MARION GENERAL HOSPITAL

# FINANCIAL STATEMENTS

# JUNE 30, 2017 AND 2016

CPAs / ADVISORS

blue

# MARION GENERAL HOSPITAL, INC.

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**REPORT OF INDEPENDENT AUDITORS**

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

We have audited the accompanying financial statements of Marion General Hospital, Inc. (the Hospital), which comprise the balance sheets as of June 30, 2017 and 2016, 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, 2017 and 2016, 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 financial statements, the Hospital adopted new accounting guidance, Accounting Standards Update (ASU) 2015-03, *Interest – Imputation of Interest*, which simplifies the presentation of debt issue costs. The Hospital also adopted 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*, which 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 financial statements are issued. Our opinion is not modified with respect to these matters.

Blue & Co., LLC

Indianapolis, Indiana
October 12, 2017

**MARION GENERAL HOSPITAL, INC.**

BALANCE SHEETS
JUNE 30, 2017 AND 2016

**ASSETS**

| | 2017 | 2016 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | $ 27,869,542 | $ 26,259,446 |
| Current portion of assets limited as to use | 2,720,934 | 3,900,911 |
| Account receivable | | |
| Patient services, less allowances for uncollectible accounts of $8,707,000 in 2017 and $5,748,000 in 2016 | 22,892,331 | 19,242,378 |
| Physician services, less allowances for uncollectible accounts of $81,000 in 2017 and $61,000 in 2016 | 1,894,767 | 1,336,411 |
| Other | 361,113 | 355,017 |
| Accrued interest | 4,728 | 5,855 |
| Inventories | 1,412,517 | 1,505,584 |
| Current portion of notes receivable | 999,830 | 790,025 |
| Prepaid expenses | 2,848,967 | 2,194,280 |
| Total current assets | 61,004,729 | 55,589,907 |
| **Assets limited as to use** | | |
| Board designated funds | 213,124,445 | 191,082,001 |
| Trustee held | 8,783,204 | 19,102,928 |
| Donor restricted | 10,155 | 10,155 |
| Total assets limited as to use, net | 221,917,804 | 210,195,084 |
| Less current portion | 2,720,934 | 3,900,911 |
| Total assets limited as to use, net | 219,196,870 | 206,294,173 |
| **Property and equipment, net** | 86,061,544 | 81,697,453 |
| **Other assets** | | |
| Investment in joint ventures | 1,518,266 | 1,681,133 |
| Notes receivable, net | 2,649,735 | 2,955,988 |
| Goodwill and other intangible assets, net | 2,018,953 | 2,069,810 |
| Other | 1,615,361 | 1,492,321 |
| Total other assets | 7,802,315 | 8,199,252 |
| Total assets | $ 374,065,458 | $ 351,780,785 |

See accompanying notes to financial statements.

# MARION GENERAL HOSPITAL, INC.

BALANCE SHEETS
JUNE 30, 2017 AND 2016

## LIABILITIES AND NET ASSETS

| | 2017 | 2016 |
|---|---|---|
| **Current liabilities** | | |
| Accounts payable | $ 7,739,862 | $ 4,676,289 |
| Accrued liabilities | | |
| Salaries and related liabilities | 7,246,237 | 8,618,051 |
| Interest | 772,507 | 769,541 |
| Other | 375,208 | 356,857 |
| Estimated third-party settlements | 4,114,062 | 1,929,093 |
| Current portion of long-term debt | 1,975,000 | 1,920,000 |
| Total current liabilities | 22,222,876 | 18,269,831 |
| **Long-term liabilities** | | |
| Long-term debt, less current portion | 62,785,307 | 64,725,467 |
| Pension liability | 21,786,284 | 27,278,241 |
| Other long-term liabilities | 1,263,299 | 1,308,518 |
| Total long-term liabilities | 85,834,890 | 93,312,226 |
| Total liabilities | 108,057,766 | 111,582,057 |
| **Net assets** | | |
| Unrestricted | 265,997,537 | 240,188,573 |
| Permanently restricted | 10,155 | 10,155 |
| Total net assets | 266,007,692 | 240,198,728 |
| Total liabilities and net assets | $ 374,065,458 | $ 351,780,785 |

See accompanying notes to financial statements.

