

**DeKalb Memorial Hospital, Inc.
d/b/a DeKalb Health**

Auditor's Report and Consolidated Financial Statements

September 30, 2013 and 2012



DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
September 30, 2013 and 2012

Contents

Independent Auditor’s Report..... 1

Consolidated Financial Statements

Balance Sheets 3
Statements of Operations 4
Statements of Changes in Net Assets 5
Statements of Cash Flows 6
Notes to Financial Statements 7

Independent Auditor's Report

Finance and Audit Committee
DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Auburn, Indiana

We have audited the accompanying consolidated financial statements of DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health and its subsidiary (Hospital), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the 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.

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 DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health and its subsidiary as of September 30, 2013 and 2012, and the results of their operations, the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, in 2013, the Hospital changed its method of presentation and disclosure of patient service revenue, provision for bad debts and allowance for doubtful accounts in accordance with Accounting Standards Update 2011-07. Our opinion is not modified for this matter.

BKD, LLP

Fort Wayne, Indiana
November 26, 2013

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Balance Sheets September 30, 2013 and 2012

	2013	2012
Assets		
Current Assets		
Cash and cash equivalents	\$ 102,771	\$ -
Accounts receivable		
Patient services, net of allowance for uncollectible accounts; 2013 - \$1,155,945, 2012 - \$862,642	7,587,634	7,325,062
Other	2,470,232	1,010,961
Estimated amounts due from third-party payers	-	142,811
Inventories	1,399,437	1,324,144
Prepaid expenses and other	1,050,045	1,040,979
Total current assets	12,610,119	10,843,957
Assets Limited as to Use		
Internally designated	17,207,351	15,473,760
Externally restricted by donor	1,817	108,889
Held by trustee	-	1,048,630
Total assets limited as to use	17,209,168	16,631,279
Property and Equipment, net	37,542,913	40,357,773
Other Assets	127,854	236,926
Total assets	\$ 67,490,054	\$ 68,069,935
Liabilities and Net Assets		
Current Liabilities		
Outstanding checks in excess of bank balance	\$ -	\$ 13,340
Current maturities of long-term debt	3,823,028	2,155,533
Accounts payable	1,779,836	1,773,900
Accrued salaries, wages and related liabilities	3,051,535	3,025,630
Estimated amounts due to third-party payers	11,800	-
Other accrued liabilities	1,777,979	1,265,064
Total current liabilities	10,444,178	8,233,467
Long-Term Debt, less current maturities	5,906,604	9,403,556
Total liabilities	16,350,782	17,637,023
Net Assets		
Unrestricted	51,137,455	50,324,022
Temporarily restricted	1,817	108,890
Total net assets	51,139,272	50,432,912
Total liabilities and net assets	\$ 67,490,054	\$ 68,069,935

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Consolidated Statements of Operations Years Ended September 30, 2013 and 2012

	2013	2012
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	\$ 55,575,454	\$ 52,847,956
Provision for uncollectible accounts	(4,443,148)	(4,525,484)
Net patient service revenue less provision for uncollectible accounts	51,132,306	48,322,472
Other	6,956,653	8,422,687
Net assets released from restrictions used for operations	41,845	26,862
Total unrestricted revenue, gains and other support	58,130,804	56,772,021
Expenses		
Salaries and wages	24,039,200	22,707,202
Payroll taxes and employee benefits	7,489,816	7,304,573
Purchased medical services	3,781,878	3,853,732
Medical supplies and drugs	8,104,177	7,587,626
Insurance	660,867	584,120
Depreciation and amortization	4,831,523	4,140,062
Interest	343,043	453,184
Other	10,140,336	9,407,795
Total expenses	59,390,840	56,038,294
Operating Income (Loss)	(1,260,036)	733,727
Other Income (Expense)		
Contributions received	-	58,534
Investment return, dividends, interest and realized gains	451,741	621,375
Investment return, change in unrealized gains on trading securities	1,339,837	1,908,412
Gain (loss) on investment in equity investee	217,304	(10,491)
Total other income	2,008,882	2,577,830
Excess of Revenue over Expenses	748,846	3,311,557
Net assets released from restrictions used for purchase of property and equipment	64,587	53,844
Increase in Unrestricted Net Assets	\$ 813,433	\$ 3,365,401

