# KDH

## King's Daughters' Health

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2013 AND 2012**

*CPAs / ADVISORS*

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# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

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DECEMBER 31, 2013 AND 2012


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# REPORT OF INDEPENDENT AUDITORS

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

## Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of King's Daughters' Health and its affiliated organizations (the "Hospital")(a nonprofit organization), which comprise the consolidated balance sheets as of December 31, 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 consolidated financial statements.

## Management's Responsibility for the Consolidated Financial Statements

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

## Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Blue & Co., LLC

Louisville, Kentucky
April 9, 2014

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

## ASSETS

| | 2013 | 2012 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | $ 8,176,716 | $ 11,894,610 |
| Investments - short term | 301,323 | -0- |
| Patient accounts receivable, net of allowance for doubtful accounts of $10,842,582 in 2013 and $11,062,908 in 2012 | 10,039,288 | 10,420,027 |
| Inventories | 2,323,063 | 2,316,588 |
| Prepaid expenses and other current assets | 4,408,672 | 1,338,550 |
| Other assets - current portion | 262,982 | 324,796 |
| Total current assets | 25,512,044 | 26,294,571 |
| **Assets whose use is limited** | 68,344,082 | 76,401,757 |
| **Property and equipment** | | |
| Land | 5,622,068 | 5,157,538 |
| Buildings and improvements | 112,551,672 | 42,618,876 |
| Fixtures and equipment | 56,126,079 | 46,851,417 |
| | 174,299,819 | 94,627,831 |
| Less accumulated depreciation | 38,579,141 | 60,633,566 |
| | 135,720,678 | 33,994,265 |
| Construction in progress | 900,258 | 96,938,140 |
| Property and equipment, net | 136,620,936 | 130,932,405 |
| **Other assets, net of current portion** | 4,762,727 | 6,854,494 |
| **Investments - long term** | 1,000,000 | 1,000,000 |
| Total assets | $ 236,239,789 | $ 241,483,227 |

*See accompanying notes to consolidated financial statements.*

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

## LIABILITIES AND NET ASSETS

| | 2013 | 2012 |
|---|---|---|
| **Current liabilities** | | |
| Accounts payable | $ 4,688,962 | $ 4,462,305 |
| Accrued payroll and payroll withholdings | 1,505,996 | 1,382,258 |
| Accrued expenses | 6,974,767 | 7,832,579 |
| Estimated third-party payor settlements | 1,300,000 | 1,300,000 |
| Current portion of obligations under capital leases | 339,430 | 139,617 |
| Total current liabilities | 14,809,155 | 15,116,759 |
| **Long-term liabilities** | | |
| Obligations under capital leases, net of current portion | 967,406 | 350,285 |
| Long-term debt, net of current portion | 97,975,255 | 97,934,743 |
| Life insurance policies | 1,433,990 | 2,397,928 |
| Deferred compensation liabilities | 123,040 | 1,087,902 |
| Total long-term liabilities | 100,499,691 | 101,770,858 |
| Total liabilities | 115,308,846 | 116,887,617 |
| **Net assets** | | |
| Controlling interest - unrestricted | 120,097,033 | 124,379,819 |
| Noncontrolling interest - unrestricted | -0- | 19,075 |
| Total unrestricted net assets | 120,097,033 | 124,398,894 |
| Temporarily restricted | 813,910 | 186,716 |
| Permanently restricted | 20,000 | 10,000 |
| Total net assets | 120,930,943 | 124,595,610 |
| Total liabilities and net assets | $ 236,239,789 | $ 241,483,227 |