# MARION GENERAL HOSPITAL, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2017 AND 2016

| | 2017 | 2016 |
|---|---|---|
| **Unrestricted revenue and support** | | |
| Net patient service revenue | $ 188,898,443 | $ 178,322,191 |
| Less provision for bad debts | 13,704,379 | 14,818,369 |
| Net patient service revenue net of provision for bad debts | 175,194,064 | 163,503,822 |
| Other revenue | 1,958,769 | 3,047,600 |
| Total unrestricted revenue and support | 177,152,833 | 166,551,422 |
| **Expenses** | | |
| Salaries and wages | 47,621,874 | 45,875,165 |
| Employee benefits | 18,265,162 | 18,038,008 |
| Physician services | 22,237,912 | 19,584,689 |
| Professional services | 9,540,858 | 10,526,483 |
| Medical supplies | 11,896,860 | 11,189,580 |
| Drugs and IV solutions | 9,630,397 | 8,490,554 |
| Food | 164,405 | 25,185 |
| Purchased services | 16,167,560 | 16,141,023 |
| Rent | 1,694,347 | 1,419,653 |
| Plant and equipment maintenance | 5,233,220 | 4,934,853 |
| Utilities | 2,287,176 | 2,123,223 |
| Nonmedical supplies | 2,205,787 | 2,311,980 |
| Leased property | 1,477,618 | 1,412,164 |
| Other | 2,378,522 | 2,296,917 |
| Insurance | 1,590,456 | 1,443,410 |
| Hospital Assessment Fee Program | 6,193,977 | 5,053,859 |
| Interest | 1,502,562 | 1,350,808 |
| Depreciation | 11,464,977 | 11,060,111 |
| Total expenses | 171,553,670 | 163,277,665 |
| Income from operations | 5,599,163 | 3,273,757 |
| **Nonoperating gain** | | |
| Investment income and other, net | 6,565,451 | 5,522,129 |
| Excess of revenue, support and gains over expenses | 12,164,614 | 8,795,886 |
| **Other changes in unrestricted net assets** | | |
| Net unrealized gain (loss) on investments | 6,937,275 | (3,971,817) |
| Pension related changes other than net periodic pension cost | 6,707,075 | 427,268 |
| Change in net assets | 25,808,964 | 5,251,337 |
| **Net assets** | | |
| Beginning of year | 240,198,728 | 234,947,391 |
| End of year | $ 266,007,692 | $ 240,198,728 |

See accompanying notes to financial statements.

# MARION GENERAL HOSPITAL, INC.

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2017 AND 2016

| | 2017 | 2016 |
|---|---|---|
| **Operating activities** | | |
| Change in net assets | $ 25,808,964 | $ 5,251,337 |
| Adjustments to reconcile change in net assets to net cash from operating activities: | | |
| Depreciation | 11,464,977 | 11,060,111 |
| Amortization of debt issuance costs and premium | 34,840 | 259,692 |
| Amortization of notes receivable | 1,036,998 | 1,329,461 |
| Provision for bad debts - net patient service revenue | 13,704,379 | 14,818,369 |
| Provision for bad debts - other | 74,576 | 343,375 |
| Loss on disposal of property and equipment | 692,659 | 363,138 |
| Change in unrealized (gain) loss on investments | (6,937,275) | 3,971,817 |
| Realized (gain) loss on sale of investments | (183,956) | 212,766 |
| Gain on equity in joint ventures | (332,918) | (464,968) |
| Loss on refunding of long-term debt | -0- | 220,696 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (17,912,688) | (16,767,724) |
| Accrued interest, inventories, prepaid expenses, and other current assets | (566,589) | 6,657,821 |
| Other long-term assets | (14,580) | 31,336 |
| Pension liability | (5,491,957) | (234,516) |
| Accounts payable and accrued liabilities | (1,006,526) | (3,205,399) |
| Estimated third-party settlements | 2,184,969 | 1,457,794 |
| Net cash flows from operating activities | 22,555,873 | 25,305,106 |
| **Investing activities** | | |
| Additions to property and equipment | (13,796,490) | (14,152,088) |
| Proceeds from the sale or maturity of investments | 71,269,820 | 76,291,987 |
| Purchases of investments | (75,814,938) | (102,553,104) |
| Dividends received from joint ventures | 330,954 | 366,570 |
| Advances on notes receivable | (1,616,649) | (1,614,490) |
| Payments received on notes receivable | 601,526 | 35,467 |
| Net cash flows from investing activities | (19,025,777) | (41,625,658) |
| **Financing activities** | | |
| Payments for debt issuance costs | -0- | (333,500) |
| Proceeds from issuance of long-term debt | -0- | 33,000,000 |
| Repayments of long-term debt | (1,920,000) | (18,945,000) |
| Net cash flows from financing activities | (1,920,000) | 13,721,500 |
| Net change in cash and cash equivalents | 1,610,096 | (2,599,052) |
| **Cash and cash equivalents** | | |
| Beginning of year | 26,259,446 | 28,858,498 |
| End of year | $ 27,869,542 | $ 26,259,446 |
| **Supplemental cash flows information** | | |
| Interest paid, net of amounts capitalized of approximately $127,000 and $239,000 in 2017 and 2016, respectively | $ 1,499,596 | $ 1,329,047 |
| Property and equipment included in accounts payable | $ 2,674,383 | $ 1,287,520 |