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2013 and 2012

	2013	2012
Unrestricted Net Assets		
Excess of revenue over expenses	\$ 748,846	\$ 3,311,557
Net assets released from restrictions used for purchase of property and equipment	<u>64,587</u>	<u>53,844</u>
Increase in unrestricted net assets	<u>813,433</u>	<u>3,365,401</u>
Temporarily Restricted Net Assets		
Contributions received	33,375	76,699
Net assets transferred to DeKalb Health Foundation	(34,016)	-
Net assets released from restrictions	<u>(106,432)</u>	<u>(80,706)</u>
Decrease in temporarily restricted net assets	<u>(107,073)</u>	<u>(4,007)</u>
Increase in Net Assets	706,360	3,361,394
Net Assets, Beginning of Year	<u>50,432,912</u>	<u>47,071,518</u>
Net Assets, End of Year	<u><u>\$ 51,139,272</u></u>	<u><u>\$ 50,432,912</u></u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Consolidated Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Operating Activities		
Change in net assets	\$ 706,360	\$ 3,361,394
Items not requiring (providing) operating cash flows		
Depreciation and amortization	4,793,353	4,140,062
Net realized and unrealized gains on investments	(1,410,362)	(2,091,805)
Restricted contributions	(33,375)	(76,699)
(Gain) loss on investment in equity investee	(217,304)	10,491
Changes in		
Patient accounts receivable	(262,572)	(165,720)
Other current assets and liabilities	(571,138)	214,153
Net cash provided by operating activities	3,004,962	5,391,876
Investing Activities		
Purchase of property and equipment	(1,843,152)	(4,856,504)
Purchase of investments	(10,764,306)	(5,752,659)
Proceeds from disposition of investments	11,596,779	5,412,878
Net cash used in investing activities	(1,010,679)	(5,196,285)
Financing Activities		
Outstanding checks in excess of bank balance	(13,340)	13,340
Proceeds from issuance of long-term debt	6,500,000	522,000
Principal payments on long-term debt	(7,602,106)	(1,705,874)
Net change in lines of credit	(809,441)	(2,076,117)
Proceeds from restricted contributions	33,375	76,699
Net cash used in financing activities	(1,891,512)	(3,169,952)
Increase (Decrease) in Cash and Cash Equivalents	102,771	(2,974,361)
Cash and Cash Equivalents, Beginning of Year	-	2,974,361
Cash and Cash Equivalents, End of Year	\$ 102,771	\$ -
Supplemental Cash Flows Information		
Interest paid (net of amount capitalized)	\$ 343,325	\$ 445,701
Capital lease obligation incurred for property and equipment	82,090	2,797,621
Fixed assets additions in accounts payable	10,829	-

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health (Hospital), a not-for-profit organization, provides inpatient and outpatient health care services generally to residents of DeKalb County, Indiana and contiguous counties. Expenses relate to the provision of medical care and related general and administrative costs. The consolidated financial statements include the accounts of DeKalb Memorial Hospital, Inc., d/b/a DeKalb Health and its wholly owned subsidiary, DeKalb Memorial Pharmicare LLC (DMP), a not-for-profit limited liability company which operates a retail pharmacy within the Hospital facility. All significant intercompany balances and transactions have been eliminated in consolidation.

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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Hospital considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At September 30, 2013 and 2012, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

At September 30, 2013, the Hospital's cash accounts did not exceed federally insured limits.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. The Hospital has classified substantially all of its investments in debt and equity securities as trading securities. The investment in equity investee is reported on the equity method of accounting. Investment return includes dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

Assets Limited as to Use

Assets limited as to use include (1) assets held by a trustee under terms of a bond indenture agreement, (2) assets restricted by donors and (3) assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital, if any, are included in current assets.

Change in Accounting Principle

In 2013, the Hospital changed its method of presentation and disclosure of patient service revenue, provision for bad debts and the allowance for doubtful accounts in accordance with Accounting Standards Update (ASU) 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The major changes associated with ASU 2011-07 are to reclassify the provision for uncollectible accounts related to patient service revenue to a deduction from patient service revenue and to provide enhanced disclosures around the Hospital's policies related to uncollectible accounts. The change had no effect on prior year change in net assets.