*See accompanying notes to consolidated financial statements.*

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2013 AND 2012

| | 2013 | 2012 |
|---|---|---|
| **Changes in unrestricted net assets** | | |
| **Operating revenues** | | |
| Net patient service revenue | $ 125,924,979 | $ 122,754,469 |
| Less: Provision for bad debts | (14,239,677) | (15,232,421) |
| Net patient service revenue less provision for bad debts | 111,685,302 | 107,522,048 |
| Other revenue | 3,005,688 | 592,733 |
| Net assets released from restrictions | 65,933 | 19,946 |
| Total operating revenues | 114,756,923 | 108,134,727 |
| **Operating expenses** | | |
| Salaries and wages | 53,273,734 | 49,300,672 |
| Employee benefits and payroll taxes | 12,917,464 | 12,483,314 |
| Professional medical fees | 1,067,152 | 1,402,095 |
| Medical supplies | 5,588,434 | 4,358,861 |
| Other supplies | 1,247,864 | 1,186,605 |
| Drugs | 7,750,542 | 7,099,364 |
| Purchased services | 9,323,284 | 8,050,030 |
| Utilities | 1,911,709 | 1,616,192 |
| Insurance | 1,267,048 | 1,168,188 |
| Depreciation and amortization | 11,216,404 | 6,233,961 |
| Interest | 4,702,261 | 35,278 |
| Hospital assessment fee | 4,026,986 | 4,454,745 |
| Other operating expenses | 7,384,528 | 5,957,851 |
| Total operating expenses | 121,677,410 | 103,347,156 |
| Income (loss) from operations | (6,920,487) | 4,787,571 |
| **Nonoperating gains (losses)** | 2,952,046 | 5,082,305 |
| **Goodwill impairment** | (1,354,067) | -0- |
| Excess revenues (expenses) | (5,322,508) | 9,869,876 |
| **Distributions** | (52,077) | (71,050) |
| Change in unrestricted net assets | (5,374,585) | 9,798,826 |
| **Changes in temporarily restricted net assets** | | |
| Contributions | 283,723 | 86,924 |
| Net assets released from restrictions | (65,933) | (19,946) |
| Change in temporarily restricted net assets | 217,790 | 66,978 |
| Change in net assets | $ (5,156,795) | $ 9,865,804 |

*See accompanying notes to consolidated financial statements.*

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
## YEARS ENDED DECEMBER 31, 2013 AND 2012

| | Controlling Interest | Noncontrolling Interest | Total |
|---|---|---|---|
| **Unrestricted Net Assets** | | | |
| Balance, December 31, 2011 | $ 114,586,599 | $ 13,469 | $ 114,600,068 |
| Excess revenues (expenses) | 9,793,220 | 76,656 | 9,869,876 |
| Distributions | -0- | (71,050) | (71,050) |
| Balance, December 31, 2012 | $ 124,379,819 | $ 19,075 | $ 124,398,894 |
| Consolidation of affiliated organization previously not consolidated (Note 1), January 1, 2013 | 1,072,724 | -0- | 1,072,724 |
| Excess revenues (expenses) | (5,355,510) | 33,002 | (5,322,508) |
| Distributions | -0- | (52,077) | (52,077) |
| Balance, December 31, 2013 | $ 120,097,033 | $ -0- | $ 120,097,033 |
| **Temporarily Restricted Net Assets** | | | |
| Balance, December 31, 2011 | | | $ 119,738 |
| Change in temporarily restricted net assets | | | 66,978 |
| Balance, December 31, 2012 | | | $ 186,716 |
| Consolidation of affiliated organization previously not consolidated (Note 1), January 1, 2013 | | | 409,404 |
| Change in temporarily restricted net assets | | | 217,790 |
| Balance, December 31, 2013 | | | $ 813,910 |
| **Permanently Restricted Net Assets** | | | |
| Balance, December 31, 2011 | | | $ 10,000 |
| Change in permanently restricted net assets | | | -0- |
| Balance, December 31, 2012 | | | $ 10,000 |
| Consolidation of affiliated organization previously not consolidated (Note 1), January 1, 2013 | | | 10,000 |
| Change in permanently restricted net assets | | | -0- |
| Balance, December 31, 2013 | | | $ 20,000 |

*See accompanying notes to consolidated financial statements.*

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 2013 AND 2012

| | 2013 | 2012 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Change in net assets | $ (5,156,795) | $ 9,865,804 |
| Adjustments to reconcile total change in net assets to net cash from operating activities | | |
| Depreciation | 11,162,932 | 6,180,489 |
| Amortization | 53,472 | 53,472 |
| Provision for bad debts | 14,239,677 | 15,232,421 |
| Reclass of distributions to financing activities | 52,077 | 71,050 |
| Loss on disposal of capital assets | 5,399,613 | 510,712 |
| Amortization of bond discount | 40,512 | 40,624 |
| Net realized gains and losses and unrealized gains and losses on assets whose use is limited | (6,299,482) | (3,835,089) |
| Goodwill impairment | 1,354,067 | -0- |
| Changes in operating assets and liabilities | | |
| Patient accounts receivable | (13,858,938) | (14,679,426) |
| Inventories | (6,475) | (203,037) |
| Prepaid expenses and other current assets | (3,070,122) | (379,309) |
| Accounts payable | 193,767 | (3,220,780) |
| Accrued payroll and payroll withholdings | 123,738 | 285,602 |
| Accrued expenses | (857,812) | 708,351 |
| Estimated third-party payor settlements | -0- | 254,362 |
| Net cash from operating activities | 3,370,231 | 10,885,246 |
| **Cash flows from investing activities** | | |
| Purchases of property and equipment | (21,512,899) | (59,017,608) |
| Proceeds from sale of capital assets | 587,750 | 20,777 |
| Change in investments | (301,323) | -0- |
| Change in assets whose use is limited | 14,357,157 | 53,602,452 |
| Change in other assets | 746,042 | (773,997) |
| Change in life insurance policies | (963,938) | 194,549 |
| Change in deferred compensation liabilities | (964,862) | 94,548 |
| Net cash from investing activities | (8,052,073) | (5,879,279) |
| **Cash flows from financing activities** | | |
| Consolidation of affiliated organization previously not consolidated | 1,492,128 | -0- |
| Principal payments on obligations under capital leases | (476,103) | (546,468) |
| Distributions to noncontrolling interest holders | (52,077) | (71,050) |
| Net cash from financing activities | 963,948 | (617,518) |
| Net change in cash and cash equivalents | (3,717,894) | 4,388,449 |
| **Cash and cash equivalents, beginning of year** | 11,894,610 | 7,506,161 |
| **Cash and cash equivalents, end of year** | $ 8,176,716 | $ 11,894,610 |