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 Grant County and surrounding areas. The Hospital operates an acute care general hospital with 99 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 2017, the Hospital's allowance for uncollectible accounts for patient and physician services increased approximately $2,978,000 from $5,809,000 to $8,787,000. The uncollectible allowance for self-pay balances increased approximately $1,021,000 during 2017. The uncollectible estimate was 96% and 95% of self-pay balances as of June 30, 2017 and 2016.

The uncollectible allowance for self-pay balances after third-party insurance increased approximately $1,958,000 during 2017. The uncollectible estimate for self-pay balances after third-party insurance was 59% and 53% as of June 30, 2017 and 2016. The change is the result of changes in historical collections on self-pay after third-party insurance balances combined with an increase in the aging of self-pay after third-party insurance balances from 2016 to 2017.

In addition, the Hospital's uncollectible write-offs decreased by approximately $2,934,000 to $10,726,000 in 2017 from $13,660,000 in 2016. 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 2017.

As of June 30, 2017, the allowance for uncollectible accounts of approximately $8,787,000 was comprised of approximately $3,082,000 reserved for self-pay balances and approximately $5,705,000 reserved for self-pay after third-party payor balances. As of June 30, 2016, the allowance for uncollectible accounts of approximately $5,809,000 was comprised of $2,061,000 reserved for self-pay balances and $3,748,000 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 2017.

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 private equity funds (fund of funds) is based on the fair value of the underlying marketable securities determined by the individual manager of the private equity fund. 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. Private equity funds totaled approximately $5,009,000 (2.4% of board-designated funds) and $8,498,000 (4.4% of board-designated funds) as of June 30, 2017 and 2016, 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 2017 and 2016, 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, 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 Debt Issuance Costs and Original Issue Discounts

The costs incurred and capitalized in issuing Hospital Revenue Bonds are classified with long-term debt and 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 debt 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 in amounts ranging from approximately $500 to $97,000 due through November 2038. The allowance for uncollectible notes receivable is not significant to the financial statements as a whole. 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 $2,266,000 and $2,308,000, respectively, as of June 30, 2017 and 2016 with accumulated amortization of approximately $247,000 and $238,000, 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 2017 and 2016, as the Hospital does not believe that there are any factors or circumstances indicating impairment as of June 30, 2017 and 2016.

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 are not significant to the financial statements for 2017 and 2016 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 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 2017 and 2016, measured at established rates, was approximately $11,660,000 and $8,271,000, respectively. The increase in financial assistance between years primarily relates to the Hospital changing its financial assistance policy during 2016. Medicaid expansion, 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 2017 and 2016, an estimated $4,461,000 and $3,254,000, respectively, arose from providing services to charity patients. 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. Uninsured self-pay discounts provided to patients were approximately $4,909,000 and $7,547,000 in 2017 and 2016, respectively. This policy did not change during 2017 or 2016.

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, 2017 and 2016, 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, 2016. 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 2017 and 2016, the Hospital recognized approximately $313,000 and $1,395,000, 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.

Going Concern Evaluation

Management evaluates 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 financial statements are issued.

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 12, 2017.

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.

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 June 30, 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 net income, rather than in other comprehensive income as currently required.

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 PRINCIPLES

During 2017, the Hospital adopted ASU No. 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. Previously, debt issue costs were aggregated and presented as a deferred charge within the other assets section of the balance sheet. Debt issue costs will continue to be amortized over the term of the related debt, but are now are presented as a component of interest expense in the statement of operations and changes in net assets.

