



KDHD

King's Daughters' Health

**KING'S DAUGHTERS' HEALTH
AND AFFILIATED ORGANIZATION**

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019 AND 2018

CPAs / ADVISORS



**KING'S DAUGHTERS' HEALTH AND
AFFILIATED ORGANIZATION**

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REPORT OF INDEPENDENT AUDITORS

Board of Managers
King's Daughters' Health
and Affiliated Organization
Madison, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of King's Daughters' Health and its affiliated organization (the "Hospital")(a nonprofit organization), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

Board of Managers
King's Daughters' Health
and Affiliated Organization
Madison, Indiana

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2019 and 2018, and the results of its operations 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 3 to the consolidated financial statements, effective January 1, 2019, the Hospital adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-02, *Leases* and ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. Our opinion is not modified with respect to these matters.

Blue & Co., LLC

Louisville, Kentucky
May 18, 2020

**KING'S DAUGHTERS' HEALTH AND
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CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

ASSETS

	2019	2018
Current assets		
Cash and cash equivalents	\$ 14,654,873	\$ 19,833,770
Patient accounts receivable, net	9,960,805	9,340,720
Inventories	2,442,862	2,507,284
Prepaid expenses and other current assets	4,107,383	3,736,223
Other assets - current portion	271,274	267,413
Total current assets	31,437,197	35,685,410
Assets whose use is limited	164,886,849	130,171,479
Property and equipment, net	95,921,827	101,960,857
Other assets, net of current portion	8,510,087	7,428,739
Total assets	\$ 300,755,960	\$ 275,246,485

LIABILITIES AND NET ASSETS

Current liabilities		
Accounts payable	\$ 2,642,407	\$ 2,553,551
Accrued personnel costs	6,946,042	6,928,655
Accrued expenses	1,891,435	1,930,403
Estimated third-party payor settlements	2,340,707	1,712,532
Current portion of obligations under finance leases	653,245	599,630
Current portion of long-term debt	1,730,000	1,645,000
Total current liabilities	16,203,836	15,369,771
Long-term liabilities		
Obligations under finance leases, net of current portion	553,616	1,147,338
Long-term debt, net of current portion	87,722,874	89,316,574
Life insurance policies	393,177	395,457
Deferred compensation liabilities	47,115	38,384
Total long-term liabilities	88,716,782	90,897,753
Total liabilities	104,920,618	106,267,524
Net assets		
Without donor restrictions	194,870,044	167,759,625
With donor restrictions	965,298	1,219,336
Total net assets	195,835,342	168,978,961
Total liabilities and net assets	\$ 300,755,960	\$ 275,246,485

See accompanying notes to consolidated financial statements.

**KING'S DAUGHTERS' HEALTH AND
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CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
Changes in net assets without donor restrictions		
Operating revenues		
Net patient service revenue	\$ 123,174,153	\$ 131,391,988
Other revenue	599,907	650,511
Net assets released from restrictions	392,407	429,186
Total operating revenues	124,166,467	132,471,685
Operating expenses		
Salaries and wages	50,800,940	52,013,296
Employee benefits and payroll taxes	13,233,498	13,352,457
Professional medical fees	2,092,158	1,385,555
Medical supplies	6,319,360	9,926,073
Other supplies	1,023,824	1,064,782
Drugs	11,622,336	10,391,221
Purchased services	13,747,460	12,448,562
Utilities	1,976,359	2,011,513
Insurance	1,531,212	1,609,189
Depreciation	8,898,588	8,694,756
Interest	5,270,407	5,345,831
Hospital assessment fee	3,937,701	3,391,276
Other operating expenses	3,996,651	4,204,795
Total operating expenses	124,450,494	125,839,306
Income (loss) from operations	(284,027)	6,632,379
Nonoperating gains (losses)	27,394,446	(8,159,280)
Excess revenues (expenses) and change in net assets without donor restrictions	27,110,419	(1,526,901)
Changes in net assets with donor restrictions		
Contributions	138,369	135,634
Net assets released from restrictions	(392,407)	(429,186)
Change in net assets with donor restrictions	(254,038)	(293,552)
Change in net assets	26,856,381	(1,820,453)
Net assets, beginning of year	168,978,961	170,799,414
Net assets, end of year	\$ 195,835,342	\$ 168,978,961

See accompanying notes to consolidated financial statements.

**KING'S DAUGHTERS' HEALTH AND
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CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
Cash flows from operating activities		
Change in net assets	\$ 26,856,381	\$ (1,820,453)
Adjustments to reconcile total change in net assets to net cash from operating activities		
Depreciation	8,898,588	8,694,756
Amortization of bond issue costs included in interest expense	53,472	53,472
Amortization of bond discount	82,828	70,672
(Gain) loss on disposal of capital assets	7,053	(97,686)
Net realized gains and losses and unrealized gains and losses on assets whose use is limited	(23,707,786)	11,516,532
Changes in operating assets and liabilities		
Patient accounts receivable	(620,085)	1,029,680
Inventories	64,422	(10,188)
Prepaid expenses and other current assets	(371,160)	(824,995)
Accounts payable	(244,292)	500,145
Accrued personnel costs	17,387	491,426
Accrued expenses	(38,968)	(108,216)
Estimated third-party payor settlements	628,175	(51,165)
Deferred compensation liabilities	8,731	(2,351)
Net cash from operating activities	11,634,746	19,441,629
Cash flows from investing activities		
Purchases of property and equipment	(2,556,286)	(2,795,529)
Proceeds from sale of capital assets	107,738	197,289
Change in assets whose use is limited	(11,007,584)	(10,414,308)
Change in other assets	(1,085,209)	(811,317)
Change in life insurance policies	(2,280)	16,177
Net cash from investing activities	(14,543,621)	(13,807,688)
Cash flows from financing activities		
Principal payments on obligations under finance leases	(625,022)	(559,408)
Principal payments on long-term debt	(1,645,000)	(1,570,000)
Change in bond discount	-	-
Net change in cash and cash equivalents	(5,178,897)	3,504,533
Cash and cash equivalents, beginning of year	19,833,770	16,329,237
Cash and cash equivalents, end of year	\$ 14,654,873	\$ 19,833,770

See accompanying notes to consolidated financial statements.