*See accompanying notes to consolidated financial statements.*

# KING'S DAUGHTERS' HEALTH AND AFFILIATED ORGANIZATIONS

## CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012

| | 2013 | 2012 |
|---|---|---|
| **Supplemental disclosure of cash flow information** | | |
| Cash paid during the year for interest | $ 4,702,261 | $ 35,278 |
| **Supplemental disclosure of noncash operating and investing activities** | | |
| Property and equipment acquired under accounts payable | $ 32,890 | $ 2,381,811 |
| **Supplemental disclosure of noncash investing and financing activities** | | |
| Property and equipment acquired under capital leases | $ 1,293,037 | $ 140,505 |

*See accompanying notes to consolidated financial statements.*

## 1. NATURE OF OPERATIONS

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

Madison Catheterization Services, LLC ("MCS"), is a limited liability company owned 51 percent by KDH. MCS performs catheterization services for the residents of Jefferson County, Indiana and surrounding areas. MCS's primary source of support is from patient revenues. MCS was legally dissolved on December 31, 2013.

The King's Daughters' Hospital Foundation, Inc. (the "Foundation") is a not-for-profit organization created in 2005 and located in Madison, Indiana. The Foundation operates for the benefit of KDH. The Foundation's main sources of revenue are earnings on investments, and contributions received. Prior to 2013, the Foundation was excluded from the consolidated financial statements due to its immaterial nature. The inclusion of the Foundation in the consolidated financial statements increased total net assets by $1,492,128 on January 1, 2013. The 2012 consolidated financial statements have not been restated for the effects of the Foundation due to immateriality.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### Reporting Entity and Consolidation Policy

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

### Management's Estimates

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

Cash and Cash Equivalents

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

Investments

Short-term investments are recorded at cost, which approximates market value, and include certificates of deposit that are not board-designated or donor restricted. Short-term investments are recorded at cost, which approximates market value. Long-term investments include shares of preferred stock in a local bank, with a term of five years and carrying a dividend rate of 7.25 percent. Long-term investments are recorded at cost, which approximates market value.

Patient Accounts Receivable and Net Patient Service Revenue

The Hospital recognizes net patient service revenues on the accrual basis of accounting in the reporting period in which services are performed based on the current gross charge structure, less actual adjustments and estimated discounts for contractual allowances, principally for patients covered by Medicare, Medicaid, managed care, and other health plans. Gross patient service revenue is recorded in the accounting records using the established rates for the types of service provided to the patient. The Hospital recognizes an estimated contractual allowance to reduce gross patient charges to the estimated net realizable amount for service rendered based upon previously agreed-to rates with a payor. The Hospital utilizes the patient accounting system to calculate contractual allowances on a payor-by-payor basis based on the rates in effect for each primary third-party payor. Another factor that is considered and could further influence the level of the contractual reserves includes the status of accounts receivable balances as inpatient or outpatient. The Hospital's management continually reviews the contractual estimation process to consider and incorporate updated laws and regulations and the frequent changes in managed care contractual terms that result from contract negotiations and renewals.

Payors include federal and state agencies, including Medicare and Medicaid, managed care health plans, commercial insurance companies, and patients. These third-party payors provide payments to the Hospital at amounts different from its established rates based on negotiated reimbursement agreements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and fee schedule payments. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowances for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts based on the Hospital's evaluation of its major payor sources of revenue, the aging of the accounts, historical losses, current economic conditions, and other factors unique to the service area and the healthcare industry. Management regularly reviews data about the major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party payor coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulty that make the realization of amounts due unlikely). For receivables associated with self-pay payments, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Hospital's current allowance for doubtful accounts policy is to reserve 85 percent of self-pay accounts less than 150 days, 100 percent of self-pay accounts 150 and older, and 100 percent of all other payor accounts 150 days and older, net of contractual allowances already taken. The December 31, 2013 and 2012 allowance for doubtful accounts balances were comprised of the following:

| | 2013 | 2012 |
|---|---|---|
| Reserve for third-party payor balances | $ 2,288,019 | $ 2,729,734 |
| Reserve for self-pay balances | 8,554,563 | 8,333,174 |
| Total allowance for doubtful accounts | $ 10,842,582 | $ 11,062,908 |

Inventories

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

Assets Whose Use is Limited

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

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

Property and Equipment

Property and equipment are recorded at cost, except for donations, which are recorded at the fair market value at the date of the donation.