The 2016 financial statements have been retroactively restated to adopt this ASU as detailed in the following table.

| | As previously reported | Effects of implementation | Restated |
|---|---|---|---|
| Balance Sheet | | | |
| Unamortized debt issuance costs | $ 717,670 | $ (717,670) | $ -0- |
| Long-term debt, less current portion | $ 65,443,137 | $ (717,670) | $ 64,725,467 |

The Hospital previously recorded the amortization of debt issuance costs within interest expense, so the adoption of this standard did not have any effect on the statements of operations and changes in net assets or cash flows for 2016.

The Hospital also adopted 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 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 financial statements.

## 3. NET PATIENT SERVICES ACCOUNTS RECEIVABLE

Net patient services accounts receivable consists of the following as of June 30, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Gross patient services accounts receivable | $ 64,134,739 | $ 53,524,601 |
| Allowance for estimated contractual adjustments | (32,535,748) | (28,534,362) |
| Allowance for uncollectible accounts | (8,706,660) | (5,747,861) |
| Net patient services accounts receivable | $ 22,892,331 | $ 19,242,378 |

## 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.

The Hospital participates in the State of Indiana's 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 2017 and 2016, the Hospital recognized HAF Program expense of approximately $6,194,000 and $5,054,000, respectively, which resulted in increased Medicaid reimbursement. The HAF Program expense is included in the 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 statements of operations and changes in net assets.

During 2017 and 2016, the net patient service revenue was increased by approximately $3,291,000 and $3,757,000, 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 2017 and 2016 follows:

| | 2017 | 2016 |
|---|---|---|
| Patient service revenue | | |
| Inpatient services | $ 115,425,081 | $ 111,909,149 |
| Outpatient services | 316,027,283 | 286,608,525 |
| Physician practice services | 28,666,232 | 24,803,461 |
| Financial assistance | (11,660,245) | (8,271,369) |
| | 448,458,351 | 415,049,766 |
| Less contractual allowances | (259,559,908) | (236,727,570) |
| Net patient service revenue | 188,898,443 | 178,322,196 |
| Less provision for bad debts | (13,704,379) | (14,818,374) |
| Net patient service revenue net of provision for bad debts | $ 175,194,064 | $ 163,503,822 |

## 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, 2017, Medicare and Medicaid reports have been audited and final settled with the fiscal intermediary through June 30, 2015.

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 2017 and 2016, the differences between original estimates and subsequent revisions for the final settlement of cost reports were not significant 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 2017 and 2016 follows:

| | Receivables | | Revenue | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Medicare | 29% | 29% | 46% | 46% |
| Medicaid | 26% | 24% | 21% | 22% |
| Blue Cross | 9% | 10% | 17% | 17% |
| Commercial | 13% | 12% | 12% | 10% |
| Self-pay, welfare, and contract | 23% | 25% | 4% | 5% |
| | 100% | 100% | 100% | 100% |

## 7. ASSETS LIMITED AS TO USE

Assets limited as to use include assets set aside by the Board of Directors for future capital improvements and other purposes and funds held by trustee subject to indenture agreements. 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.

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, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Cash and cash equivalents | $ 689,174 | $ 463,907 |
| Mutual funds | 207,426,063 | 182,120,282 |
| Private equity funds | 5,009,208 | 8,497,812 |
| | $ 213,124,445 | $ 191,082,001 |

The funds held by trustee subject to indentures (investments are comprised of cash and cash equivalents) consist of the following as of June 30, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Indiana Financing Authority | | |
| Hospital revenue bonds, Series 2012A, Project fund | $ -0- | $ 2,348,021 |
| Hospital revenue bonds, Series 2012A, Interest fund | 1,376,091 | 1,365,466 |
| Variable rate demand revenue bonds, Series 2008A, Project fund | -0- | 2 |
| Variable rate demand revenue bonds, Series 2015A, Project fund | 7,407,113 | 15,389,439 |
| | $ 8,783,204 | $ 19,102,928 |