Consolidated Statements of Operations	As Restated	2012	Effect of Change
		As Previously Reported	
Net Patient Service Revenue	\$ 48,322,472	\$ 52,847,956	\$ (4,525,484)
Total unrestricted revenues, gains and other support	56,772,021	61,297,505	(4,525,484)
Operating expenses	56,038,294	60,563,778	(4,525,484)

Patient Accounts Receivable

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for bad debts in the period of service

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Hospital's allowance for doubtful accounts for self-pay patients increased from \$862,642 at September 30, 2012, to \$1,155,945 at September 30, 2013. In addition, the Hospital's write-offs decreased approximately \$82,000 from approximately \$4,443,000 for the year ended September 30, 2012, to approximately \$4,525,000 for the year ended September 30, 2013. The increase in the allowance for doubtful accounts is due to higher self-pay activity during the year. The decrease in write-offs was the result of positive trends experienced in the collection of self-pay patients in fiscal year 2013.

Inventories

Supply inventories are stated at the lower of cost, determined using the first-in, first-out (FIFO) method or market.

Property and Equipment

Property and equipment are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

The Hospital capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowing. Total interest incurred was:

	<u>2013</u>	<u>2012</u>
Interest costs capitalized	\$ -	\$ 46,000
Interest costs charged to expense	<u>343,043</u>	<u>453,184</u>
Total interest incurred	<u>\$ 343,043</u>	<u>\$ 499,184</u>

Long-Lived Asset Impairment

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

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

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.

No asset impairment was recognized during the years ended September 30, 2013 and 2012. Fair value was determined based on current and projected cash flows.

Patient Accounts Receivable Financing

Under a credit financing agreement, qualified self-pay patients can receive interest-bearing loans from an independent financial institution to pay their receivable balances to the Hospital. The transfer of these receivables is with full recourse to the Hospital. At September 30, 2013 and 2012, these receivables totaled \$342,492 and \$292,565, respectively. The Hospital has recorded a liability for estimated required repayments of \$4,726 and \$19,984 on these loans at September 30, 2013 and 2012, respectively.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Temporarily restricted net assets at September 30, 2013 and 2012, were available for the purchase of building improvements and equipment and operational expenses of various Hospital service lines.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. The Hospital's direct and indirect costs for services furnished under its charity care policy aggregated approximately \$1,155,000 and \$874,000 in 2013 and 2012, respectively.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted contributions and released from restriction.

Estimated Malpractice Costs

The Hospital participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the Hospital, with the balance paid by the State of Indiana Patient Compensation Fund. The Hospital carries a claims-made basis insurance policy covering the Hospital's \$250,000 of exposure per claim with a \$5,000,000 annual aggregate. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents, including an estimate for claims incurred but not yet reported. Based upon the Hospital's claim experience, an accrual of \$75,000 has been made at September 30, 2013 and 2012, which is included in other accrued liabilities. It is reasonably possible that this estimate could change materially in the near term.

In 2012, the Hospital adopted the provisions of Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*. This ASU eliminates the practice of netting claim liabilities with expected related insurance recoveries for balance sheet presentation. As a result of the adoption of ASU 2010-24, the Hospital has recorded a long-term asset and liability of approximately \$542,000 and \$490,000 included in other current assets and liabilities on the consolidated balance sheet as of September 30, 2013 and 2012, respectively.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

In 2013, the Hospital completed the second-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately \$940,000, which is included in other revenue within operating revenues in the statements of operations. In 2012, the Hospital completed the first-year requirements under both the Medicare and Medicaid programs and recorded revenue of approximately \$1,919,000, which is also included in other revenue within operating revenues in the statements of operations.

Pension Plan

The Hospital has a noncontributory defined contribution pension plan covering all eligible employees. The Hospital's cost each year is determined by the plan as a specific percentage of each participating employee's salary. It is the Hospital's policy to fund pension costs as accrued. Pension expense was approximately \$1,001,000 and \$916,000 in 2013 and 2012, respectively.

Self Insurance

The Hospital has elected to self-insure certain costs related to employee health programs. Costs resulting from noninsured losses are charged to income when incurred. The Hospital has purchased insurance that limits its exposure for individual claims to \$95,000 per covered employee and that limits its aggregate exposure to approximately \$5,174,000.

Income Taxes

The Hospital has been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income. The Hospital files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Hospital is no longer subject to U.S. federal or state examinations by tax authorities for years before 2010.

The Hospital has elected to have DMP's income taxed as a partnership under provisions of the Internal Revenue Code and a similar section of the state income tax law. Therefore, taxable income or loss is reported to the Hospital for inclusion in its tax returns and no provision for federal and state income taxes is included in these statements.