Property and equipment include expenditures for additions and repairs which substantially increase the useful lives of existing property and equipment. Maintenance, repairs, and minor improvements are expensed as incurred.

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

Cost of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets, if any, are capitalized as a component of the cost of acquiring those assets. For the years ended December 31, 2013 and 2012, interest costs incurred were as follows:

| | 2013 | 2012 |
|---|---|---|
| Interest costs capitalized | $ 783,042 | $ 4,517,787 |
| Interest costs expensed | 4,702,261 | 35,278 |
| Interest costs incurred | $ 5,485,303 | $ 4,553,065 |

Temporarily and Permanently 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. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity.

Consolidated Statements of Operations

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

Performance Indicator

The consolidated statements of operations include *excess revenues (expenses).* Consistent with industry practice, changes in net assets which are excluded from *excess revenues (expenses)* include, if any, unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets.)

Charity Care

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

Donor-Restricted Gifts

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

Income Taxes

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

MCS is a limited liability company which is treated as a partnership for income tax purposes. As such, net taxable income or loss is taxed directly to the members and not to MCS. Accordingly, income taxes have not been reflected in the accompanying consolidated financial statements. As of December 31, 2013, the 2009 – 2013 income tax years are still open for tax examinations.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and recognize a tax liability if the Hospital has taken an uncertain tax position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Hospital, and has concluded that as of December 31, 2013 and 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Hospital is subject to routine audits by taxing jurisdictions. However, as of the date of the financial statements were issued, there were no audits for any tax periods in progress.

Risk Management

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

Non-Controlling Interest

Non-controlling interests represent the portion of the equity (net assets) that is attributable to investors that are external to and not included in the Hospital's consolidated financial statements.

Reclassifications

Certain 2012 amounts have been reclassified to provide for consistency with reporting of 2013 information. These reclassifications have no effect on the previously reported total change in net assets or net assets.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued, which is April 9, 2014.

## 3. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Total investments are reported at cost which approximates market value and include the following at December 31, 2013 and 2012:

| | 2013 | % | 2012 | % |
|---|---|---|---|---|
| Certificates of deposit | $ 301,323 | 23.2 % | $ -0- | 0.0 % |
| Bank preferred stock | 1,000,000 | 76.8 | 1,000,000 | 100.0 |
| Total investments | $ 1,301,323 | 100.0 % | $ 1,000,000 | 100.0 % |

Assets whose use is limited are reported at market value and include the following at December 31, 2013 and 2012:

| | 2013 | % | 2012 | % |
|---|---|---|---|---|
| Cash and cash equivalents | $ 18,150,321 | 26.6 % | $ 25,122,881 | 32.9 % |
| Common stocks | 13,185,710 | 19.3 | 13,708,512 | 17.9 |
| Mutual funds | 29,635,167 | 43.4 | 29,781,304 | 39.0 |
| Certificates of deposit | 490,901 | 0.7 | -0- | 0.0 |
| Corporate bonds | 1,461,319 | 2.1 | 1,062,352 | 1.4 |
| U.S. Government securities | 5,420,664 | 7.9 | 6,726,708 | 8.8 |
| Total assets whose use is limited | $ 68,344,082 | 100.0 % | $ 76,401,757 | 100.0 % |

| | 2013 | % | 2012 | % |
|---|---|---|---|---|
| Board-Designated Funds | $ 60,630,270 | 88.7 % | $ 52,729,610 | 69.0 % |
| Trustee-Held Funds | 6,756,862 | 9.9 | 22,387,529 | 29.3 |
| Donor-Restricted Funds | 833,910 | 1.2 | 196,716 | 0.3 |
| Deferred Compensation | 123,040 | 0.2 | 1,087,902 | 1.4 |
| Total | $ 68,344,082 | 100.0 % | $ 76,401,757 | 100.0 % |

Investment income is comprised of the following for the years ended December 31, 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| Dividends and interest income | $ 1,410,261 | $ 1,391,687 |
| Realized gains (losses) on investments | 2,294,385 | (1,465,863) |
| Change in net unrealized gains (losses) on investments | 4,005,097 | 5,300,952 |
| Investment fees | (262,766) | (248,370) |
| Total investment income, net | $ 7,446,977 | $ 4,978,406 |

Board-Designated Funds

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

Trustee-Held Funds

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

Donor-Restricted Funds

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

Deferred Compensation Funds

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

Fair Value Measurements and Disclosures

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.

- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2013 and 2012.

- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.

- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.

- *Corporate bonds*: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

- *U.S. government securities*: Valued using pricing models maximizing the use of observable inputs for similar securities.

The following table sets forth by level, within the hierarchy, the Hospital's assets measured at fair value on a recurring basis as of December 31, 2013 are as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets whose use is limited | | | | |
| Common stocks | | | | |
| Basic materials | $ 1,534,106 | $ -0- | $ -0- | $ 1,534,106 |
| Consumer goods | 1,471,179 | -0- | -0- | 1,471,179 |
| Consumer services | 2,798,666 | -0- | -0- | 2,798,666 |
| Financials | 2,359,265 | -0- | -0- | 2,359,265 |
| Health care | 1,566,116 | -0- | -0- | 1,566,116 |
| Industrials | 1,036,117 | -0- | -0- | 1,036,117 |
| Technology | 2,256,785 | -0- | -0- | 2,256,785 |
| Utilities | 163,476 | -0- | -0- | 163,476 |
| | 13,185,710 | -0- | -0- | 13,185,710 |
| Mutual funds | | | | |
| Fixed income | 4,004,999 | -0- | -0- | 4,004,999 |
| High yield | 2,194,240 | -0- | -0- | 2,194,240 |
| Domestic mid cap core | 2,133,304 | -0- | -0- | 2,133,304 |
| World blend | 2,416,756 | -0- | -0- | 2,416,756 |
| Inflation protected | 1,016,002 | -0- | -0- | 1,016,002 |
| Intermediate term | 6,573,818 | -0- | -0- | 6,573,818 |
| Foreign large blend | 9,448,967 | -0- | -0- | 9,448,967 |
| International emerging markets | 1,847,081 | -0- | -0- | 1,847,081 |
| | 29,635,167 | -0- | -0- | 29,635,167 |
| Corporate bonds | | | | |
| Consumer discretionary | -0- | 145,318 | -0- | 145,318 |
| Consumer services | -0- | 362,108 | -0- | 362,108 |
| Financials | -0- | 493,328 | -0- | 493,328 |
| Industrials | -0- | 99,121 | -0- | 99,121 |
| Information technology | -0- | 145,660 | -0- | 145,660 |
| Materials | -0- | 114,750 | -0- | 114,750 |
| Utilities | -0- | 101,034 | -0- | 101,034 |
| | -0- | 1,461,319 | -0- | 1,461,319 |
| U.S. Government Securities | | | | |
| U.S. Treasury notes | -0- | 4,112,663 | -0- | 4,112,663 |
| Federal National Mortgage Association | -0- | 853,803 | -0- | 853,803 |
| Federal Home Loan Mortgage Corp | -0- | 454,198 | -0- | 454,198 |
| | -0- | 5,420,664 | -0- | 5,420,664 |
| Total assets at fair value | $ 42,820,877 | $ 6,881,983 | $ -0- | 49,702,860 |
| Cash | | | | 18,150,321 |
| Certificates of deposit | | | | 490,901 |
| Total investments | | | | $ 68,344,082 |