Investment return is comprised of the following for 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Other nonoperating gains | | |
| Investment return | | |
| Interest and dividends | $ 6,048,577 | $ 5,490,623 |
| Net realized gain (loss) on sale of investments | 183,956 | (212,766) |
| Other gain (loss) | | |
| Gain on equity in joint ventures | 332,918 | 464,968 |
| Loss on refunding of long-term debt | -0- | (220,696) |
| | $ 6,565,451 | $ 5,522,129 |
| Unrealized gain (loss) on investments | $ 6,937,275 | $ (3,971,817) |

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, 2017 and 2016. The schedule further segregates the securities that have been in a gross unrealized position as of June 30, 2017 and 2016, 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 2018. 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, 2017 and 2016.

| | June 30, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | 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 | $ 62,018,454 | $ 1,606,675 | $ 11,735,482 | $ 2,545,947 | $ 73,753,936 | $ 4,152,622 |

| | 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 |

## 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, 2017 and 2016:

- *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.

- *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 private equity funds 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, 2017 and 2016:

| | June 30, 2017 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| **Assets** | | | | |
| Assets limited as to use | | | | |
| Mutual funds | | | | |
| Fixed income | $ 116,050,777 | $ 116,050,777 | $ -0- | $ -0- |
| Global bond | 13,959,950 | 13,959,950 | -0- | -0- |
| International | 33,154,753 | 33,154,753 | -0- | -0- |
| Large cap | 32,657,761 | 32,657,761 | -0- | -0- |
| Small cap | 6,223,901 | 6,223,901 | -0- | -0- |
| Managed futures mutual funds | 5,378,921 | 5,378,921 | -0- | -0- |
| Total mutual funds | 207,426,063 | $ 207,426,063 | $ -0- | $ -0- |
| Private equity funds (a) | 5,009,208 | | | |
| Cash | 9,482,533 | | | |
| | $ 221,917,804 | | | |

| | 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- |
| Private equity funds (a) | 8,497,812 | | | |
| Cash | 19,576,990 | | | |
| | $ 210,195,084 | | | |

(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 2017 and 2016.

Realized gains (losses) are reported in the statements of operations and changes in net assets as a component of investment income. Realized gains (losses) of approximately $184,000 and ($213,000) were recorded during 2017 and 2016, respectively.

The market value of investments exceeded the cost by approximately $14,037,000 and $7,100,000 as of June 30, 2017 and 2016, 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, 2017 and 2016 and are reported in the statements of operations and changes in net assets as net unrealized gain on investments. During 2017 and 2016, the Hospital recognized unrealized gains (losses) of approximately $6,937,000 and ($3,972,000), 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 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, 2017 and 2016, respectively.

June 30, 2017

| Investment | Fair Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---|---|---|---|---|
| Private equity funds | $ 5,009,000 | None | First day of January, April, July, & October | 70 days |

June 30, 2016

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

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.

## 9. PROPERTY AND EQUIPMENT

Property, equipment, and their estimated useful lives are as follows as of June 30, 2017 and 2016:

| | 2017 | 2016 | Range of estimated useful lives |
|---|---|---|---|
| Land | $ 4,646,548 | $ 4,646,548 | |
| Land improvements | 3,353,531 | 3,353,531 | 10-20 years |
| Buildings | 61,353,759 | 56,987,621 | 5-40 years |
| Medical office buildings | 18,110,312 | 17,797,103 | 5-40 years |
| Building service equipment | 42,904,801 | 39,122,657 | 5-25 years |
| Leasehold improvements | 3,287,382 | 2,473,673 | 15-20 years |
| Fixed equipment | 1,144,744 | 1,005,608 | 10-20 years |
| Leased equipment | -0- | 142,740 | 4 years |
| Major movable equipment | 68,548,863 | 77,480,138 | 2-20 years |
| Vehicles | 1,024,345 | 1,070,672 | 4 years |
| | 204,374,285 | 204,080,291 | |
| Less accumulated depreciation | (128,401,538) | (131,047,841) | |
| Construction in progress | 10,088,797 | 8,665,003 | |
| | $ 86,061,544 | $ 81,697,453 | |

Construction in progress as of June 30, 2017 primarily relates to inpatient room renovation and various facility improvement projects. The estimated cost to complete these projects as of June 30, 2017 is approximately $5,500,000 and all of that has been contractually committed.