**KING'S DAUGHTERS' HEALTH AND
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CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ 5,164,952	\$ 5,251,124
Property and equipment acquired under accounts payable	\$ 333,148	\$ 17,568
Property and equipment acquired under capital leases	\$ -0-	\$ 936,360
Right-of-use assets obtained	\$ 84,915	\$ -0-
Operating cash flows from finance leases	\$ 58,127	\$ -0-
Financing cash flows from finance leases	\$ 625,022	\$ -0-

See accompanying notes to consolidated financial statements.

**KING'S DAUGHTERS' HEALTH AND
AFFILIATED ORGANIZATION**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

1. NATURE OF OPERATIONS

King's Daughters' Health ("KDH") is a not-for-profit, acute care hospital owned by the Bethany Circle of King's Daughters' of Madison, Indiana, Inc., located in Madison, Indiana. KDH is organized for the purpose of providing healthcare services to the residents of Jefferson County, Indiana and the surrounding area. KDH's primary sources of support are from patient revenues. Patient revenues include funds received from Medicare, state agencies, insurance companies, and the patients themselves.

The King's Daughters' Hospital Foundation, Inc. (the "Foundation") is a not-for-profit organization created in 2005 and located in Madison, Indiana. The Foundation operates for the benefit of KDH. The Foundation's main sources of revenue are earnings on investments and contributions received.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by KDH and the Foundation (collectively the "Hospital") in the preparation of the consolidated financial statements are summarized below:

Reporting Entity and Consolidation Policy

The accompanying consolidated financial statements include the accounts of KDH and the Foundation. Intercompany transactions and balances have been eliminated in consolidation.

Basis of Accounting

The Hospital prepares its consolidated financial statements using the accrual basis of accounting. Accrual accounting requires the recognition of revenues when its performance obligations are satisfied, and the recognition of expenses in the period in which they occur.

Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis, and have been prepared with a focus on the entity as a whole. Net assets, revenue, support gains, and losses are classified based on the existence or absence of donor restrictions. Accordingly, the net assets of the Hospital are classified and reported as follows:

Net assets without donor restrictions: Net assets that are currently available for operating purposes under the direction of the board or designated by the board for specific use.

Net assets with donor restrictions: Net assets subject to donor stipulations for specific operating purposes or time restrictions. These include donor restrictions requiring the net assets be held in perpetuity or for a specified term with investment return available for operations or specific purposes.

KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2019 AND 2018

Management's Estimates

Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less excluding amounts included in assets whose use is limited.

Patient Accounts Receivable and Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which the Hospital expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others, and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Hospital bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Hospital receiving inpatient acute care services or patients receiving services in our outpatient centers or in their homes (home care). The Hospital measures the performance obligation from admission into the Hospital, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Hospital does not believe it is required to provide additional goods or services related to that sale.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Hospital has elected to apply the optional exemption provided in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to previously are primarily related to inpatient acute care

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2019 AND 2018

services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Hospital determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Hospital's policy, and implicit price concessions provided to uninsured patients. The Hospital determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Hospital determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or net realizable value, with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Hospital's Board of Managers for future capital improvements and other long-term uses, over which the Board retains control and may at its discretion subsequently use for other purposes; assets held by trustees under indenture agreements; donor restricted assets whose use by the Hospital has been limited by donors to a specific time period or purpose or whose use has been restricted by donors in perpetuity; and deferred compensation assets related to certain deferred compensation agreements.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the consolidated balance sheets. Investment income or loss, including unrealized gains and losses on trading securities, interest, and dividends is included in nonoperating gains of unrestricted net assets, unless the income is restricted by donor or law.

Property and Equipment

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

The property and equipment of the Hospital are being depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association's *Estimated Useful Lives of Depreciable Hospital Assets*.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Leases

The Hospital determines if an arrangement is a lease at inception. Operating leases, if any, are included in operating lease right-of-use ("ROU") assets and operating lease liabilities on the consolidated balance sheets. Finance leases are included in property and equipment and obligations under finance leases on the consolidated balance sheets.

ROU assets represent the Hospital's right to use an underlying asset for the lease term and lease liabilities represent the Hospital's obligation to make lease payment arising from the lease. Operating lease ROU assets and liabilities, if any, are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Hospital's leases do not provide an implicit rate, the Hospital uses an incremental borrowing rate based on the estimated rate of interest for collateralized borrowing at commencement date. The operating lease ROU asset, if any, also includes any lease payments made and excludes lease incentives. The lease terms may include options to extend or terminate the lease when it is reasonable certain that the Hospital will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term. Lease and non-lease components within any lease agreements the Hospital has are accounted for separately.

Cost of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets, if any, are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2019 and 2018, interest costs incurred were as follows:

	<u>2019</u>	<u>2018</u>
Interest costs capitalized	\$ -0-	\$ -0-
Interest costs expensed	<u>5,270,407</u>	<u>5,345,831</u>
Total interest costs incurred	<u>\$ 5,270,407</u>	<u>\$ 5,345,831</u>

Consolidated Statements of Operations and Changes in Net Assets

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenues and expenses and included within the line *income (loss) from operations* in the consolidated statements of operations and changes in net assets. Peripheral and incidental transactions are reported as nonoperating gains (losses). Nonoperating gains (losses) which are excluded from *income (loss) from operations* include contributions and donations, investment income or loss, and gain or loss on disposal of capital assets.

KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2019 AND 2018

Performance Indicator

The consolidated statements of operations and changes in net assets include *excess revenues (expenses)*. Consistent with industry practice, changes in net assets which are excluded from *excess revenues (expenses)* include, if any, unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, 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).

Advertising

The Hospital expenses advertising costs as incurred. Advertising expenses were \$180,417 and \$195,908 for the years ending December 31, 2019 and 2018, respectively.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are reported as deductions from revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give, if any, are reported at fair value at the date the gift is received. The gifts are reported as revenue with donor restrictions 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, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated 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 reported as contributions without donor restrictions in the accompanying consolidated financial statements.

Income Taxes

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

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and recognize a tax liability if the Hospital has taken an uncertain tax

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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 December 31, 2019 and 2018, there are no uncertain tax positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Hospital is subject to routine audits by taxing jurisdictions. However, as of the date the consolidated financial statements were issued, there were no audits for any tax periods in progress.

Going Concern Evaluations

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 consolidated financial statements are issued.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Hospital is insured for medical malpractice claims and judgments.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is May 18, 2020.