DMP is subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for all periods since its inception in 2011.

Excess of Revenue Over Expenses

The consolidated statements of operations include excess of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Note 2: Net Patient Service Revenue

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the statement of operations as a component of net patient service revenue.

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services provided to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment although determination of certain elements of the rates can occur after the current period and generate final settlement after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary.

Medicaid. The Hospital is reimbursed for Medicaid inpatient and outpatient services at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Other Reimbursement Arrangements. The Hospital also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations 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.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended September 30, 2013 and 2012, respectively, was approximately:

	2013	2012
Medicare	\$ 11,575,451	\$ 12,729,646
Medicaid	3,932,712	4,340,833
Other third-party payers	31,796,756	28,368,581
Self-pay	8,270,535	7,408,896
Total	<u>\$ 55,575,454</u>	<u>\$ 52,847,956</u>

In 2011, the state of Indiana submitted certain Medicaid State Plan Amendments to the Centers for Medicare and Medicaid Services (CMS) to incorporate a Provider Assessment Fee, requesting retroactive approval to July 1, 2011, which was approved by CMS initially in 2012. The effect of the Provider Assessment Fee on reimbursement is to increase Medicaid base fee for service and diagnosis related group payment rates to Indiana hospitals and reduce the level of Medicaid lump sum payments made under the existing Medicaid Supplemental Payment programs. For the year ended September 30, 2013, the Hospital paid Provider Assessment Fees of approximately \$2,300,000, and received payments from the program of approximately \$3,900,000, yielding a net

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

increase to 2013 revenue in excess of expenses of approximately \$1,600,000. For the year ended September 30, 2012, the Hospital paid Provider Assessment Fees of approximately \$2,077,000, of which approximately \$415,000 related to the September 30, 2011, calendar year, and received payments from the program of approximately \$3,493,000, of which approximately \$699,000 related to the September 30, 2011, calendar year, yielding a net increase to 2012 revenue in excess of expenses of approximately \$1,416,000, of which approximately \$283,000 relates to 2011. Provider Assessment Fee expense is included within other expenses and additional reimbursements received from the program are included within net patient service revenue on the 2013 and 2012 consolidated statements of operations.

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents and are generally insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2013 and 2012, was:

	<u>2013</u>	<u>2012</u>
Commercial insurance	30%	43%
Medicare	26	19
Medicaid	4	4
Self-pay	33	26
Other	7	8
	<u>100%</u>	<u>100%</u>

Note 4: Investments and Investment Return

Assets Limited as to Use

Assets limited as to use at September 30, include:

	<u>2013</u>	<u>2012</u>
Cash and money market funds	\$ 92,136	\$ 1,238,415
Mutual funds		
Equity mutual funds		
Large blend and growth funds	4,834,868	5,934,655
Intermediate term growth funds	1,707,642	1,311,421
Small blend and growth funds	934,078	834,575
International funds	6,696,061	4,271,739
Other funds	1,249,707	969,519
Fixed income mutual funds	1,694,676	2,070,955
	<u>\$ 17,209,168</u>	<u>\$ 16,631,279</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Internally designated	\$ 17,207,351	\$ 15,473,760
Externally restricted by donors	1,817	108,889
Held by trustee	-	1,048,630
	<u>\$ 17,209,168</u>	<u>\$ 16,631,279</u>

Total investment return is comprised of the following:

	<u>2013</u>	<u>2012</u>
Interest and dividend income	\$ 381,215	\$ 434,382
Realized gains on sales of securities	70,526	186,993
Unrealized gains on trading securities	1,339,837	1,908,412
	<u>\$ 1,791,578</u>	<u>\$ 2,529,787</u>

Note 5: Property and Equipment

Property and equipment at September 30 consists of:

	<u>2013</u>	<u>2012</u>	<u>Estimated Useful Life</u>
Land	\$ 393,118	\$ 393,118	
Land improvements	1,699,339	1,968,432	5-15 years
Hospital buildings	42,710,321	43,672,704	5-40 years
Medical office buildings	9,427,779	9,695,673	5-40 years
Equipment	19,311,432	20,708,722	5-20 years
Medical office equipment	52,658	55,281	5-20 years
Equipment held under capital lease	2,105,113	2,914,188	5 years
Construction in progress	106,925	225,281	
	75,806,685	79,633,399	
Less accumulated depreciation and amortization	<u>(38,263,772)</u>	<u>(39,275,626)</u>	
	<u>\$ 37,542,913</u>	<u>\$ 40,357,773</u>	

Note 6: Investment in Equity Investee

The Hospital has a 50% ownership in a joint venture, which operates an occupational health clinic (RediMed DeKalb LLC) in Auburn, Indiana. The Hospital accounts for the investment under the equity method of accounting. As a result, the Hospital recognized a gain (loss) of \$17,803 and (\$10,491) related to its investment in RediMed DeKalb LLC for the years ended September 30,

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2013 and 2012

2013 and 2012, respectively, which is included in other income (expense) category in the statements of operations.

