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STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT
OF

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF
HARRISON COUNTY, INDIANA

January 1, 2011 to December 31, 2011

FILED
11/16/2012

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HOSPITAL OFFICIALS

Office	Official	Term
Chief Executive Officer	Steven L. Taylor	01-01-11 to 12-31-12
Chief Financial Officer	Jeffrey L. Davis	01-01-11 to 12-31-12
Chairman of the Hospital Board	Paul Martin	01-01-11 to 12-31-12
President of the Board of County Commissioners	James Goldman	01-01-11 to 12-31-12

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302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2769

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE HARRISON COUNTY HOSPITAL, HARRISON COUNTY, INDIANA

We have audited the accompanying financial statements of the business-type activities, of the Harrison County Hospital (Hospital) as of and for the year ended December 31, 2011, as listed in the Table of Contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the Harrison MOB, LLC, which represent 100 percent of the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Harrison MOB, LLC, is based on the report of the other auditors.

We conducted our audit 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital and its discretely presented component unit as of December 31, 2011, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management discussion and analysis, as listed in the Table of Contents, be presented to supplement the basis financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

STATE BOARD OF ACCOUNTS

October 2, 2012

HARRISON COUNTY HOSPITAL

Management Discussion and Analysis (MD&A)

This section of Harrison County Hospital's (HCH) annual financial statements presents background information and management discussion and analysis of the HCH financial performance for the year ended December 31, 2011. HCH reports results on a fiscal year of January 1 to December 31, and any reference to a year in this MD&A indicates the HCH fiscal years. This MD&A does not include a discussion and analysis of the activities and results of the Harrison County Hospital Foundation or the Harrison MOB LLC.

This MD&A should be read together with the financial statements and accompanying Notes to the Financial Statements included in this report.

Financial Highlights

- HCH net assets decreased by $6,480,909 in 2011, resulting from an operating loss of ($561,073), and net non-operating items of ($5,919,836). The main non-operating items were interest expense of ($1,366,997) and the recognition of a loss on the valuation of a derivative financing instrument in the amount of ($4,905,351).

- Total net patient revenue, net of provision for bad debt, increased by 10.4%, while operating expenses increased by 4.3%.

- Long term debt, including current maturities, is $9,431,733 at December 31, 2011, compared to $28,155,000 payable at the end of 2010. This amount represents outstanding debt related to the new hospital construction completed in 2008. Scheduled payments related to the long term debt in 2011 consisted of principal of $675,000 and interest of $1,214,263. In June of 2011 the Hospital reduced and restructured long term debt. The 2005 Revenue Bonds that were originally issued for the Hospital construction were retired using cash and a $10 million loan from a consortium of local and regional banks. The sources of cash for debt reduction were a contribution of $8 million from Harrison County gaming revenues and a Hospital matching amount of $10 million from cash reserves. More information on the debt restructuring and long term debt is presented in the Notes to the Financial Statements.

- In 2006 HCH entered into an agreement with several physicians and healthcare providers to establish Harrison MOB, LLC. This entity was formed to invest in and operate a new medical office building to be located on the campus of the new HCH facility. As of the 2011 year-end HCH had a net investment of $1,090,070 which includes ownership of approximately 61% of the shares of the LLC. Harrison MOB, LLC is a discrete component unit of HCH, and the financial statements of this unit are presented in a separate independent audit report.

- HCH continues to upgrade and expand hospital and physician practice information systems to improve quality of information for clinical and financial management. In December of 2011 the hospital entered into agreements for replacement of hospital and physician information systems. The implementation of the new systems will occur in 2012. The total initial costs of the systems is approximately $3.36 million, and the hospital expects to recover 65%-70% of this cost through federal and state electronic health records (EHR) incentives, and to a lesser extent Medicare cost reimbursement for patient services. The enhanced information systems will also allow for operational efficiencies as patient volumes increase, will be vital in conforming to regulatory requirements, and will provide the platform which will allow HCH to qualify for government incentive payments related to EHR and quality initiatives in the future.

- Recruiting and retaining a core group of physicians has been part of the strategic plan of HCH for many years. In recent years HCH has entered into employment arrangements with a growing number of physicians, rather than the physicians maintaining independent practices. The strategy of hospitals employing physicians has become widespread due to changes in the industry which make the arrangement necessary and advantageous in many instances. The long term effect of physician employment will be that an adequate number of primary care and specialty providers will be retained in the community, which in turn will generate patients and revenue streams for HCH. In the short term, salary and benefits costs will increase in total and in relation to net revenue, as it normally will take the physician practices three to five years to build and mature.

The Financial Statements

The HCH financial statements consist of - a Statement of Net Assets, a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These statements provide short-term and long-term financial information.

The Statement of Net Assets and Statement of Revenues, Expenses, and Changes in Net Assets provide information on the HCH resources and its activities. These two statements report the net assets of HCH and its changes. Increases or decreases of the HCH net assets are one indicator of whether its financial health is improving or eroding. However, other non-financial factors such as changes in economic conditions, population growth, patient demographic changes, and new or changed government legislation should also be considered.

The Statement of Net Assets includes all of the HCH assets and liabilities, and the net assets, which can be thought of as the net worth of HCH. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the financial results of the HCH operations and presents revenue earned and expenses incurred. The other primary financial statement is the Statement of Cash Flows. This statement provides information about HCH sources and uses of cash during the year, and the cash flows from operating activities, capital and related financing activities, and investing activities.

A summary of the HCH Net Assets as of December 31, 2011 and 2010 is presented below, in 000's:

	2011	2010	$ Change	% Change
Assets:				
Cash and Investments	$10,429	$17,375	($6,946)	-40.0%
Capital Assets	39,556	42,795	(3,239)	-7.6%
Other Assets	4,860	11,372	(6,512)	-57.3%
Restricted Assets - Cash	5,154	7,752	(2,598)	-33.5%
Restricted Assets - Receivable	672	8,000	(7,328)	-91.6%
Total Assets	$60,671	$87,294	($26,623)	-30.5%
Liabilities:				
Long Term Debt Outstanding	$9,079	$27,290	($18,211)	-66.7%
Current and Other Liabilities	6,148	8,079	(1,931)	-23.9%
Total Liabilities	15,227	35,369	(20,142)	-56.9%
Net Assets:				
Invested in Capital Assets - Net of Related Debt	30,124	14,640	15,484	105.8%
Unrestricted	11,319	29,122	(17,803)	-61.1%
Restricted	4,001	8,163	(4,162)	-51.0%
Total Net Assets	45,444	51,925	(6,481)	-12.5%
Total Liabilities and Net Assets	$60,671	$87,294	($26,623)	-30.5%

Significant changes in Net Assets from 2010 to 2011 were a reduction of cash and restricted receivables which were used to retire $18 million in debt, with the decrease in assets being offset by the decrease in liabilities. Other reductions realized in assets were in net capital assets, which was due to depreciation recognized on capital assets related to the 2008 building project, and a reduction in other assets of $6.5 million due mainly to the change in accounting for a derivative investment valuation.