Reclassifications

Current reclassifications have been made to the 2018 consolidated financial statements to correspond to the current year's format. Total net position and change in net position are unchanged due to these reclassifications.

3. CHANGE IN ACCOUNTING PRINCIPLES

On January 1, 2019, the Hospital adopted the new lease accounting standard issued by the FASB and Accounting Standards Update ("ASU") No. 2016-02, *Leases* (Topic 842). The lease standard is intended to improve financial reporting about leasing transactions by requiring entities to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases, and to provide additional disclosures regarding the leases. Leases with terms (as defined in ASU No. 2016-02) of twelve months or less are not required to be reflected on an entity's balance sheet.

KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2019 AND 2018

The Hospital applied the modified retrospective approach to all operating and financing lease agreements when adopting the ASU. ASU No. 2016-02 was applied retrospectively to the beginning of the period of adoption through a cumulative-effective adjustment recognized as of January 1, 2019. Prior period amounts have not been adjusted and continue to be reported in accordance with the previous accounting guidance. In previous years, leases that are currently reported as obligations under finance leases were referred to as obligations under capital leases. The adoption of ASU No. 2016-02 did not have a material impact on the consolidated balance sheets, or on the consolidated statements of operations and changes in net assets. The accounting for finance leases remained substantially unchanged. The Hospital utilized the package of practical expedients allowing the Hospital to not reassess whether any expired or existing contracts contain a lease, the classification for any expired or existing leases, or the initial direct costs for any existing leases. The Hospital has also elected to apply an exemption for short-term leases whereby leases with initial lease terms of one year or less are not recorded on the consolidated balance sheets.

On January 1, 2019, the Hospital also adopted adopted FASB ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this ASU clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. The amendments clarify how an entity determines whether a resource provider is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred. Additionally, the amendments in this ASU require that an entity determine whether a contribution is conditional on the basis of whether an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. Finally, ASU 2018-08 amends the "simultaneous release accounting policy" to allow a not-for-profit entity to recognize a restricted contribution directly in net assets without donor restrictions if the restriction is met in the same period that revenue is recognized. The adoption of ASU No. 2018-08 did not have a material effect on the accompanying consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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4. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited are reported at market value and include the following at December 31, 2019 and 2018:

	2019	2018
Cash and cash equivalents	\$ 1,264,948	\$ 2,549,861
Certificates of deposit	604,851	510,624
Money market mutual funds	12,503,400	8,526,796
Mutual funds	48,594,651	38,226,812
Exchange-traded funds	58,481,930	46,804,678
Common stocks	35,018,051	25,718,002
Corporate bonds	1,686,468	1,581,354
U.S. Government securities	6,732,550	6,253,352
	<u>\$ 164,886,849</u>	<u>\$ 130,171,479</u>
	2019	2018
Board-designated funds	\$ 157,128,628	\$ 122,260,188
Trustee-held under debt agreement	6,781,906	6,764,844
Donor-restricted funds	929,200	1,108,063
Deferred compensation fund	47,115	38,384
	<u>\$ 164,886,849</u>	<u>\$ 130,171,479</u>
	2019	2018
Dividends and interest income	\$ 4,104,332	\$ 3,420,355
Realized gains on investments	864,685	1,529,413
Change in net unrealized gains (losses) on investments	22,843,101	(13,045,945)
Investment fees	(615,524)	(577,438)
	<u>\$ 27,196,594</u>	<u>\$ (8,673,615)</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2019 AND 2018

Board-Designated Funds

The Hospital's Board of Managers approved the funding of depreciation expense to meet the capital asset replacement needs of the facility. Depreciation is funded totally with expenditures for capital assets reducing the funded depreciation balance. All income amounts earned by the Board-designated funds are left to accumulate as additions to the funds.

Trustee-Held Under Debt Agreement

The trustee-held funds are restricted for the payments of principal, interest, and construction costs related to certain long-term debt agreements.

Donor-Restricted Funds

Donor-restricted funds represent contributions that have been restricted by the donors for a specific purpose or in perpetuity.

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under separate deferred compensation plans. The Hospital simply maintains the funds for the participants until they are withdrawn according to the specific terms of each separate deferred compensation agreement. The Hospital records liabilities equal to the deferred compensation assets.

Fair Value Measurements and Disclosures

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.

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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 at December 31, 2019 and 2018.

- *Money market mutual funds*: Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV); however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.
- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Exchange-traded funds (ETFs)*: Valued at the closing price on the active exchange on which the individual securities are traded. Unlike mutual funds, ETFs trade like common stocks and are not required to publish and transact their daily net asset value. The ETFs held by the Hospital are deemed to be actively traded.
- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Corporate bonds*: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.
- *U.S. Government securities*: Valued using pricing models maximizing the use of observable inputs for similar securities.

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The following table sets forth by level, within the hierarchy, the Hospital's assets measured at fair value on a recurring basis as of December 31, 2019 are as follows:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ -0-	\$ 12,503,400	\$ -0-	\$ 12,503,400
Mutual funds				
Corporate bond	2,756	-0-	-0-	2,756
Emerging markets	5,934,315	-0-	-0-	5,934,315
Foreign large cap	6,482,733	-0-	-0-	6,482,733
High yield bond	1,611,720	-0-	-0-	1,611,720
Inflation-protected bond	2,991,988	-0-	-0-	2,991,988
Intermediate core bond	8,731	-0-	-0-	8,731
Intermediate core plus bond	10,502,182	-0-	-0-	10,502,182
International large cap	828	-0-	-0-	828
Large cap	8,651,499	-0-	-0-	8,651,499
Mid cap	2,568,416	-0-	-0-	2,568,416
Multisector bond	2,538,231	-0-	-0-	2,538,231
Short-term bond	19,035	-0-	-0-	19,035
Small cap	4,834,498	-0-	-0-	4,834,498
World allocation	770,213	-0-	-0-	770,213
World bond	1,675,618	-0-	-0-	1,675,618
World stock	1,888	-0-	-0-	1,888
Total mutual funds	48,594,651	-0-	-0-	48,594,651
Exchange-traded funds				
Commodities broad basket	1,042,837	-0-	-0-	1,042,837
Diversified emerging markets	6,027,114	-0-	-0-	6,027,114
Equity precious metals	1,351,120	-0-	-0-	1,351,120
Europe stock	696,696	-0-	-0-	696,696
Foreign large cap	2,990,458	-0-	-0-	2,990,458
Global real estate	959,677	-0-	-0-	959,677
Inflation-protected bond	736,606	-0-	-0-	736,606
Intermediate-term bond	8,282,799	-0-	-0-	8,282,799
Large cap	25,687,147	-0-	-0-	25,687,147
Mid cap	9,237,113	-0-	-0-	9,237,113
Real estate	1,470,363	-0-	-0-	1,470,363
Total exchange-traded funds	58,481,930	-0-	-0-	58,481,930