The following table sets forth by level, within the hierarchy, the Hospital's assets measured at fair value on a recurring basis as of December 31, 2012 are as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets whose use is limited | | | | |
| Common stocks | | | | |
| Basic materials | $ 2,215,461 | $ -0- | $ -0- | $ 2,215,461 |
| Consumer goods | 970,636 | -0- | -0- | 970,636 |
| Consumer services | 2,420,093 | -0- | -0- | 2,420,093 |
| Financials | 2,174,601 | -0- | -0- | 2,174,601 |
| Health care | 1,344,294 | -0- | -0- | 1,344,294 |
| Industrials | 1,255,040 | -0- | -0- | 1,255,040 |
| Technology | 2,628,973 | -0- | -0- | 2,628,973 |
| Utilities | 699,414 | -0- | -0- | 699,414 |
| | 13,708,512 | -0- | -0- | 13,708,512 |
| Mutual funds | | | | |
| Fixed Income | 4,632,627 | -0- | -0- | 4,632,627 |
| High yield | 4,275,736 | -0- | -0- | 4,275,736 |
| Domestic mid cap core | 1,577,453 | -0- | -0- | 1,577,453 |
| Domestic small cap growth | 774,404 | -0- | -0- | 774,404 |
| Domestic small cap value | 802,638 | -0- | -0- | 802,638 |
| Intermediate term | 4,952,260 | -0- | -0- | 4,952,260 |
| Foreign large blend | 11,096,054 | -0- | -0- | 11,096,054 |
| International emerging markets | 1,670,132 | -0- | -0- | 1,670,132 |
| | 29,781,304 | -0- | -0- | 29,781,304 |
| Corporate bonds | | | | |
| Consumer discretionary | -0- | 46,264 | -0- | 46,264 |
| Consumer staples | -0- | 95,298 | -0- | 95,298 |
| Financials | -0- | 570,059 | -0- | 570,059 |
| Industrials | -0- | 99,378 | -0- | 99,378 |
| Information technology | -0- | 59,004 | -0- | 59,004 |
| Materials | -0- | 97,858 | -0- | 97,858 |
| Telecommunications | -0- | 94,491 | -0- | 94,491 |
| | -0- | 1,062,352 | -0- | 1,062,352 |
| U.S. Government Securities | | | | |
| U.S Treasury notes | -0- | 3,233,609 | -0- | 3,233,609 |
| U.S. Treasury inflation notes | -0- | 525,251 | -0- | 525,251 |
| Federal National Mortgage Association | -0- | 1,885,949 | -0- | 1,885,949 |
| Federal Home Loan Mortgage Corp | -0- | 1,081,899 | -0- | 1,081,899 |
| | -0- | 6,726,708 | -0- | 6,726,708 |
| Total assets at fair value | $ 43,489,816 | $ 7,789,060 | $ -0- | 51,278,876 |
| Cash | | | | 25,122,881 |
| Certificates of deposit | | | | -0- |
| Total investments | | | | $ 76,401,757 |

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels 1 and 2 during 2013 and 2012.

Risks and Uncertainties

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

## 4. OTHER ASSETS

Other assets consist of the following at December 31, 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| Bond issue costs, net of accumulated amortization | $ 1,693,246 | $1,746,718 |
| Goodwill of physician practices, net of accumulated amortization | -0- | 1,354,067 |
| Investment in captive insurance company | 335,311 | 335,311 |
| Captive insurance company subscriber savings | 941,075 | 621,691 |
| Life insurance policies | 1,433,990 | 2,397,928 |
| Notes receivable | 622,087 | 723,575 |
| Total other assets | 5,025,709 | 7,179,290 |
| Less: current portion of other assets | (262,982) | (324,796) |
| Other assets, net of current portion | $ 4,762,727 | $6,854,494 |

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

Goodwill relates to the purchase of physician practices in 1997 and 2000. Goodwill is tested each year for impairment. The fair value of goodwill is determined based on discounted expected future cash inflows. During 2013, the Hospital determined that the carrying amount of the goodwill exceeded its fair value, resulting in a write-off of the remaining goodwill balance of $1,354,067.

The Hospital is a 12.5 percent owner of Indiana Healthcare Reciprocal Risk Retention Group (the "Captive"), a risk retention company created to purchase professional liability and general liability insurance for its members. The Hospital accounts for this investment using the cost method. In addition, the Captive retains a subscriber savings account for each of its members based upon the premiums paid in and the resulting claims paid out, plus other factors. Members are paid the balance of their subscriber savings account once they leave the Captive in accordance with the terms of the Captive agreement.

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

Physician recruiting notes receivable are forgiven if the physicians meet the period of service requirement. If the physicians do not meet the period-of-service requirement, the notes are immediately due in full. Other physician notes receivable are paid back over the terms of the notes. All physician notes receivable are in varying amounts maturing through July 2019 and carry interest rates ranging from 3.25 percent to 5.25 percent.

The current portion of other assets represents the amount of notes receivable from physicians expected to be repaid or forgiven in the next fiscal year, according to individual employment contracts.

## 5. OBLIGATIONS UNDER CAPITAL LEASES

The Hospital is the lessee of certain equipment under capital leases expiring in various years through 2018. The assets and liabilities under capital leases are initially recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Amortization of assets held under capital leases is included in depreciation expense and was $280,800 and $124,326 for the years ended December 31, 2013 and 2012, respectively.