Cash generated from operations for 2011 was $4.26 million, which resulted from positive cash flow from patient services provided. More detail on net assets and cash flow activity can be found in the accompanying Financial Statements.

A summary of the HCH Statement of Revenues, Expenses, and Changes in Net Assets as of December 31, 2011 and 2010 is presented below, in 000's:

	2011	2010	$ Change	% Change
Revenue:				
Net Patient Service Revenue, net of provision for Bad Debt: 2011 ($6,306); 2010($5,404)	$40,638	$36,821	$3,817	10.4%
Other	1,497	1,243	254	20.4%
Total Operating Revenue	42,135	38,064	4,071	10.7%
Expenses:				
Salaries and Benefits	23,992	22,716	1,276	5.6%
Medical Supplies and Drugs	4,160	3,688	472	12.8%
Depreciation and Amortization	4,618	5,093	(475)	-9.3%
Other	9,926	9,430	496	5.3%
Total Operating Expenses	42,696	40,927	1,769	4.3%
Operating Income	(561)	(2,863)	2,302	-80.4%
Non-Operating Revenue	407	678	(271)	-40.0%
Non-Operating Expense	(6,327)	(1,350)	(4,977)	368.7%
Excess of Revenue over Expenses	(6,481)	(3,535)	(2,946)	83.3%
Capital Grants and Contributions	0	8,000	(8,000)	-100.0%
Total Net Assets - Beginning of Year	51,925	47,460	4,465	9.4%
Total Net Assets - End of Year	$45,444	$51,925	($6,481)	-12.5%

Sources of Revenue

During 2011 and 2010 HCH derived substantially all of its revenue from patient service and other related programs. Revenue is received from Medicare and Medicaid programs, self pay patients, insurance carriers, preferred provider organizations, and managed care companies. Other revenue includes cash subsidies from Harrison County for the operation of the county ambulance service, totaling $986,791 in 2011 and $1,274,505 in 2010.

The following table presents the percentages of gross revenue for patient services, by payer, for the years ended December 31, 2011 and 2010, respectively.

Payer	**2011**	**2010**
Medicare	42.8%	44.1%
Medicaid	16.8%	15.6%
Anthem	15.0%	14.0%
Managed Care	13.0%	12.6%
Commercial Insurance	2.8%	3.1%
Self Pay	7.1%	7.6%
Other	2.5%	3.0%
Total	100.0%	100.0%

Operating and Financial Performance

Revenue

Net patient service revenue increased 10.4% during 2011 due to higher patient volumes.

- Inpatient days of service increased by 23% in 2011, while total outpatient visits increased by 1%. Increases in inpatients and in surgery revenue came primarily from obstetric and newborn services, which was due to a new OB GYN physician joining the active hospital staff.

- The portion of deductions from gross revenue recognized by HCH for uninsured care and charity care in 2011 was $9.0 million, or 8.1% of gross revenue, compared to $8.3 million, or 8.7% of gross revenue in 2010. Uninsured care is included in provision for bad debt expense and represents uncollected charges for services not covered by insurance, and for patients that do not have health insurance. Charity care is recognized as a deduction from gross revenue, and represents charges written off that were incurred in providing care to uninsured low income and indigent patients. HCH has a policy and a commitment to provide emergency care to all patients without regard for their ability to pay for services. Over the past ten years there has been a trend of increasing uninsured care.

- Settlements totaling $1,180,266 were received in 2011 under the Indiana Medicaid program, relating to the State of Indiana's fiscal year 2011. These payments were made as part of the Disproportionate Share Hospital program, and are recorded as offsets to revenue adjustments in the HCH accounting records. These payments were made from funds that are available to partially cover the hospital's cost of care to Medicaid and uninsured patients.

Expenses

Total operating expenses increased by 4.3% in 2011. Factors that had an impact on expenses are discussed below.

- Salaries and benefits costs for 2011 increased by 5.6%. Labor costs in inpatient nursing and in the surgery departments increased in response to higher patient volumes. In addition, salary increases were given to employees during the year for cost of living and market adjustments, in order to remain competitive in the local labor market.

- Medical supplies and drugs increased by 12.8% in 2011. This was primarily due to increased inpatient and surgery volumes, and an increase in surgical implantable devices which are high cost yet are also revenue generating supply items. Other expenses increased moderately due to patient volumes and cost increases, while depreciation expense decreased by 9.3%.

Capital Contributions

A pledge made in December 2010 for a capital contribution from Harrison County gaming revenues in the amount of $8,000,000 was received in installments during 2011. This contribution was used for the retirement of a portion of the long term debt outstanding.

Non-operating Expense

Non-operating expense includes a loss of $4.9 million related to a SWAP agreement, which is a derivative instrument that was part of the 2005 hospital financing. The recognized loss consists of a $1 million payment in 2011 to terminate a portion of the SWAP agreement, and $3.9 million for the remaining valuation of the loss on the SWAP. This recognition of the loss is a change from prior years accounting for derivatives, when a corresponding asset and liability was recorded for the valuation. The accounting for the derivative will continue until the SWAP agreement is fully terminated, and the valuation with the corresponding gains or losses will fluctuate based on certain market-based interest rate factors.

Long Term Debt

At the fiscal year end 2011, HCH had total notes payable of $9.08 million, which represents the refinanced debt outstanding for the construction of the new hospital facility. The new loan was obtained in June of 2011, and monthly principal and interest payments are scheduled to be made over the 20 year term of the loan. More detailed information on HCH's long term debt is presented in the Notes to the Financial Statements.