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Common stocks				
Basic materials	515,527	-0-	-0-	515,527
Communication services	845,190	-0-	-0-	845,190
Consumer cyclical	3,104,772	-0-	-0-	3,104,772
Consumer defensive	2,168,299	-0-	-0-	2,168,299
Energy	1,932,515	-0-	-0-	1,932,515
Financial services	6,537,067	-0-	-0-	6,537,067
Healthcare	4,683,576	-0-	-0-	4,683,576
Industrials	4,283,781	-0-	-0-	4,283,781
Real estate	1,232,197	-0-	-0-	1,232,197
Technology	8,224,845	-0-	-0-	8,224,845
Utilities	1,490,282	-0-	-0-	1,490,282
Total common stocks	<u>35,018,051</u>	<u>-0-</u>	<u>-0-</u>	<u>35,018,051</u>
Corporate bonds	-0-	1,686,468	-0-	1,686,468
U.S. government securities	-0-	6,732,550	-0-	6,732,550
Total assets at fair value	<u>\$ 142,094,632</u>	<u>\$ 20,922,418</u>	<u>\$ -0-</u>	<u>163,017,050</u>
Cash and cash equivalents				1,264,948
Certificates of deposit				<u>604,851</u>
Total assets whose use is limited				<u>\$ 164,886,849</u>

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The following table sets forth by level, within the hierarchy, the Hospital's assets measured at fair value on a recurring basis as of December 31, 2018 are as follows:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ -0-	\$ 8,526,796	\$ -0-	\$ 8,526,796
Mutual funds				
Commodities	1,269	-0-	-0-	1,269
Corporate bond	5,751	-0-	-0-	5,751
Emerging markets	4,996,280	-0-	-0-	4,996,280
Foreign large cap	4,868,883	-0-	-0-	4,868,883
Global real estate	1,252	-0-	-0-	1,252
High yield bond	1,272,065	-0-	-0-	1,272,065
Inflation-protected bond	2,563,575	-0-	-0-	2,563,575
Intermediate core bond	8,384	-0-	-0-	8,384
Intermediate core plus bond	7,806,526	-0-	-0-	7,806,526
International large cap	1,942	-0-	-0-	1,942
Large cap	6,663,562	-0-	-0-	6,663,562
Mid cap	1,958,972	-0-	-0-	1,958,972
Multisector bond	2,335,227	-0-	-0-	2,335,227
Real estate	2,023	-0-	-0-	2,023
Short-term bond	18,249	-0-	-0-	18,249
Small cap	3,774,373	-0-	-0-	3,774,373
World allocation	639,776	-0-	-0-	639,776
World bond	1,306,621	-0-	-0-	1,306,621
World stock	2,082	-0-	-0-	2,082
Total mutual funds	38,226,812	-0-	-0-	38,226,812
Exchange-traded funds				
Commodities broad basket	924,912	-0-	-0-	924,912
Diversified emerging markets	5,039,986	-0-	-0-	5,039,986
Equity precious metals	1,146,419	-0-	-0-	1,146,419
Europe stock	548,061	-0-	-0-	548,061
Foreign large cap	2,454,962	-0-	-0-	2,454,962
Global real estate	818,225	-0-	-0-	818,225
Inflation-protected bond	680,386	-0-	-0-	680,386
Intermediate-term bond	7,405,001	-0-	-0-	7,405,001
Large cap	19,594,075	-0-	-0-	19,594,075
Mid cap	7,036,925	-0-	-0-	7,036,925
Real estate	1,155,726	-0-	-0-	1,155,726
Total exchange-traded funds	46,804,678	-0-	-0-	46,804,678

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Common stocks				
Basic Materials	49,546	-0-	-0-	49,546
Communication services	227,919	-0-	-0-	227,919
Consumer cyclical	2,502,111	-0-	-0-	2,502,111
Consumer defensive	1,854,792	-0-	-0-	1,854,792
Energy	1,834,626	-0-	-0-	1,834,626
Financial services	4,390,407	-0-	-0-	4,390,407
Healthcare	3,802,565	-0-	-0-	3,802,565
Industrials	3,185,726	-0-	-0-	3,185,726
Real estate	974,127	-0-	-0-	974,127
Technology	5,443,240	-0-	-0-	5,443,240
Utilities	1,452,943	-0-	-0-	1,452,943
Total common stocks	25,718,002	-0-	-0-	25,718,002
Corporate bonds	-0-	1,581,354	-0-	1,581,354
U.S. government securities	-0-	6,253,352	-0-	6,253,352
Total assets at fair value	\$ 110,749,492	\$ 16,361,502	\$ -0-	127,110,994
Cash and cash equivalents				2,549,861
Certificates of deposit				510,624
Total assets whose use is limited				\$ 130,171,479

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels 1 and 2 during 2019 and 2018.

Risks and Uncertainties

The Hospital holds investments in common stocks, mutual funds, exchange-traded funds, corporate bonds, and U.S. Government Securities. Such investments are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could affect the amounts reported in the accompanying consolidated financial statements. The Hospital's management is currently unable to determine the effect, if any, the decline in market conditions may ultimately have on the Hospital's investment portfolio and ability to fund certain projects.

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5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following at December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Land	\$ 3,989,556	\$ 4,039,775
Buildings and improvements	118,503,603	117,953,918
Fixtures and equipment	61,554,800	65,537,067
Construction in progress	<u>279,315</u>	<u>406,086</u>
	184,327,274	187,936,846
Less accumulated depreciation	<u>(88,405,447)</u>	<u>(85,975,989)</u>
Property and equipment, net	<u>\$ 95,921,827</u>	<u>\$ 101,960,857</u>

Impairment of Property and Equipment

The Hospital evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. The Hospital did not recognize a loss on impairment of property and equipment for the years ended December 31, 2019 and 2018, respectively.