The Hospital capitalizes interest cost as a component cost of significant construction and renovation projects. Interest cost capitalized was approximately $127,000 and $239,000 in 2017 and 2016, respectively. Investment income earned on unexpended debt proceeds administered by a trustee for specific projects is offset against the amount of interest cost capitalized. Such amounts were not significant to the financial statements as a whole during 2017 and 2016.

## 10. INVESTMENT IN JOINT VENTURES

The Hospital has an equity interest in a joint venture to operate a cancer care center (Progressive Cancer Center, LLC) in Marion, Indiana. As of June 30, 2017 and 2016, Hospital's ownership in Progressive Cancer Center, LLC is approximately 51%. 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 $168,000 and $308,000 related to its investment in Progressive Cancer Center, LLC for 2017 and 2016, respectively. The Hospital received dividend distributions during 2017 and 2016 of approximately $331,000 and $367,000 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, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Total assets | $ 3,908,090 | $ 4,476,015 |
| Total liabilities | $ 929,754 | $ 1,279,429 |
| Total equity | $ 2,978,336 | $ 3,196,586 |
| Total revenue | $ 1,949,572 | $ 2,219,225 |
| Net income | $ 328,858 | $ 602,880 |

## 11. LONG-TERM DEBT

Long-term debt consists of the following as of June 30, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Indiana Finance Authority | | |
| Hospital revenue bonds, Series 2015A | | |
| Variable rate securities, payable through June 2041, variable rate interest of 1.47% at June 30, 2017 | $ 31,705,000 | $ 33,000,000 |
| Hospital revenue bonds, Series 2012A | | |
| Serial bonds payable through July 1, 2029, interest from 2.000% to 5.000% | 16,765,000 | 17,390,000 |
| 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 |
| | 65,190,000 | 67,110,000 |
| Unamortized premium | 233,570 | 253,137 |
| Less current portion | (1,975,000) | (1,920,000) |
| Less unamortized debt issue costs | (663,263) | (717,670) |
| | $ 62,785,307 | $ 64,725,467 |

In July 2015, the Hospital issued $33,000,000 of Series 2015A Bonds through the Indiana Finance Authority (the Authority). The proceeds were used to refund the Series 2008A Bonds, in addition to making upgrades and renovations to the Hospital's main facility. The Series 2015A Bonds and are due in varying principal amounts ranging from $245,000 to $2,350,000 through June 2041.

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 provides that BMO will 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 Series 2012A Serial and Term Bonds, through the Authority, at a premium of approximately $339,000 to finance inpatient room renovations, purchase equipment, and to refinance and retire the Series 2002 Bonds. The 2012A Serial Bonds are due in annual principal payments ranging from $670,000 to $2,705,000 through July 2029. The 2012A Term Bonds are due in annual principal payments of ranging from $2,815,000 to $3,250,000 beginning in 2030 through July 2036.

The Hospital granted a security interest in its gross revenue (as defined) as collateral for the Series 2015A and 2012A 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, 2017 and 2016.

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

| Year Ending June 30, | |
|---|---|
| 2018 | $ 1,975,000 |
| 2019 | 2,040,000 |
| 2020 | 2,110,000 |
| 2021 | 2,175,000 |
| 2022 | 2,240,000 |
| Thereafter | 54,650,000 |
| | $ 65,190,000 |

## 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 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, 2017 and 2016 (Measurement Date):

| | 2017 | 2016 |
|---|---|---|
| Change in benefit obligation | | |
| Benefit obligation, beginning of year | $ 105,525,177 | $ 98,367,418 |
| Interest cost | 3,359,791 | 3,983,022 |
| Actuarial (gain)/loss | (6,887,793) | 7,493,628 |
| Benefit payments | (4,675,070) | (4,318,891) |
| Projected benefit obligation, end of year | 97,322,105 | 105,525,177 |
| Changes in plan assets | | |
| Fair value of plan assets, beginning of year | 78,246,936 | 70,854,661 |
| Actual return on plan assets | (36,045) | 7,941,246 |
| Employer contributions | 2,000,000 | 3,769,920 |
| Benefit payments | (4,675,070) | (4,318,891) |
| Fair value of plan assets, end of year | 75,535,821 | 78,246,936 |
| Unfunded status | | |
| Unfunded status of the plan, end of year | $ (21,786,284) | $ (27,278,241) |
| Amounts recorded in the balance sheet consist of | | |
| Pension liability | $ (21,786,284) | $ (27,278,241) |