Capital Assets

During 2011 HCH invested $1.34 million in various capital assets. A summary of the capital assets is presented below, in 000's:

	2011	2010	$ Change	% Change
Land and Land Improvements	$6,728	$6,750	($22)	-0.3%
Buildings and Fixed Equipment	36,958	36,931	27	0.1%
Equipment	20,013	19,453	560	2.9%
Total Capital Assets	63,699	63,134	565	0.9%
Less Accumulated Depreciation	(24,934)	(20,387)	(4,547)	22.3%
Construction in Progress	791	48	743	1547.9%
Capital Assets - Net	$39,556	$42,795	($3,239)	-7.6%

HCH continues to invest in capital equipment in order to meet the needs of the service area population. These capital improvements result in increased service capacity, greater efficiencies, and upgraded technology. With the addition of substantially all new facilities and equipment in 2008, major asset purchases will be minimal for several years, with the exception of information systems. Federal and industry requirements to expand electronic health records systems will necessitate the upgrade of hospital and physician information systems. In 2012 the Hospital will implement a significant information systems project for enhancement of electronic health records.

The table below shows HCH's 2012 capital budget with projected spending of $4.25 million for capital projects. Equipment to be placed in service in 2012 will be purchased from operating cash and cash reserves.

Capital Budget (in 000's)	**2012**
Equipment Replacement & Upgrades	$1,250
Information Systems	3,400
Total Capital Budget	$4,650

More information on HCH's capital assets is presented in the Notes to the Financial Statements.

Economic and Industry Factors for 2012 Budget

The HCH Board of Trustees and management considered many factors when setting the 2012 budget. Of primary importance in setting the budget was the status of the economy and industry trends, which takes into account market forces and regulatory factors such as the following items:

- Population growth, demographic shifts, and the expanding need for services
- Continuously increasing expectations for quality improvement
- Advances in medical equipment technology and the need to replace obsolete equipment
- Healthcare reform legislation, federal and state financial incentives, and requirements to improve electronic medical records
- Privacy legislation – Health Insurance Portability and Accountability Act (HIPAA)
- Increasing emphasis on the integrity of public financial information
- Growing number of uninsured and underinsured patients
- Increasing costs of labor, medical supplies and drugs, and insurance
- Access to additional capital, and management of cash and debt levels
- Cash and resource requirements needed for the HCH strategic plan

The focus of management is to implement a multi-year plan that will consider expanded services, continuous quality improvement, cost control, capital requirements, and financing in support of net asset improvement.

Contacting HCH's Financial Manager

This report is designed to provide our citizens, customers, and creditors with a general overview of HCH's finances and to demonstrate accountability. If you have questions about this report or need additional information, contact the Chief Financial Officer, Jeffrey L. Davis at 812-738-4251.

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF HARRISON COUNTY, STATE OF INDIANA
STATEMENT OF NET ASSETS
December 31, 2011

Assets	Primary Government
Current assets:	
Cash and cash equivalents	$ 10,428,915
Patient accounts receivable, net of	
estimated uncollectibles of $11,553,546	5,371,903
Supplies and other current assets	2,242,674
Noncurrent cash and investments:	
Internally designated	1,824,924
Held by trustee for interest rate swap	71,459
Held for interest rate swap	3,257,984
Due from operating to held for interest rate swap	671,367
Investment derivative instrument - Interest rate swap	(3,929,351)
Capital assets:	
Land and construction in progress	3,971,570
Depreciable capital assets, net of accumulated depreciation	35,584,807
Other assets	
Investment in affiliated companies	956,593
Other	218,611
Total assets	$ 60,671,456

Liabilities and Net Assets	
Current liabilities:	
Current maturities of long-term debt	$ 353,100
Accounts payable and accrued expenses	2,192,431
Estimated third-party payor settlements	2,028,439
Other current liabilities	903,376
Due to Restricted Cash Reserve for interest rate swap	671,367
Long-term debt, net of current maturities	9,078,633
Total liabilities	15,227,346
Net assets:	
Invested in capital assets, net of related debt	30,124,644
Restricted:	
For interest rate swap	4,000,810
Unrestricted	11,318,656
Total net assets	45,444,110
Total liabilities and net assets	$ 60,671,456

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF HARRISON COUNTY, STATE OF INDIANA
BALANCE SHEET
December 31, 2011

Assets	Discrete Component Unit
Current assets:	
Cash	$ 74,019
Receivables:	
Tenants - rent	640
Tenants - suite improvements	889
Net receivables	1,529
Prepaid expenses	11,623
Total current assets	87,171
Other asset:	
Unamortized loan costs (net of amortization of $69,664)	97,708
Property:	
Tenant improvements	2,628,951
Building	4,712,880
Total property	7,341,831
Less accumulated depreciation	735,079
Net property	6,606,752
Total assets	$ 6,791,631
Liabilities and Members' Equity	
Current Liabilities	
Current installments of long-term debt	$ 354,534
Accounts payable	151,914
Accounts payable - related party	26,797
Deferred revenue	14,262
Total current liabilities	547,507
Long-term liabilities:	
Long-term debt, less current installments	5,090,160
Interest rate swap	1,318,697
Total long-term liabilities	6,408,857
Members' Equity (Deficit):	
Contributed capital	1,420,015
Deficit	(304,055)
Accumulated other comprehensive loss	(1,280,693)
Total members' equity (deficit)	(164,733)
Total liabilities and members' equity (deficit)	$ 6,791,631

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF HARRISON COUNTY, STATE OF INDIANA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2011

	Primary Government
Operating revenues:	
Net patient service revenue (net of provision for bad debt)	$ 40,637,503
Other	1,497,478
Total operating revenues	42,134,981
Operating expenses:	
Salaries and benefits	23,992,446
Professional fees and purchased services	5,849,390
Medical supplies and drugs	4,160,279
Insurance	607,612
Other supplies	1,657,923
Depreciation and amortization	4,617,492
Other	1,810,912
Total operating expenses	42,696,054
Operating loss	(561,073)
Nonoperating revenues (expenses):	
Investment income	360,080
Interest expense	(1,366,997)
Noncapital grants and contributions	47,294
Loss on sale of equipment	(22,183)
Loss on investment in affiliated companies	(32,679)
Loss on interest rate swap	(4,905,351)
Total nonoperating expenses	(5,919,836)
Decrease in net assets	(6,480,909)
Net assets beginning of the year	51,925,019
Net assets end of the year	$ 45,444,110

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF HARRISON COUNTY, STATE OF INDIANA
STATEMENT OF INCOME, EXPENSES, AND CHANGES IN MEMBERS' EQUITY
Year Ended December 31, 2011