Conditional Asset Retirement Obligation

FASB ASC Topic 410 (Topic 410) clarified when an entity is required to recognize a liability for a conditional asset retirement obligation. Management has considered Topic 410, specifically as it relates to its legal obligation to perform asset retirement activities, such as asbestos removal, on its existing properties. Management believes there is an indeterminate settlement date for the asset retirement obligations, if any, because the range of time over which the Hospital may settle the obligations is unknown and cannot be estimated. As a result, as of December 31, 2019 and 2018, the Hospital cannot reasonably estimate a liability related to these potential asset retirement activities nor determine conclusively that a liability exists.

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6. OTHER ASSETS

Other assets consist of the following at December 31, 2019 and 2018:

	2019	2018
Investment in captive insurance company	\$ 335,311	\$ 335,311
Captive insurance company subscriber savings	2,286,240	2,000,460
Executive Benefit Plan notes receivable	5,151,511	4,544,498
Life insurance policies	393,177	395,457
Physician recruiting notes receivable	579,024	309,153
Pledges receivable	36,098	111,273
Total other assets	8,781,361	7,696,152
Less: current portion of other assets	(271,274)	(267,413)
Other assets, net of current portion	\$ 8,510,087	\$ 7,428,739

The Hospital is less than 20 percent owner of Tecumseh Health Reciprocal Risk Retention Group (the "Captive"), a risk retention company created to purchase professional liability and general liability insurance for its members. The Hospital accounts for this investment using the cost method. In addition, the Captive retains a subscriber savings account for each of its members based upon the premiums paid in and the resulting claims paid out, plus other factors. Members are paid the balance of their subscriber savings account once they leave the Captive in accordance with the terms of the Captive agreement.

See Note 7 for a description of the Executive Benefit Plan.

The Hospital is the holder of life insurance policies for several different physicians and key management members. The Hospital has a liability outstanding for the expected payout that will be paid out on the insured's behalf.

Physician recruiting notes receivable are forgiven if the physicians meet the period-of-service requirement. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Other physician notes receivable are paid back over the terms of the notes. All physician notes receivable are in varying amounts maturing through 2023 and carry interest rates ranging from 3.25 percent to 7.50 percent.

Pledges receivable represent pledges made by donors for the construction of the cancer center at the Hospital. Pledges receivable are recorded at their estimated net realizable value and discounted to their estimated net present value. The Hospital's management uses historical losses, economic climate, and other factors when estimating the allowance for uncollectible pledges amount. The allowance for uncollectible pledges was \$-0- at both December 31, 2019 and 2018.

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Pledges receivable consist of the following at December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Pledges receivable	\$ 37,637	\$ 117,077
Less: discounts to present value (4.5%)	<u>(1,539)</u>	<u>(5,804)</u>
Pledges receivable, net of discount	<u>\$ 36,098</u>	<u>\$ 111,273</u>

The pledges receivable at December 31, 2019 were all due in less than one year from the consolidated balance sheet date. The current portion of other assets represents the amount of notes receivable from physicians expected to be repaid or forgiven in the next fiscal year, according to individual employment contracts and the amount of pledges receivable due in one year.

7. EXECUTIVE BENEFIT PLAN

The Hospital entered into collateral assignment split-dollar life insurance arrangements, referred to as the Executive Benefit Plan, for certain current or former executives. Under the Executive Benefit Plan, the Hospital pays the planned periodic premiums set forth in the policies for each participant during their employment with the Hospital. The premium payments made by the Hospital are treated as a series of loans (notes) by the Hospital to the participants that are secured by the death benefit of the policy.

Death benefits under the policy subject to a collateral assignment are as follows:

1. The employer shall receive an amount equal to the recoverable amount, determined as of the date the death benefit is paid, which amount shall be paid before any other amounts, and
2. The balance of the death benefit shall be payable to the beneficiary under the policy.

The recoverable amount is determined as follows:

1. The pre-effective date premium amount plus the premium accretion amount, using the applicable interest rate, plus
2. The cumulative premiums that have been paid by the employer plus the premium accretion amount for each premium payment using the interest factor.

The balance of the Executive Benefit Plan notes receivable as of December 31, 2019 and 2018 was \$5,151,511 and \$4,544,498, respectively. The notes bear interest at the applicable Federal rate for a term loan, as defined in Internal Revenue Code Section 1274(d), at the date the note is made. The Federal rates for the notes outstanding at December 2019 range from 1.84% to 3.50%.

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8. OPERATING AND FINANCE LEASE OBLIGATIONS

The Hospital has finance lease expiring in various years through 2024. The interest rates used in determining the carrying value of finance lease obligations are determined using the stated interest rate in the lease agreements, or using interest rates the Hospital is able to obtain from lenders in the normal course of business in a similar financing scenario. The lease obligations are secured by equipment leased. Amortization of assets held under finance leases is included in depreciation expense. Assets held under finance lease obligations are included with property and equipment on the consolidated balance sheets.

The components of finance lease assets and liabilities as of December 31, 2019 and 2018 is as follows:

	2019	2018
Equipment	\$ 2,884,036	\$ 2,812,429
Less: accumulated depreciation	1,723,145	1,119,799
Equipment, net	<u>\$ 1,160,891</u>	<u>\$ 1,692,630</u>
Current portion of obligations under finance leases	\$ 653,245	\$ 599,630
Obligations under finance leases, net of current portion	553,616	1,147,338
Total obligations under finance leases	<u>\$ 1,206,861</u>	<u>\$ 1,746,968</u>

The components of operating and finance lease expense for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Depreciation of right-of-use assets	\$ 611,090	\$ 495,459
Interest expense on lease liabilities	58,127	65,799
Short-term lease costs	1,147	148,819
Total operating and finance lease expense	<u>\$ 670,364</u>	<u>\$ 710,077</u>

At December 31, 2019, the weighted-average lease term and weighted-average discount rate on finance lease obligations are as follows:

Weighted-average remaining lease term

Finance leases 2.43 years

Weighted-average remaining lease term

Finance leases 3.61%

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Minimum future lease payments under finance leases as of December 31, 2019 are as follows:

Year Ending December 31,	Amount
2020	\$ 684,931
2021	271,308
2022	207,247
2023	91,593
2024	2,739
Total lease payments	1,257,818
Less: amount representing interest	50,957
Present value of minimum lease payments	\$ 1,206,861

9. LONG-TERM DEBT

At December 31, 2019 and 2018, the Hospital was obligated for long-term debt agreements as follows:

	2019	2018
Indiana Finance Authority Hospital Revenue Bonds, dated October 2010, payable in annual principal installments commencing August 2015 through August 2045, in amounts ranging from \$1,370,000 to \$6,400,000. Serial remaining fixed interest rates ranging from 5.0% to 5.5%. Secured by gross revenues.	\$ 92,525,000	\$ 94,170,000
Less unamortized bond discounts	(1,699,715)	(1,782,543)
Less bond issue costs	(1,372,411)	(1,425,883)
Less current portion	(1,730,000)	(1,645,000)
Long-term debt, net of current portion	\$ 87,722,874	\$ 89,316,574

Bond issue costs are being amortized over the 35-year life of the bonds and began in 2010.