Following is a summary of property held under capital leases:

| | 2013 | 2012 |
|---|---|---|
| Equipment | $1,740,889 | $ 689,742 |
| Less: accumulated amortization | 378,133 | 202,500 |
| | $1,362,756 | $ 487,242 |

Minimum future lease payments under capital leases as of December 31, 2013 are as follows:

| Year Ending December 31, | Amount |
|---|---|
| 2014 | $ 391,382 |
| 2015 | 386,671 |
| 2016 | 357,973 |
| 2017 | 226,072 |
| 2018 | 62,499 |
| | 1,424,597 |
| Less: amount representing interest | 117,761 |
| Present value of minimum lease payments | $1,306,836 |

## 6. LONG-TERM DEBT

At December 31, 2013 and 2012, the Hospital was obligated for long-term debt agreements as follows:

| | 2013 | 2012 |
|---|---|---|
| Indiana Finance Authority Hospital Revenue Bonds, dated October 2010, payable in annual principal installments commencing August 2015 through August 2045, in amounts ranging from $1,370,000 to $6,400,000. Serial remaining fixed interest rates ranging from 4.5% to 5.5%. Secured by gross revenues. | $ 100,035,000 | $100,035,000 |
| Less unamortized bond discounts | (2,059,745) | (2,100,257) |
| Long-term debt, net of current portion | $ 97,975,255 | $ 97,934,743 |

Maturities of long-term debt for each of the five years subsequent to December 31, 2013, are as follows:

| Year Ending December 31, | Principal Amount |
|---|---|
| 2014 | $ -0- |
| 2015 | 1,370,000 |
| 2016 | 1,430,000 |
| 2017 | 1,495,000 |
| 2018 | 1,570,000 |
| Thereafter | 94,170,000 |
| Unamortized bond discounts | (2,059,745) |
| Total | $ 97,975,255 |

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

## 7. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are donor-restricted for a specific use or by the passage of time. Permanently restricted net assets are donor-restricted assets whereby the principal amount is never to be expended. Income earned from these principal amounts includes both temporarily restricted and unrestricted amounts. Temporarily and permanently restricted net assets include the following at December 31, 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| Temporarily restricted | | |
| Prenatal/Postnatal Education Program Fund | $ 1,851 | $ 1,869 |
| Tobacco Settlement Fund | 185,383 | 169,681 |
| Teen Event Fund | 6,751 | 6,751 |
| Girls on the Run Fund | -0- | 3,779 |
| May Library Fund | 4,638 | 4,636 |
| Fit Kids | 102 | -0- |
| Art Work (New Hospital) | 3,000 | -0- |
| Bill Zink Scholarship Fund | 26,583 | -0- |
| Building | 5,115 | -0- |
| Building/Technology (Cancer Center) | 5,560 | -0- |
| Cardio Rulmonary Rehab | 230 | -0- |
| Cardiology | 26 | -0- |
| Caring and Responding to Employees (CARE) | 13,735 | -0- |
| CEO Discretionary Fund | 7,750 | -0- |
| Community Benefit Initiative (Jefferson Co. Fdn) | 45,430 | -0- |
| Dialysis | 50 | -0- |
| E. Pendleton Fund | 14,492 | -0- |
| E. Pendleton Interest Earned (Hospice) | 612 | -0- |
| Education | 996 | -0- |
| EMS Development | 850 | -0- |
| Girls on the Run | 12,263 | -0- |
| Home Health/Hospice | 21,241 | -0- |
| Hospice | 64,092 | -0- |
| Immediate Response Fund | 31,460 | -0- |
| Oncology | 17,268 | -0- |
| Hope & Healing campaign | 173,371 | -0- |
| Pediatrics | 39,027 | -0- |
| Physician Wall | 3,158 | -0- |
| Prostate Health | 1,917 | -0- |
| Radiology | 1,227 | -0- |

| | | |
|---|---|---|
| Rehab | 30 | -0- |
| Ripley County | 1,100 | -0- |
| Scholarship Endowment - W. Wright | 9,359 | -0- |
| Scholarship Fund | 27,005 | -0- |
| Taustine | 1,000 | -0- |
| Wellness | 17,605 | -0- |
| Women's Health | 69,633 | -0- |
| Total temporarily restricted net assets | $ 813,910 | $ 186,716 |
| Permanently restricted | | |
| Heberhart Endowment | $ 10,000 | $ 10,000 |
| E. Pendleton Hospice Endowment | 10,000 | -0- |
| Total permanently restricted net assets | $ 20,000 | $ 10,000 |

## 8. ENDOWMENTS

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

The Board of Managers has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets, if any, is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

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

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

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

On balances of endowed funds, as of the beginning of each fiscal year, an amount as determined by the Hospital Board will be distributed for the intended purposes of the endowment annually. Growth of the endowment will come from the annual earnings of investments in excess of distributions plus contributions made to the endowment.