	Discrete Component Unit
Rental Income	$ 814,116
Operating expenses:	
Utilities	92,677
Rent	74,284
Repairs and maintenance	18,444
Insurance	8,566
Depreciation	241,568
Amortization	16,165
Professional fees	9,500
Cleaning	16,258
Security	10,920
Miscellaneous	5,411
Total operating expenses	493,793
Operating income	320,323
Other income (expenses):	
Interest income	120
Interest expense	(411,173)
Loss on interest rate swap	(6,006)
Total other expenses	(417,059)
Deficiency of income under expenses before other comprehensive loss and return of capital distributions	(96,736)
Other comprehensive loss	(204,189)
Return of capital distributions	(73,500)
Members' equity beginning of the year	209,692
Members' equity end of the year	$ (164,733)

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF HARRISON COUNTY, STATE OF INDIANA
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2011

Cash flows from operating activities:	
Receipts from and on behalf of patients	$ 39,879,530
Payments to suppliers and contractors	(12,357,936)
Payments to employees	(23,829,887)
Other receipts and payments, net	573,404
Net cash provided by operating activities	4,265,111
Cash flows from noncapital financing activities:	
Noncapital grants and contributions	8,047,294
Cash flows from capital and related financing activities:	
Defeasance of bonds	(10,340,495)
Principal paid on long-term debt	(8,179,644)
Interest paid on long-term debt	(1,352,966)
Proceeds from sale of assets	293
Acquisition and construction of capital assets	(1,336,647)
Net cash used by capital and related financing activities	(21,209,459)
Cash flows from investing activities:	
Interest and dividends on investments	404,880
Purchase of derivative instrument	(976,000)
Loan to Harrison MOB, LLC	15,625
Net cash used by investing activities	(555,495)
Net decrease in cash and cash equivalents	(9,452,549)
Cash and cash equivalents at beginning of year	24,964,372
Cash and cash equivalents at end of year	$ 15,511,823

Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	$ 10,428,915
Internally designated	1,824,924
Restricted cash and cash equivalents	3,257,984
Total cash and cash equivalents	$ 15,511,823

Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	$ (561,073)
Adjustments to reconcile operating loss to net cash flows used in operating activities:	
Depreciation and amortization	4,617,492
Provision for bad debts	6,306,359
(Increase) decrease in current assets:	
Patient accounts receivable	(7,064,332)
Supplies and other current assets	111,915
Other assets	(19,851)
Increase (decrease) in current liabilities:	
Accounts payable and accrued expenses	(129,769)
Other current liabilities	125,781
Estimated third-party payor settlements	891,733
Other liabilities related to operating activities	(13,144)
Net cash provided in operating activities	$ 4,265,111

Noncash investing, capital, and financing activities:
Equipment acquired by reimbursement from Harrison County for EMS totaling $231,610.

The Hospital held investment derivative instruments at December 31, 2011, with a fair value of ($3,929,351). During 2011, the net decrease in the fair value of this investment was $716,910.

On June 1, 2011, the Hospital issued $10,000,000 in 2011 economic development revenue refunding bonds to refund $20,155,000 of outstanding 2005 Hospital construction revenue bonds. The accounting loss of $400,298 has been recognized on the Statement of Net Assets as Long-term debt, net of current maturities and will be amortized using the straight line method and charged to interest expense over the next 20 years.

The accompanying notes are an integral part of the financial statements.

I. Summary of Significant Accounting Policies

A. Reporting Entity

Harrison County Hospital (Hospital) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides short-term inpatient and outpatient health care.

The Board of County Commissioners of Harrison County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Harrison County.

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component unit. The component unit discussed below is included in the Hospital's reporting entity because of the significance of its operational or financial relationship with the Hospital. Blended component units, although legally separate entities are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government. Discretely presented component units are involved in activities of an operational nature independent from the government; their transactions are reported on a separate page in the basic financial statements to emphasize that it is legally separate from the Hospital.

Discretely Presented Component Unit

The Harrison MOB, LLC, was organized in September 2006, and is a significant discretely presented component unit of the Hospital. The discrete component unit is fiscally dependent on the primary government. The discrete component unit is a partnership that reports its financial results according to Accounting Standards Codification 820 (formerly Statement of Financial Accounting Standards No. 157). No modifications have been made to the discrete component unit's financial information in the Hospital's financial reporting entity for these differences; however, significant note disclosures to the discrete component unit's financial statements have been incorporated into the Hospital's notes to the financial statements.

The financial statements of the individual component unit may be obtained from its respective office as follows:

Harrison County Hospital
1141 Hospital Drive NW
Corydon, IN 47112

A separate audit report is prepared for the individual component unit.

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the enterprise fund statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The Hospital has elected not to follow subsequent private-sector guidance.

During the year 2010, the Hospital adopted GASB Statement No. 53, *"Accounting and Financial Reporting for Derivative Instruments."*

C. Assets, Liabilities, and Net Assets or Equity

1. Deposits and Investments

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

Short-term investments are investments with remaining maturities of up to 90 days.

Statutes authorize the Hospital to invest in interest-bearing deposit accounts, passbook savings accounts, certificates of deposit, money market deposit accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Nonparticipating certificates of deposit, demand deposits, and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Open-end mutual funds are reported at fair value.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investments in affiliated companies are reported using the equity method of accounting, or at cost, as applicable.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Other Net Assets.

2. Use of Estimates

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

3. Investment Derivative Instrument – Interest Rate Swap

The Hospital uses an interest rate swap agreement to manage financial risks related to interest rate movements and the effects on its cash flows. The Hospital is accounting for the interest rate swap agreement as an investment derivative instrument. As a result, the agreement is recorded at its fair value in the Statement of Net Assets. The net cash payments or receipts under the interest rate swap agreement are recorded as an increase or decrease to interest expense.

4. Capital Assets

Capital assets, which include land, land improvements, buildings and fixed equipment, and equipment, are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the financial statements are as follows:

Primary Government	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Land	$ 5,000	Not Applicable	Not Applicable
Land improvements	5,000	Straight-line	AHA guide
Buildings and fixed equipment	5,000	Straight-line	AHA guide
Equipment	5,000	Straight-line	AHA guide

Discrete Component Unit	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Tenant improvements	Unknown	Straight-line	20 years
Buildings	Unknown	Straight-line	40 years

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. The total interest expense incurred by the Hospital during the current year was $1,366,997. Of the amount, $0 was included as part of the cost of capital assets under construction in connection with new medical facilities and various other renovation projects. The total interest expense incurred by the discrete component unit during the current year was $411,173. Of the amount, $0 was included as part of the cost of building and tenant improvements.