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Maturities of long-term debt for each of the five years subsequent to December 31, 2019, are as follows:

Year Ending December 31,	Principal Amount
2020	\$ 1,730,000
2021	1,815,000
2022	1,910,000
2023	2,005,000
2024	2,110,000
Thereafter	82,955,000
Total	\$ 92,525,000

Under the terms of the Series 2010 Bonds, the Hospital is required to maintain certain deposits with a trustee. Such deposits are reported in the consolidated financial statements as assets whose use is limited. These agreements also place limits on the occurrence of additional borrowings and require that the Hospital satisfy certain covenants, including debt service coverage ratio, days cash on hand, and submission of audited financial statements. Management believes the Hospital is in compliance with all restrictive covenants.

10. NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are restricted for the following purposes or periods ad of December 31, 2019 and 2018:

	2019	2018
Subject to expenditure for specified purpose:		
Art Work (New Hospital)	\$ -0-	\$ 1,933
Bill Zink Scholarship Fund	20,633	22,633
Building	5,135	5,135
Building/Technology (Cancer Center)	24,460	24,460
Business Office	483	483
Caring and Responding to Employees (CARE)	4,603	6,327
Diabetes Care	255	255
E. Pendleton Fund	20,548	18,337
E. Pendleton Interest Earned (Hospice)	1,567	2,308
Education	9,936	13,404
Emergency Medical Services Development	1,253	1,648
Engagement Network Patient Safety and Quality Outcomes (Indiana Hospital Association)	378	692

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	2019	2018
Girls on the Run	5,256	7,266
Hearing Aids for Diabetic Patients	10,000	10,000
Healthy Indiana Plan 2.0 Premium Assistance	2,743	2,158
Home Health/Hospice	65,941	68,822
Hope and Healing Campaign (Cancer Center)	483,634	642,158
Mammography	3,700	-0-
Nursing	11,264	3,344
Oncology	14,150	18,958
Oncology - Convenience Medications	105	83
Oncology - Snacks	3,164	-0-
Oncology - Staff Discretionary	6,768	7,298
Pediatrics	31,379	36,903
Pet Therapy	325	325
Physician Wall	5,020	7,404
Prostate Health	582	282
Quilt	150	150
Radiology	1,370	1,370
Rehab	1,870	1,870
Ripley County	1,100	1,100
Scholarship Fund	10,826	20,520
Taustine	1,000	1,000
Volunteer Services	351	251
We Care About Our Patients	19,022	23,294
Wellness	45,525	47,299
Wellness - Community Health Initiatives	55,271	39,851
Wellness - Community Health Zero Suicide Initiative	16,904	14,498
Wellness - Community Health Lifestyles	861	-0-
Womens' Health	21,668	34,244
	909,200	1,088,063
 Subject to the passage of time and expenditure for specified purpose:		
Pledges Receivable - Hope and Healing Campaign (Cancer Center)	36,098	111,273
 Subject to spending policy and appropriation:		
Investment in perpetuity:		
Heberhart Endowment	10,000	10,000
E. Pendleton Hospice Endowment	10,000	10,000
	20,000	20,000
Total net assets with donor restrictions	\$ 965,298	\$ 1,219,336

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11. ENDOWMENTS

The Hospital's endowment funds consist of two individual funds established for a variety of purposes. The endowment consists of donor-restricted endowment funds established by the donor to function as endowments. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds, including funds designated by the Board of Managers to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Hospital is subject to the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and, thus, classifies amounts in its donor-restricted endowment funds as net assets with donor restrictions. The Board of Managers has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital considers a fund to be underwater if the fair value of the fund is less than the sum of (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The Hospital has adopted a policy to not spend from underwater endowments unless directed by the donor. No underwater funds existed as of December 31, 2019 and 2018.

In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

- (1) The duration and preservation of the fund
- (2) The purposes of the Hospital and the donor-restricted endowment funds
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Hospital
- (7) The investment policies of the Hospital

The Hospital has adopted investment and spending policies for endowment assets that attempt to balance the mission of building capital for future use with the corresponding obligation to support current and future needs of the Hospital. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the Board of Managers, the endowment assets are invested in a manner that is intended to produce long-term growth of capital without undue exposure to risk.

To satisfy its long-term rate of return objectives, the Hospital relies on a total return strategy in which investment decisions shall be made with the intent of maximizing the long-term total return of the portfolio through market value changes (realized and unrealized) and through earned income (dividends and interest).

On balances of endowed funds, as of the beginning of each fiscal year, an amount as determined by the Hospital Board will be distributed for the intended purposes of the endowment annually. Growth of the

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endowment will come from the annual earnings of investments in excess of distributions plus contributions made to the endowment.

Endowment net asset composition by type of fund as of December 31, 2019 is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Donor restricted endowment funds			
The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA	-0-	20,000	20,000
Accumulated investment gains	-0-	1,567	1,567
	\$ -0-	\$ 21,567	\$ 21,567

Changes in endowment net assets for the year ended December 31, 2019 is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ -0-	\$ 22,308	\$ 22,308
Investment income and contributions	-0-	244	244
Net assets released from restrictions	-0-	(985)	(985)
Endowment net assets, end of year	\$ -0-	\$ 21,567	\$ 21,567

Endowment net asset composition by type of fund as of December 31, 2018 is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Donor restricted endowment funds			
The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA	-0-	20,000	20,000
Accumulated investment gains	-0-	2,308	2,308
	\$ -0-	\$ 22,308	\$ 22,308

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Changes in endowment net assets for the year ended December 31, 2018 is as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ -0-	\$ 22,244	\$ 22,244
Investment income and contributions	-0-	64	64
Endowment net assets, end of year	\$ -0-	\$ 22,308	\$ 22,308

12. NET PATIENT SERVICE REVENUE

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigation and/or allegations concerning possible violations of fraud and abuse statutes and/or regulations by health care providers. Laws and regulations concerning government programs, including Medicare and Medicaid, are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Hospital believes that it is in compliance with all applicable laws and regulations.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the Hospital's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant in 2019 and 2018.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Hospital also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Hospital estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price

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are generally recorded as adjustments to net patient service revenue in the period of the change. For the years ended December 31, 2019 and 2018, adjustments were recognized due to changes in the Hospital's estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant. Subsequent changes that are significant and determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Hospital's mission, care is provided to patients regardless of their ability to pay. Therefore, the Hospital has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Hospital expects to collect based on its collection history with those patients.