Note 7: Medical Office Buildings

The Hospital owns medical office buildings (MOBs) adjacent to the Hospital, and leases space in these MOBs to physicians under various operating leases. Other revenue for the years ended September 30, 2013 and 2012, includes gross rental income of approximately \$709,000 and \$712,000, respectively, from cancelable and noncancelable leases of the medical office building.

The following is a schedule, by year, of future minimum rental income to be received under operating leases which have initial or remaining noncancelable terms in excess of one year as of September 30, 2013:

2014		\$	419,293	
2015			246,114	
2016			116,631	
			116,631	
		\$	782,038	

Note 8: Long-Term Debt

Long-term debt at September 30, consists of the following:

	2013		2012	
Hospital Authority of DeKalb County, Indiana, Revenue Bonds, Series 2006: Series A and B Bonds, payable through August 1, 2016, interest at 3.9% to 5.0% (A)	\$ -	\$	5,351,775	
Note payable to bank, maturity date of December 14, 2021 (B)	-		3,241,376	
Note payable to bank, maturity date of January 14, 2018 (C)	2,431,936		-	
Note payable to bank, maturity date of March 14, 2020 (D)	5,900,000		-	
Note payable to third party, maturity date of June 1, 2016 to purchase land adjacent to campus, paid in full during 2013.	-		522,000	
Capital lease obligations, at various imputed interest rates ranging from 2.26% to 2.33%	1,397,696		2,443,938	
	9,729,632		11,559,089	
Less current maturities	(3,823,028)		(2,155,533)	
	\$ 5,906,604		\$ 9,403,556	

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

- (A) The Hospital Authority of DeKalb County (Authority) was established in accordance with the Indiana Hospital Authority Act to issue tax-exempt revenue bonds for hospitals within DeKalb County. Payments due under the bonds are made from amounts received by the Authority from the Hospital under a loan agreement. The Hospital's financial statements reflect the debt and related transactions of the Authority, on behalf of the Hospital, as if the Hospital had issued the tax-exempt bonds.

The Series 2006 Bonds matured serially in varying annual amounts through August 2016. At its option, the Hospital may redeem outstanding Series 2006 Bonds at any time on or after August 1, 2011. The Hospital exercised this option during the year ended September 30, 2013, and the Bonds were fully refunded and the Hospital was relieved of its obligation associated with these Bonds.

- (B) In 2011, the Hospital entered into a \$9,000,000 revolving bank line of credit originally expiring in 2021. At September 30, 2012, there was \$3,241,376 borrowed against this line. During the year ended September 30, 2013, this line was refinanced into a new revolving bank line of credit and this line was terminated.
- (C) In 2013, the Hospital entered into a \$9,000,000 revolving bank line of credit expiring in 2018, but is subject to a due on demand clause. At September 30, 2013, there was \$2,431,936 borrowed against this line. The line of credit is secured by certain investments. Monthly payments of accrued interest are due beginning February 2013, and the line of credit is due on demand. If no demand is made by the bank, the outstanding principal and any accrued and unpaid interest is due January 2018. Interest varies based on an internal index of the issuing bank, and was 2.75% at September 30, 2013.
- (D) In 2013, the Hospital entered into a \$6,500,000 term note maturing in 2020. At September 30, 2013 there was \$5,900,000 borrowed against this note. The note is secured by inventory, accounts receivable, equipment and certain other assets. Monthly principal payments of \$75,000 plus interest are due beginning February 2013. All outstanding principal and any accrued and unpaid interest is due March 2020. Interest varies based on an internal index of the issuing bank, and was 2.75% at September 30, 2013.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2013 and 2012

Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2013, are:

	Long-Term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2014	\$ 3,331,936	\$ 517,211
2015	900,000	446,201
2016	900,000	446,102
2017	900,000	37,175
2018	900,000	-
Thereafter	1,400,000	-
	\$ 8,331,936	1,446,689
Less amount representing interest		(48,993)
Present value of future minimum lease payments		1,397,696
Less current maturities		(491,092)
Noncurrent portion		\$ 906,604

Property and equipment include the following property under capital leases:

	2013	2012
Equipment	\$ 2,105,113	\$ 2,914,188
Less accumulated depreciation	(631,534)	(401,542)
	\$ 1,473,579	\$ 2,512,646

Note 9: Disclosures About Fair Value of Assets and Liabilities

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2013 and 2012:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013				
Investments				
Money market funds	\$ 87,004	\$ 87,004	\$ -	\$ -
Equity mutual funds				
Large blend and growth funds	4,834,868	4,834,868	-	-
Intermediate term growth funds	1,707,642	1,707,642	-	-
Small blend and growth funds	934,078	934,078	-	-
International funds	6,696,061	6,696,061	-	-
Other funds	1,249,707	1,249,707	-	-
	15,422,356	15,422,356	-	-
Fixed income mutual funds	1,694,676	1,694,676	-	-
	<u>\$ 17,204,036</u>	<u>\$ 17,204,036</u>	<u>\$ -</u>	<u>\$ -</u>

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2012				
Investments				
Money market funds	\$ 1,129,526	\$ 1,129,526	\$ -	\$ -
Equity mutual funds				
Large blend and growth funds	5,934,655	5,934,655	-	-
Intermediate term growth funds	1,311,421	1,311,421	-	-
Small blend and growth funds	834,575	834,575	-	-
International funds	4,271,739	4,271,739	-	-
Other funds	969,519	969,519	-	-
	13,321,909	13,321,909	-	-
Fixed income mutual funds	2,070,955	2,070,955	-	-
	<u>\$ 16,522,390</u>	<u>\$ 16,522,390</u>	<u>\$ -</u>	<u>\$ -</u>

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. The Hospital has no liabilities measured at fair value on a recurring basis. Additionally, the Hospital has no assets or liabilities measured at fair value on a nonrecurring basis. There have been no significant changes in the valuation of techniques during the year ended September 30, 2013.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. The Hospital has no Level 2 securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Hospital has no Level 3 securities.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2013 and 2012

Note 10: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Note 1.

Regulatory Investigations

The U.S. Department of Justice, the Internal Revenue Service and other federal agencies routinely conduct regulatory investigations and compliance audits of health care providers. The Hospital is subject to these regulatory efforts. Management is currently unaware of any regulatory matters which may have a material adverse effect on the Hospital's financial position or results of operations.

Investments

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying balance sheets.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. At September 30, 2013 and 2012, no accrual of potential losses from litigation was recorded other than in relation to the Hospital's estimated malpractice insurance costs as discussed in Note 1. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health

Notes to Consolidated Financial Statements

September 30, 2013 and 2012

Note 11: Related Party Transactions

The Hospital and DeKalb County Community Memorial Hospital Foundation, Inc. (Foundation) are related parties that are not financially interrelated organizations. The Foundation was established to receive and administer funds and to apply them for the acquisition, construction, establishment and operation of a Community Memorial Hospital for DeKalb County, Indiana. In the absence of donor restrictions, funds are distributed as determined by the Foundation's Board of Directors, which are separately appointed from that of the Hospital.

The Hospital received \$162,000 in donations from the Foundation for the year ended September 30, 2012. The Hospital did not receive any donations from the Foundation for the year ended September 30, 2013. During the year ended September 30, 2013, the Hospital transferred \$34,016 of funds to the Foundation. There were no transfers for the year ended September 30, 2012.

Note 12: Functional Expenses

The Hospital provides health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>2013</u>	<u>2012</u>
Health care services	\$ 52,857,848	\$ 49,874,082
General and administrative	<u>6,532,992</u>	<u>6,164,212</u>
	<u>\$ 59,390,840</u>	<u>\$ 56,038,294</u>

Note 13: *Patient Protection and Affordable Care Act*

The *Patient Protection and Affordable Care Act* (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

DeKalb Memorial Hospital, Inc. d/b/a DeKalb Health
Notes to Consolidated Financial Statements
September 30, 2013 and 2012

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible it will have a negative impact on the Hospital's net patient service revenue. In addition, it is possible the Hospital will experience payment delays and other operational challenges during PPACA's implementation.

Note 14: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.