximum recovery for medical malpractice claims to $1,250,000 per occurrence, of which, the first $250,000 is the responsibility of the Hospital, with the balance paid by the State of Indiana Patient Compensation Fund.

The Hospital is a member of a Vermont insurance company, Indiana Healthcare Reciprocal Risk Retention Group (IHRRRG) formerly known as VHA Central (a Reciprocal Risk Retention Group), as a means to comply with the Hospital's required portion of the insurance coverage pursuant to the Act, as well as its liability insurance. Membership in IHRRRG includes eight Indiana hospitals as of June 30, 2016. The Hospital's investment in IHRRRG of approximately $1,126,000 and $969,000 is included in other assets as of June 30, 2016 and 2015, respectively. The Hospital recognized a gain of approximately $157,000 in 2016 and a loss of approximately $11,000 in 2015 related to IHRRRG. The gain and loss are included in investment income and other, net on the statements of operations and changes in net assets.

The Hospital has estimated the reserve for loss contingencies using actuarial valuations in determining the estimated reserve for loss contingencies, including the incurred but not reported claims. Management of the Hospital has estimated a reserve for loss contingencies of approximately $522,000 and $418,000, respectively, as of June 30, 2016 and 2015 to cover malpractice exposures.

16. COMMITMENTS AND CONTINGENCIES

Regulatory Investigations

The U.S. Department of Justice, the Internal Revenue Service, and other federal agencies routinely conduct regulatory investigations and compliance audits of healthcare providers. The Hospital is subject to these regulatory efforts. Management believes that any liability resulting from these matters will not have a material impact on the financial position, results of operations or cash flows of the Hospital.

Legal Matters

The Hospital is involved in various legal actions in the normal course of its operations. Management believes that any liability resulting from these matters will not have a material impact on the financial position, results of operations or cash flows of the Hospital.

Self-Insured Health Plan

The Hospital has a self-insurance plan for its employees' health care benefits. A third party claims administrator has been retained to process all benefit claims. The Plan purchased individual excess risk insurance to cover individual health claims in excess of $200,000. The Plan does not have an aggregate stop loss. Total expense was approximately $7,783,000 for 2016 and $7,629,000 for 2015.

17. FUNCTIONAL EXPENSES

The Hospital provides inpatient, outpatient and other ancillary services to the residents within its geographical region. Expenses related to directly providing these services were approximately 93% of total expenses for 2016 and 2015, respectively.

Certain costs have been allocated among health care services and administrative and general 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.