Patients who meet the Hospital's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

The Hospital has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors, geography, service lines, method of reimbursement, and timing of when revenue is recognized. The following tables provide details of these factors.

The composition of net patient service revenue by primary payor for the years ended December 31 is as follows:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 44,593,403	\$ 44,181,432
Medicaid	15,632,040	13,813,030
Managed Care and other third-party payors	62,521,955	72,952,063
Self-Pay	<u>426,755</u>	<u>445,463</u>
	<u>\$ 123,174,153</u>	<u>\$ 131,391,988</u>

Revenue from patient's deductibles and coinsurance are included in the preceding categories based on the primary payor.

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The composition of net patient service revenue based on its lines of business and timing of revenue recognition for the years ended December 31, 2019 and 2018, are as follows:

Services lines	2019	2018
Hospital inpatient	\$ 31,784,876	\$ 29,414,606
Hospital outpatient	66,620,920	73,534,043
Physician services	23,289,295	26,991,075
Home health and hospice	1,479,062	1,452,264
	\$ 123,174,153	\$ 131,391,988

The Hospital grants credit without collateral to its patients, most of who are local residents and insured under third-party payor agreements. The mix and concentration of gross patient service revenue and patient accounts receivable at December 31, 2019 and 2018 is as follows:

	2019		2018	
	Gross Revenue	Accounts Receivable	Gross Revenue	Accounts Receivable
Medicare	50 %	35 %	50 %	36 %
Medicaid	16	14	16	14
Blue Cross	17	12	17	11
Other Commercial	15	25	15	25
Self-Pay	2	14	2	14
	100 %	100 %	100 %	100 %

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- Medicare.** The Hospital is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Hospital is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital.

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- **Medicaid.** The Hospital is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Hospital is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient programs.
- **Other.** The Hospital has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these arrangements is a discount from established charges and fee schedule payments.
- **Charity Care and Uninsured Discounts.** The Hospital provides care without charge or at less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associating with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2019 and 2018, the Hospital incurred estimated charity costs of \$710,706 and \$442,796, respectively.

The Centers for Medicare and Medicaid Services ("CMS") has been granted authority to suspend payments, in whole or in part, to Medicare providers if CMS possess reliable information on overpayment, fraud or if willful misrepresentation exists. If CMS suspects payments are being made as the result of fraud or misrepresentation, CMS may suspend payment at any time without providing prior notice to the Hospital. The initial suspension period is limited to 180 days. However, the payment suspension period can be extended indefinitely if the matter is under investigation by the United States Department of Health and Human Services Office of Inspector General or the United States Department of Justice. Therefore, the Hospital is unable to predict if or when it may be subject to a suspension of payments by the Medicare and/or Medicaid programs, the possible length of the suspension period, or the potential cash flow impact of a payment suspension. Any such suspension would adversely impact the Hospital's financial position, results of operations, and cash flows.

13. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for 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 on September 30th). 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, program utilization using inpatient days multiplied by a

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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 when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the consolidated financial statement effects of the grants must be both recognizable and measurable. During 2019 and 2018, the Hospital recognized \$7,043 and \$10,443, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the Hospital records income at the end of the EHR reporting period in which compliance is achieved. EHR incentive income/expense is included in other revenue in the consolidated statements of operations. 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.

14. RETIREMENT PLAN

The Hospital sponsors a defined contribution retirement plan that covers all eligible employees who work over 1,000 hours a year. All employees are eligible for enrollment on the first day of the month following their hire date. The Hospital contributes 2 percent of eligible wages. The employee may contribute up to 15 percent with a maximum of 6 percent being matched at a rate of 50 percent. For the years ended December 31, 2019 and 2018, the amount of retirement expense was \$1,853,592 and \$2,005,921, respectively.

15. DEFERRED COMPENSATION AGREEMENTS

Previously, the Hospital maintained a deferred compensation plan for a select group of key management employees. Under the terms of the plan, the Hospital contributed 4 percent of a participant's compensation, as defined in the agreement, each calendar quarter. The Hospital no longer offers this plan, but still records a liability for any amounts that were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both \$47,115 and \$38,384 at December 31, 2019 and 2018, respectively.

16. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act, IC 34-18 (the "Act"), provided for a maximum recovery of \$1,250,000 for an occurrence of malpractice through June 30, 2017. Starting July 1, 2017, the Act provides for a maximum recovery of \$1,650,000 through the period ending June 30, 2019, and \$1,800,000 beginning June

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30, 2019. The Act required the Hospital to maintain Medical malpractice liability insurance in the amount of at least \$250,000 per occurrence (\$5,000,000 in the annual aggregate) through June 30, 2017. Starting July 1, 2017, the Act requires the Hospital to maintain medical malpractice liability insurance of \$400,000 per occurrence (\$8,000,000 in the annual aggregate) through the period ending June 30, 2019, and \$500,000 per occurrence (\$10,000,000 in the annual aggregate) beginning July 1, 2019. The Act also requires the Hospital to pay a surcharge to the State Patient's Compensation Fund (the "Fund"). The Fund is used to pay medical malpractice claims in excess of the per occurrence and annual aggregate amounts noted above, under certain terms and conditions. No accrual for possible losses attributable to incidents that may have occurred but that have not been identified has been made because the amount, if any, is not reasonably estimable. The Fund is on a claims-made basis and as long as this coverage is continuous or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be insured. The Hospital maintains professional liability insurance through a multi-provider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

	2019	2018
Hospital per occurrence	<u>\$ 500,000</u>	<u>\$ 400,000</u>
Hospital aggregate	<u>\$ 10,000,000</u>	<u>\$ 8,000,000</u>
Group umbrella aggregate	\$ 10,000,000	\$ 10,000,000
Group first additional umbrella aggregate	10,000,000	10,000,000
Group second additional umbrella aggregate	<u>10,000,000</u>	<u>10,000,000</u>
Total Group umbrella aggregate	<u>\$ 30,000,000</u>	<u>\$ 30,000,000</u>

Liabilities for incurred but not reported losses at December 31, 2019 and 2018, are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Hospital's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Hospital intends to continue carrying such insurance.