5. Other Assets

Other Assets consist of Investment in affiliated companies, and deferred financing costs. The investment in affiliated companies is further described in Note III E. Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

6. Deferred Loss on Refunding

   Deferred loss on refunding, which is included in long-term debt, net of current maturities on the Statement of Net Assets, represents losses incurred in connection with the refunding of long-term debt. Such losses are being amortized over the shorter of the term of the respective original debt or the term of the new debt using the straight-line method.

7. Net Assets and Members' Equity (Deficit)

   Net assets of the Hospital are classified in three components.

   Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

   Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, contributors, or enabling legislation external to the hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note II G.

   Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

   Members' equity (deficit) of the discrete component unit is classified in three components.

   Contributed capital consists of purchases of shares of units net of any return of capital distributions.

   Deficit is the accumulated net income (loss).

   Accumulated other comprehensive loss consists of the gain or loss on the effective portion of the change in the fair value of the derivative financial instrument.

D. Grants and Contributions

   From time to time, the Hospital receives grants from Harrison County and the State of Indiana as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

   From time to time, the discrete component unit receives grants from Harrison County Hospital, individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as other income. Amounts restricted to capital acquisitions are reported after other income and expenses.

E. Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

F. Operating Revenues and Expenses

The Hospital's Statement of Revenues, Expenses and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Non-exchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

G. Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue represents 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. 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.

H. Charity Care

The Hospital has a policy of providing charity care to patients who are unable to pay. Such patients are identified based on financial information obtained from the patient and subsequent analysis. Because the agency does not expect payment, estimated charges for charity are not included in revenue.

I. Supplies

Inventories of drugs and other supplies are stated at the lower of cost, determined using the first-in, first-out method, or market.

J. Compensated Absences

The Hospital's policy on paid days off (which includes vacation, sick leave, personal leave, and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 60 days.

Paid days off are accrued when incurred and reported as a liability.

K. Fair Value of Financial Instruments

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

<u>Cash and Cash Equivalents</u>

The carrying amount reported in the Statement of Net Assets for cash and cash equivalents approximates its fair value.

Investments

Fair values, which are the amounts reported in the Statement of Net Assets, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Investment Derivative Instrument – Interest Rate Swap

Carrying amounts are based on mathematical approximations of market values derived from proprietary models as of the close of business on December 31, 2011, should the interest rate swap agreement be unwound. These valuations are calculated on a mid-market basis and do not include bid/offer spread that would be reflected in an actual price quotation. Valuations based on other models or assumptions may yield different results.

Other Assets

The investment in affiliated companies is accounted for by the equity method of accounting.

Accounts Payable and Accrued Expenses

The carrying amount reported in the Statement of Net Assets for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the Statement of Net Assets for estimated third-party payor settlements approximates its fair value.

Long Term Debt

Fair values of the Hospital's revenue notes are based on current traded value. The fair value of the Hospital's remaining long term debt is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

The discrete component unit adopted the provisions of ASC 820, *Fair Value Measurements*, for financial assets and financial liabilities. The discrete component unit has no nonfinancial assets and nonfinancial liabilities determined at fair value.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

1. Inputs to the valuation methodology are quoted prices, unadjusted for identical assets or liabilities in active markets. A quoted market price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

2. Inputs to the valuation methodology include quoted market prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted market prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.

3. Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The discrete component unit's interest rate swap liability is measured on a recurring basis. As of December 31, 2011, the balance of the interest rate swap was a liability in the amount of $1,318,697, using level 2 above.

Interest Rate Swap. The interest rate swap is reported at fair value on a recurring basis using Level 2 inputs. The fair value is based on expected cash flows over the life of the contract. The expected cash flows are determined by evaluating transactions with a pricing model using a specific market environment. The value of the interest rate swap was estimated using the closing mid-market rate/ price environment of December 31, 2011. While management believes the discrete component unit's valuation methodologies are appropriate and consistent, the use of different methodologies or assumptions to determine fair value could result in a different estimate of fair value at the reporting date.

Derivative Financial Instrument

The discrete component unit has designated a fixed rate interest rate swap as a cash flow hedge of the variability of cash flows to be paid on long-term debt. The gain or loss on the effective portion of the hedge (i.e., change in the fair value) is initially recorded as a component of other comprehensive income. The remaining gain or loss, if any, representing the ineffective portion is recognized currently in earnings. Amounts in accumulated other comprehensive income are reclassified into earnings in the same period in which the hedged forecasted transaction affects earnings (when interest expense is recognized in earnings).

The discrete component unit documents the relationship between its hedging instruments and hedged liabilities. This process includes linking all derivatives that are designated as cash flow hedges to specific forecasted interest payments for long-term debt.

The discrete component unit assesses both at the cash flow hedge's inception and on an ongoing basis, whether the derivative instruments that are used in hedging transactions have been highly effective in offsetting changes in cash flows and whether they are expected to continue to be highly effective in future periods. When it is determined that a derivative has ceased to be highly effective as a cash flow hedge, the discrete component unit discontinues hedge accounting prospectively.

The discrete component unit discontinues cash flow hedge accounting prospectively when (1) it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) the derivative is designated as a hedge instrument, because it is unlikely that the forecasted transaction (cash flows) will occur; or (4) management determines that designation of the derivative as a hedge instrument is no longer appropriate. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the net derivative gain or loss that was accumulated in other comprehensive income will be recognized immediately in earnings. In all other situations in which cash flow hedge accounting is discontinued, the net derivative gain or loss related to the discontinued cash flow hedge remains in accumulated other comprehensive income and is reclassified into earnings in the same period or periods during which the hedged forecasted transaction offsets earnings.

II. Detailed Notes

A. Deposits, Investments, and Investment Derivative Instrument – Interest Rate Swap

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 allows a Hospital Governing Board to deposit public funds in a financial institution. The Hospital does not have a formal policy regarding custodial credit risk for deposits. At December 31, 2011, the Hospital had deposit balances in the amount of $16,904,379.

The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Harrison MOB, LLC maintains its cash at financial institutions. At times, the balances may be in excess of federally insured limits.