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 5.20% for determining net periodic pension cost and 5.30% for determining benefit obligation cost for 2017. 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 2017 and 2016 for the Pension Plan:

| | 2017 | 2016 |
|---|---|---|
| Amounts not yet reflected in net periodic benefit cost and included in other changes in unrestricted net assets | | |
| Actuarial loss | $ 29,843,907 | $ 36,550,982 |
| Components of net periodic benefit cost | | |
| Interest cost | 3,359,791 | 3,983,022 |
| Expected return on plan assets | (4,010,041) | (3,833,966) |
| Amortization of loss | 3,865,368 | 3,813,616 |
| Net periodic benefit cost | $ 3,215,118 | $ 3,962,672 |
| Weighted-average actuarial assumptions to determine net periodic pension cost of June 30 | | |
| Discount rate | 3.26% | 4.15% |
| Expected long-term rate of return on assets | 5.20% | 5.60% |
| Weighted-average actuarial assumptions to determine benefit obligation cost of June 30 | | |
| Discount rate | 3.59% | 3.26% |
| Expected long-term rate of return on assets | 5.30% | 5.20% |

The Pension Plan asset target allocation for 2018, as well as the allocation as of June 30, 2017 and 2016, by asset category are as follows:

| | Target Allocation | Percentage of Plan assets | |
|---|---|---|---|
| Asset category | 2018 | June 30, 2017 | June 30, 2016 |
| 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, 2017 and 2016:

| | June 30, 2017 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Mutual funds | | | | |
| Bonds | $ 3,403,425 | $ 3,403,425 | $ -0- | $ -0- |
| Foreign | 3,256,414 | 3,256,414 | -0- | -0- |
| Total mutual funds | 6,659,839 | 6,659,839 | -0- | -0- |
| Fixed income obligations | | | | |
| Government obligations | 40,336,374 | -0- | 40,336,374 | -0- |
| Municipal obligations | 637,201 | -0- | 637,201 | -0- |
| Corporate obligations | 26,493,883 | -0- | 26,493,883 | -0- |
| Total fixed income obligations | 67,467,458 | -0- | 67,467,458 | -0- |
| | 74,127,297 | $ 6,659,839 | $ 67,467,458 | $ -0- |
| Cash | 1,408,524 | | | |
| | $ 75,535,821 | | | |

| | 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 | | | |

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 $1,000,000 to the Pension Plan in 2018.

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

| Year Ending June 30, | |
|---|---|
| 2018 | $ 4,773,000 |
| 2019 | 4,959,000 |
| 2020 | 5,170,000 |
| 2021 | 5,356,000 |
| 2022 | 5,527,000 |
| 2023-2027 | 28,799,000 |
| | $ 54,584,000 |

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 Internal Revenue 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 2017 and 2016 approximated $1,062,000 and $1,028,000, 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 2023. Lease rental income of approximately $336,000 and $339,000 is included in other revenue in the statements of operations and changes in net assets for 2017 and 2016, respectively.

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

| Year Ending June 30, | |
|---|---|
| 2018 | $ 246,000 |
| 2019 | 123,000 |
| 2020 | 28,000 |
| 2021 | 24,000 |
| 2022 | 25,000 |
| Thereafter | 13,000 |
| | $ 459,000 |

## 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 $1,054,000 and $1,100,000 for 2017 and 2016, respectively. Future minimum payments under the operating leases with initial terms in excess of one year are as follows:

| Year Ending June 30, | |
|---|---|
| 2018 | $ 1,588,000 |
| 2019 | 1,473,000 |
| 2020 | 1,233,000 |
| 2021 | 944,000 |
| 2022 | 818,000 |
| Thereafter | 1,012,000 |
| | $ 7,068,000 |

## 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, Tecumseh Health Reciprocal Risk Retention Group (THRRRG), 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 THRRRG includes 14 hospitals as of June 30, 2017. The Hospital's investment in THRRRG of approximately $1,291,000 and $1,126,000 is included in other assets as of June 30, 2017 and 2016, respectively. The Hospital recognized a gain of approximately $165,000 and $157,000 in 2017 and 2016 related to THRRRG, respectively. The gain is 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 $614,000 and $522,000, respectively, as of June 30, 2017 and 2016 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 $8,603,000 for 2017 and $7,783,000 for 2016.

## 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 2017 and 2016, 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.