17. HOSPITAL ASSESSMENT FEE

The purpose of the Hospital Assessment Fee ("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 hospital assessment fee reported in the consolidated statements of operations and changes in net assets. Previously, the State share was funded by government 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.

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The Hospital recognized HAF program expense of \$3,937,701 and \$3,391,276 for the years ending December 31, 2019 and 2018, respectively.

18. CONCENTRATIONS OF CREDIT RISK

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

19. FUNCTIONAL EXPENSES

The Hospital provides general healthcare services to residents within its geographic area. Expenses related to providing these services are broken down as follows for the years ended December 31, 2019 and 2018:

	2019			
	Healthcare Services	General and Administrative	Fundraising	Total
Salaries and benefits	\$ 51,261,545	\$ 12,679,668	\$ 93,225	\$ 64,034,438
Purchased services and professional medical fees	9,799,375	6,040,243	-0-	15,839,618
Supplies and drugs	18,122,748	837,750	5,022	18,965,520
Depreciation and amortization	6,065,334	2,832,990	264	8,898,588
Interest	3,515,748	1,754,659	-0-	5,270,407
Hospital assessment fee	3,937,701	-0-	-0-	3,937,701
Other operating expenses	2,765,822	4,715,688	22,712	7,504,222
	\$ 95,468,273	\$ 28,860,998	\$ 121,223	\$ 124,450,494

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	2018			
	Healthcare Services	General and Administrative	Fundraising	Total
Salaries and benefits	\$ 53,100,279	\$ 12,173,641	\$ 91,833	\$ 65,365,753
Purchased services and professional medical fees	8,713,175	5,114,942	6,000	13,834,117
Supplies and drugs	20,495,682	881,676	4,718	21,382,076
Depreciation and amortization	5,946,805	2,747,693	258	8,694,756
Interest	3,574,958	1,770,873	-0-	5,345,831
Hospital assessment fee	3,391,276	-0-	-0-	3,391,276
Other operating expenses	2,986,488	4,826,895	12,114	7,825,497
	<u>\$ 98,208,663</u>	<u>\$ 27,515,720</u>	<u>\$ 114,923</u>	<u>\$ 125,839,306</u>

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Hospital. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation and occupancy, which are both allocated based on square footage, as well as salaries and benefits, which are allocated based on estimates of time and effort.

20. LIQUIDITY AND AVAILABILITY OF RESOURCES

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year at December 31, 2019 and 2018, comprise the following:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 14,654,873	\$ 19,833,770
Patient accounts receivable, net	9,960,805	9,340,720
Current portion of pledges receivable	<u>36,098</u>	<u>111,273</u>
	<u>\$ 24,651,776</u>	<u>\$ 29,285,763</u>

As part of the liquidity management plan, excess cash within the Hospital operating checking account is invested via an autosweep function with the financial institution, German American Bank. The excess funds are invested in Federal securities to achieve a better rate of return on the available funds.

Amounts not available include board-designated funds that are intended to meet capital asset replacement needs not considered in the annual operating budget. In the event the need arises to utilize the board-designated funds for liquidity purposes, the reserves could be drawn upon through board resolution.

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21. CONTINGENCIES

The Hospital is susceptible to a variety of legal proceedings and claims by others against the Hospital in a variety of matters arising out of the conduct of the Hospital's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the financial statements.

The Hospital has identified billing errors and discrepancies relating to certain salaried providers. As of December 31, 2019 and 2018, Hospital management estimates the potential loss for payback and related penalties to range between \$1,250,000 and \$2,000,000. The Hospital has therefore accrued a liability for this loss contingency of \$1,250,000 at December 31, 2019 and 2018, that is included in estimated third-party payor settlements on the consolidated balance sheets.

HIPAA

Management continues to implement policies, procedures, and a compliance-monitoring organizational structure to enforce and monitor compliance with the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") and other government statutes and regulations. The Hospital's compliance with such laws and regulations is subject to future government review and interpretations, as well as regulatory actions which are unknown or unasserted at this time.

22. COMMITMENTS

As of December 31, 2019, the Hospital has construction and renovation project commitments as follows:

Project	Expected Date of Completion	Estimated Total Cost of Project	Costs Incurred as of December 31, 2019
McKesson - Conserus Enterprise SW	4th Qtr 2020	\$ 33,388	\$ 16,694
GE Healthcare - Anesthesia Machines	1st Qtr 2020	159,000	140,818
Artekna - C Section Suite	1st Qtr 2020	175,000	4,003
Vitrix/Varian 2020 Upgrade	1st Qtr 2020	20,000	860
Siemens - Elare Max Medical Imaging	1st Qtr 2020	117,000	116,940
		<u>\$ 504,388</u>	<u>\$ 279,315</u>

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23. RELATED PARTY TRANSACTIONS

German American Bank

A Hospital Board member is the spouse of the Regional Chairman of German American Bank. The spouse retired in 2018, thereby eliminating the related party relationship for 2019. At December 31, 2018, the Hospital had the following related party transactions with German American Bank:

	<u>2018</u>
Deposits	\$ 16,766,476
Interest income	\$ 156,130
Service fees	\$ 7,288

24. SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared Coronavirus (COVID-19) a pandemic. The continued spread of COVID-19, or any similar outbreaks in the future, may adversely impact the local, regional, national, and global economies. The extent to which COVID-19 impacts the Hospital's operating results is dependent on the breadth and duration of the pandemic and could be affected by other factors management is not currently able to predict. Potential impacts include, but are not limited to, delays, loss of, or reduction to, revenue, contributions and funding, and investment portfolio declines. Management believes the Hospital is taking appropriate actions to respond to the pandemic, however, the full impact is unknown and cannot be reasonably estimated at the date the consolidated financial statements were issued.