2. Investments

Authorization for investment activity is stated in Indiana Code 16-22-3-20. As of December 31, 2011, the Hospital had the following investments:

Investment Type	Primary Government Market Value
U.S. treasuries and securities	$ 71,459

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in:

Any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

Repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective.

Mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana.

Securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

Investment Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Hospital does not have a formal investment policy for custodial credit risk for investments. The Hospital's investments did not have custodial credit risk.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Hospital does not have a formal investment policy for interest rate risk for investments. The Hospital's investments did not have interest rate risk.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Hospital does not have a formal investment policy for credit risk for investments. The Hospital's investments did not have credit risk.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Hospital does not have a policy in regards to concentration of credit risk. United States of America government and United States of America governmental agency securities are exempt from this policy requirement. The Hospital's investments did not have concentration of credit risk.

Foreign Currency Risk

The Hospital does not have a formal policy in regards to foreign currency risk. The Hospital's investments did not have foreign currency risk.

3. Investment Derivative Instrument – Interest Rate Swap

In June 2011, the Hospital defeased the 2005 Hospital construction revenue bonds with proceeds from the issuance of the 2011 economic development refunding bonds, a contribution from Harrison County and current cash. The pay-fixed, receive-variable interest rate swap agreement (swap agreement) associated with the 2005 Hospital construction revenue bonds was not terminated as part of the defeasance. The Hospital determined that the swap did not meet the criteria for effectiveness with the 2011 economic development refunding bonds and discontinued hedge accounting; therefore, the derivative instrument has been reclassified from a hedging derivative instrument to an investment derivative instrument. The changes in fair value of the swap agreement of $716,910 are shown as adjustments to the carrying amount of the investment derivative instrument – interest rate swap on the Statement of Net Assets.

Under the swap agreement, the Hospital pays the counterparty, U.S. Bancorp Piper Jaffray Financial Products Inc., a fixed payment of 3.81 percent and receives a variable payment computed as 70 percent of the London Interbank Offered rate (LIBOR). The swap is highly sensitive to interest rate changes. The swap's notional value declined by $5,323,000 in 2011. The swap agreement matures on October 1, 2032.

As of December 31, 2011, the swap had a negative fair value of $3,929,351. The swap's fair value represented the Hospital's credit exposure to the counterparty at the reporting date. Should the counterparty to this transaction fail to perform according to the terms of the swap agreement, the Hospital has a maximum possible loss equivalent to the swap's fair value at that date. As of December 31, 2011, the Hospital was not exposed to credit risk in the amount of the derivative's fair value, because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Hospital would be exposed to credit risk in the amount of the derivative's fair value. The swap counterparty is currently rated A- by Standard & Poor's, Baa1 by Moody's Investors Service and A by Fitch Ratings.

Summary of activity during the reporting period and balances at year end are as follows:

Primary Government	Beginning Balance	Additions	Reductions	Ending Balance	Notional Amount
Noncurrent Cash and Investments:					
Investment Derivative Instrument -					
Interest Rate Swap	$ -	$ (3,929,351)	$ -	$ (3,929,351)	$ 17,832,000

B. Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at year end consisted of these amounts:

Patient Accounts Receivable	
Receivable from patients and their insurance carriers	$ 12,063,338
Receivable from Medicare	4,157,527
Receivable from Medicaid	704,584
Total patient accounts receivable	16,925,449
Less allowance for uncollectible amounts	11,553,546
Patient accounts receivable, net	$ 5,371,903

Accounts Payable and Accrued Expenses	
Payable to employees	$ 859,565
Payable to suppliers	1,332,866
Total accounts payable and accrued expenses	$ 2,192,431

C. Capital Assets

Capital asset activity for the year ended December 31, 2011, was as follows:

Primary Government	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	$ 3,202,421	$ -	$ 22,476	$ 3,179,945
Construction in progress	47,972	900,711	157,058	791,625
Total capital assets, not being depreciated	3,250,393	900,711	179,534	3,971,570
Capital assets, being depreciated:				
Land improvements	3,547,739	-	-	3,547,739
Buildings and fixed equipment	36,930,812	36,880	9,192	36,958,500
Equipment	19,453,368	635,162	75,818	20,012,712
Totals	59,931,919	672,042	85,010	60,518,951
Less accumulated depreciation for:				
Land improvements	976,804	252,015	-	1,228,819
Buildings and fixed equipment	6,365,419	2,049,973	-	8,415,392
Equipment	13,044,686	2,297,512	52,265	15,289,933
Totals	20,386,909	4,599,500	52,265	24,934,144
Total capital assets, being depreciated, net	39,545,010	(3,927,458)	32,745	35,584,807
Total primary government capital assets, net	$ 42,795,403	$ (3,026,747)	$ 212,279	$ 39,556,377

Discretely Presented Component Unit	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, being depreciated:				
Tenant improvements	$ 2,474,919	$ 154,032	$ -	$ 2,628,951
Buildings	4,712,880	-	-	4,712,880
Totals	7,187,799	154,032	-	7,341,831
Less accumulated depreciation	493,511	241,568	-	735,079
Total discretely presented component unit capital assets, net	$ 6,694,288	$ (87,536)	$ -	$ 6,606,752

D. Construction Commitments

Construction work in progress is composed of the following:

Project	Total Project Authorized	Expended to December 31, 2011	Committed
Hospital Information Systems	$ 3,365,600	$ 586,674	$ 2,778,926
Leasehold Improvements	245,000	200,844	44,156
Remodeling Projects	25,000	4,107	20,893
Totals	$ 3,635,600	$ 791,625	$ 2,843,975

E. Leases

Operating Leases

The Hospital has entered into various operating leases having initial or remaining noncancelable terms exceeding one year for office space. Rental expenditures for these leases were $714,785. The following is a schedule by years of future minimum rental payments as of year end:

2012	$ 753,993
2013	692,695
2014	692,695
2015	692,695
2016	692,695
Thereafter	1,404,209
Total	$ 4,928,982

F. Long-Term Liabilities

1. Economic Development Revenue Refunding Bonds, 2011

In June 2011, the Hospital participated in the issuance of $10,000,000 economic development revenue refunding bonds, Series 2011 (2011 bonds), issued through Harrison County. The proceeds were used for the refunding of the Hospital's 2005 Hospital construction revenue bonds (2005 bonds). However, the interest rate swap agreement (swap agreement) associated with the 2005 bonds was not terminated as part of the defeasance (Note II.A.3). The bonds are to be paid over 20 years by income derived from the acquired or constructed assets. Revenue bonds outstanding at year end are as follows:

Purpose	Interest Rates	Balance at December 31	Less: Deferral of Loss on Refunding	Amount
Economic Development Revenue Refunding Bonds, 2011	3.55%	$ 9,820,356	$ 388,623	$ 9,431,733

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Principal	Interest
2012	$ 353,100	$ 348,634
2013	367,010	334,723
2014	380,440	321,294
2015	394,361	307,372
2016	407,955	293,778
2017-2021	2,278,747	1,229,921
2022-2026	2,727,517	781,150
2027-2031	2,911,226	246,634
Totals	$ 9,820,356	$ 3,863,506

2. Harrison MOB, LLC, Note Payable

Long-term debt at December 31, 2011, was as follows:

Purpose	Interest Rates	Amount
Note payable to Harrison County Hospital in monthly installments of interest only, principal due April 2012	7.50%	$ 250,000
Note payable in monthly installments of principal and interest at one month LIBOR plus 1.25% (1.53% at December 31, 2011) maturing July 2017	Variable	5,188,970
Note payable in monthly installments of interest only at prime plus 1.20% (4.45% at December 31, 2011) maturing September 2017	5.00%	5,724
Total		$ 5,444,694

In 2011, Harrison MOB, LLC, (LLC) entered into a credit agreement to finance additional tenant improvements with a total amount available of $324,342. During construction, the agreement requires payments of interest only on the outstanding balance. On October 22, 2012, the agreement requires the commencement of monthly principal and interest payments totaling $2,103 with repayment of the obligation over 5 years at an interest rate of 5 percent. A final payment for the remaining principal balance will be due on September 22, 2017. The amount drawn on the construction loan as of December 31, 2011, of $5,724 has been classified as long-term debt.

Following is a schedule by years of maturity requirements on long-term debt as of December 31, 2011:

2012	$ 354,534
2013	106,185
2014	114,111
2015	122,628
2016	131,780
Thereafter	4,615,456
Total	$ 5,444,694

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the LLC entered into an interest rate swap agreement to hedge the variability in the forecasted interest payments for the variable rate term note described above. The agreement provides for the LLC to receive interest from the counterparty at one month LIBOR and to pay interest to the counterparty at a fixed rate of 5.97 percent on the outstanding notional amount which amortizes based on the expected amortization of the variable rate term note. At December 31, 2011, the fair value of the interest rate swap agreement was a liability in the amount of $1,318,697.

Summary information with respect to the interest rate swap agreement at December 31, 2011, was as follows:

	Fair Value	Notional Amount
Portion designated as a hedge	$ 1,280,693	$ 5,188,970
Portion not designated as a hedge	38,004	160,008
Total interest rate swap	$ 1,318,697	$ 5,348,978

3. Current Refunding

In June 2011, the Hospital defeased the 2005 bonds with proceeds from the issuance of the 2011 bonds, a contribution from Harrison County and current cash. However, the swap agreement associated with the 2005 bonds was not terminated as part of the defeasance. The 2011 bonds require that the Hospital establish and maintain a separate deposit account (cash reserve), so long as the swap agreement is in full force and effect. The Hospital shall maintain a cash reserve in an amount equal to any payment that may be due by the Hospital under the swap master agreement due to the termination of the swap agreement. The amount of the cash reserve shall be determined as of the date of the 2011 bond agreement and upon the receipt from time to time of the Hospital's annual financial statements as though the swap agreement was terminated as of such date. The purchaser of the 2011 bonds may consent to release funds from the cash reserve in the event the amount of funds then on deposit in the cash reserve exceeds the termination payment on such date. The Hospital has no rights in or claims to moneys on deposit in the cash reserve.

The following proceeds, at December 31, 2011, were set aside in restricted cash and investment accounts:

Primary Government	Amount
Noncurrent cash and investments:	
Held for interest rate swap	$ 3,257,984
Due from operating for held for interest rate swap	671,367
Total Held for interest rate swap	$ 3,929,351

4. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2011, was as follows:

Primary Government	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Revenue:					
Indiana Health and Educational Facility Financing Authority	$28,155,000	$ -	$28,155,000	$ -	$ -
Economic Development Revenue Refunding Bonds, 2011	-	10,000,000	179,644	9,820,356	353,100
Less deferred loss on refunding	-	(400,298)	(11,675)	(388,623)	(20,015)
Total bonds payable	28,155,000	9,599,702	28,322,969	9,431,733	333,085
Total long-term liabilities	$28,155,000	$9,599,702	$28,322,969	$9,431,733	$ 333,085
Discretely Presented Component Unit					
General long-term debt	$ 5,533,466	$ 5,724	$ 94,496	$5,444,694	$ 354,534

5. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2011, are required by terms of the financing agreement between the Hospital and Community Trust Bank, purchaser of the 2011 bonds:

Revenue from operations	$ 42,134,981
Investment income	360,080
Less:	
Net loss on disposal of assets	22,183
Expenses (excluding depreciation, amortization and interest on funded debt)	38,078,562
Total net revenue available for debt service	$ 4,394,316
Funded debt service for year	$ 3,287,009
Historical debt service coverage ratio	1.34 : 1

G. Restricted Net Assets

Hospital restricted, expendable net assets are available for the following purposes:

	2011
Expendable for interest rate swap:	
General	$ 71,459
Specified by creditors	3,929,351
Total expendable, restricted net assets	$ 4,000,810

H. Net Patient Service Revenue

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:

1. Medicare

   Inpatient acute care services and most outpatient services rendered to Medicare program beneficiaries are paid at 101 percent of allowable costs as reported on an annual Medicare Cost Report. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

2. Medicaid

   Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under bundled payments and fee for service payments, at amounts determined by the state. The Hospital is reimbursed at these rates on an interim basis, with subsequent lump sum payments made that are based on formulas which factor in the amount and types of services to uninsured and Medicaid patients.

Revenue from the Medicare and Medicaid programs accounted for approximately 36.07 percent and 8.56 percent, respectively, of the Hospital's net patient revenue for the year ended 2011. Laws and regulations governing the Medicare and Medicaid programs 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. The 2011 net patient service revenue increased approximately $718,287 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

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

I. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were $2,670,227 (6.57 percent) for 2011.

J. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

Funded Depreciation – Amounts transferred from the Operating Fund by the Hospital Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the Hospital buildings as authorized by Indiana Code 16-22-3-13.

Internally designated:	
Funded depreciation:	
Cash and cash equivalents	$ 1,824,924

III. Other Information

A. Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk.

Medical Benefits to Employees and Dependents

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees and dependents. The risk financing fund is accounted for in the Operating Fund, where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of $50,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years. Amounts are paid into the fund by all departments and are available to pay claims, claim reserves, and administrative costs of the program. Provisions are also made for unexpected and unusual claims.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported (IBNRs). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

However, claim liabilities cannot be reasonably estimated.

B. Subsequent Event

In December of 2011, the Hospital entered into agreements for replacement of Hospital clinical, financial and physician information systems. The implementation of the new systems will occur in 2012 with plans to place the systems in service in December 2012. The total initial cost of the systems is approximately $3.36 million, and the project will be funded from cash reserves. To date $1.7 million has been paid out on the project. Periodic payments based on services completed will be made as the project progresses with the final payments due in early 2013. The Hospital expects to recover 65 percent - 70 percent of this cost over the next several years through federal and state electronic health records (EHR) incentives, and to a lesser extent Medicare cost reimbursement for patient services.

C. Contingent Liabilities

Litigation

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

D. Fair Value Measurements

The Hospital has characterized its investments in securities, based on the priority of the inputs used to value the investments, into a three level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the investment.

Investments recorded in the statement of net assets are categorized based on the inputs to valuation techniques as follows:

Level 1 – These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Hospital has the ability to access.

Level 2 – These are investments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the investments. These investments are comprised of privately held securities.

Level 3 – These are investments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the investments. These investments could be certain private equity investments.

Based upon the levels as defined the investments as of December 31, 2011, are classified as follows:

		Fair Value Measurements at Reporting Date Using:		
Hospital Investment Type	December 31, 2011	Quoted Prices in Active Markets For Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government securities	$ 71,459	$ -	$ 71,459	$ -

E. Investment in Affiliated Companies

Harrison-Floyd Health Services, LLC

In 2004, the Hospital entered into an agreement with Floyd Memorial Hospital and Health Services to establish and operate a limited liability company, Harrison-Floyd Health Services, LLC. In accordance with this agreement, each hospital invested $150,000 for 50 percent equity interest in the LLC. The investment was made in the fiscal years 2004 and 2005. The LLC began operation in 2004. The investment is recorded on the equity method. The Hospital's investment in affiliated company is included in the Other assets category of the Statement of Net Assets.

Summarized financial information as of December 31, 2011, and for the year then ended from the unaudited financial statements of the affiliated company follows:

Current assets	$ 43,016
Noncurrent assets	31,789
Current liabilities	14,583
Net Assets	60,222
Revenues	90,125
Expenses	107,954
Net loss	(17,829)

Harrison MOB, LLC

On July 26, 2006, the Hospital entered into an agreement with several physicians and physician groups to establish and operate a medical office building to be located on the Hospital's campus in Corydon, Indiana, known as Harrison MOB, LLC (LLC). In accordance with this agreement, 68 Class A units and 37 Class B units were sold for $10,000 each, for an aggregate proceeds of $1,050,000. Each unit represents an equity interest of approximately .952 percent in the company. The Hospital purchased 64 units for an investment of $640,000 representing approximately 61.0 percent equity interest in the company. The medical office building was operational as of February 2009. The Hospital committed to lease available finished square footage in the building up to a 90 percent occupancy level for the first five years and up to 85 percent occupancy level for the next five years. The investment is recorded on the equity method. The Hospital's investment in affiliated company is included in the Other assets category of the Statement of Net Assets.

In July 2007, the LLC entered into a credit agreement in the principal amount of $5,440,000 to finance the construction of a medical office building on the campus of Harrison County Hospital. In February 2009, the building was deemed substantially complete and the LLC began making principal payments to amortize the balance of the loan of $5,440,000 over 25 years. The note payable is secured by all the LLC's assets, assignments of rents and a guarantee by Harrison County Hospital.

Summarized financial information as of December 31, 2011, and for the year then ended from the audited financial statements of the affiliated company follows:

Current assets	$ 87,171
Other assets	97,708
Capital assets, net	6,606,752
Current liabilities	547,507
Noncurrent liabilities	6,408,857
Members' deficit	(164,733)
Revenues	814,236
Expenses	910,972
Net loss	(96,736)

Equity distributions were received by Harrison County Hospital from the LLC in 2011 in the amount of $73,500.

F. Revenues Pledged

Revenues Pledged in Connection with Discrete Component Unit Debt

The Hospital has entered into a 10 year master lease agreement with Harrison MOB, LLC, which requires the Hospital to rent enough space to maintain a 90 percent occupancy level during the first five years starting February 2009. During the remaining five years of the agreement the requirement drops to 85 percent. For the year ended December 31, 2011, the Hospital's leases totaled $652,716.

G. Pension Plan

<u>Plan Description</u>

The Hospital has a defined contribution pension plan administered by MetLife as authorized by Indiana Code 16-22-3-11. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. That report may be obtained by contacting:

MetLife
c/o FasCare LLC
P.O. Box 173768
Denver, Colorado 80217-3768
Ph. (800) 543-2520

<u>Funding Policy and Annual Pension Cost</u>

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan member contributions are voluntary and are established by written authorization for payroll deduction into an annuity savings account. The Hospital is required to contribute at an actuarially determined rate. The current rate is 5 percent of annual covered payroll. Employer and employee contributions to the plan were $765,145 and $662,367, respectively.

H. Ambulance Service Subsidy

The Hospital provides ambulance service for Harrison County residents, through an agreement dated December 19, 1977. The agreement provides that Harrison County is to reimburse the Hospital, on a monthly basis, for the amount that expenses exceed revenues for the period. During the year 2011, Harrison County reimbursed the Hospital $986,791 for ambulance services. At December 31, 2011, Harrison County owed the Hospital an additional $319,373.

HARRISON COUNTY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on October 2, 2012, with Paul Martin, Chairman of the Hospital Board; Steven L. Taylor, Chief Executive Officer; Jeffrey L. Davis, Chief Financial Officer; and Keith Lieber, Controller. Our audit disclosed no material items that warrant comment at this time.