Endowment Net Asset Composition by Type of Fund as of December 31, 2013:

| | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|
| Donor restricted endowment funds | $ 612 | $ 20,000 | $ 20,612 |

Changes in Endowment Net Assets for the Year Ended December 31, 2013:

| | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|
| Endowment net assets, beginning of year | $ -0- | $ 10,000 | $ 10,000 |
| Consolidation of affiliated organization previously not consolidated | -0- | 10,000 | 10,000 |
| Contributions | -0- | -0- | -0- |
| Investment income | 612 | -0- | 612 |
| Appropriation of endowment assets for expenditure | -0- | -0- | -0- |
| Endowment net assets, end of year | $ 612 | $ 20,000 | $ 20,612 |

Endowment Net Asset Composition by Type of Fund as of December 31, 2012:

| | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|
| Donor restricted endowment funds | $ -0- | $ 10,000 | $ 10,000 |

Changes in Endowment Net Assets for the Year Ended December 31, 2012:

| | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|
| Endowment net assets, beginning of year | $ -0- | $ 10,000 | $ 10,000 |
| Contributions | -0- | -0- | -0- |
| Investment income | -0- | -0- | -0- |
| Appropriation of endowment assets for expenditure | -0- | -0- | -0- |
| Endowment net assets, end of year | $ -0- | $ 10,000 | $ 10,000 |

| Permanently restricted net assets | 2013 | 2012 |
|---|---|---|
| The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA | $ 20,000 | $ 10,000 |

## 9. NET PATIENT SERVICE REVENUE

For the years ended December 31, 2013 and 2012, net patient service revenue was as follows:

| | 2013 | 2012 |
|---|---|---|
| Gross patient service revenue | | |
| Inpatient revenue | $ 78,954,367 | $ 73,074,641 |
| Outpatient revenue | 228,666,270 | 209,142,562 |
| Total gross patient service revenue | 307,620,637 | 282,217,203 |
| Deductions from revenue | | |
| Contractual allowances | 175,187,560 | 154,942,068 |
| Charity care | 6,508,098 | 4,520,666 |
| Provision for bad debts | 14,239,677 | 15,232,421 |
| Total deductions from revenue | 195,935,335 | 174,695,155 |
| Total net patient service revenue | $ 111,685,302 | $ 107,522,048 |

For the years ended December 31, 2013 and 2012, net patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), by major payor source was as follows:

| | 2013 | 2012 |
|---|---|---|
| Patient service revenue (net of contractual allowances and discounts): | | |
| Third party payors | $ 117,493,298 | $ 115,455,516 |
| Patients | 8,431,681 | 7,298,953 |
| Total | $ 125,924,979 | $ 122,754,469 |

The Hospital grants credit without collateral to its patients, most of who are local residents and insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2013 and 2012 is as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Revenue | Receivables | Revenue | Receivables |
| Medicare | 45 % | 33 % | 47 % | 32 % |
| Medicaid | 16 | 17 | 15 | 17 |
| Blue Cross | 16 | 12 | 16 | 12 |
| Other Commercial | 17 | 17 | 17 | 19 |
| Self-Pay | 6 | 21 | 5 | 20 |
| | 100 % | 100 % | 100 % | 100 % |

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

- ***Medicare***. The Hospital is a provider of services to patients entitled to coverage under Title XVIII (Medicare) of the Health Insurance Act. The Hospital is reimbursed for Medicare inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG) and Medicare outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. As of December 31, 2013, the Hospital's submitted Medicare cost reports have been final settled with the Fiscal Intermediary through December 31, 2009.

- ***Medicaid***. The Hospital is a provider of services to patients entitled to coverage under Title XIX (Medicaid) of the Health Insurance Act. The Hospital is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. There is no cost settlement for either of the inpatient or outpatient programs.

- ***Other***. The Hospital has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these arrangements is a discount from established charges and fee schedule payments.

- ***Charity Care and Uninsured Discounts***. The Hospital provides care without charge or at less than its established rates to patients who meet certain criteria under its charity care policy. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associating with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2013 and 2012, the Hospital incurred estimated charity costs of $2,524,743 and $1,657,961, respectively.

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. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs. The Hospital believes that it is in compliance with all applicable laws and regulations.

## 10. ELECTRONIC HEALTH RECORDS (EHR) INCENTIVE PAYMENTS

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for EHR incentive payments, the Hospital must meet "meaningful use" criteria that become more stringent over time. The Hospital periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending on September 30th). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Hospital's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, program utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as grant income when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2013 and 2012, the Hospital recognized approximately $2,370,500 and $0, respectively, in EHR incentive payments as grant income using the cliff recognition method. Under the cliff recognition method, the Hospital records income at the end of the EHR reporting period in which compliance is achieved. EHR incentive income is included in other revenue in the consolidated statements of operations. EHR incentive income recognized is based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

Receipt of these funds is subject to the fulfillment of certain obligations by the Hospital as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

## 11. PENSION PLAN

The Hospital sponsors a defined contribution pension plan that covers all eligible employees who work over 1,000 hours a year. All employees are eligible for enrollment on the first day of the month following their hire date. The Hospital contributes 2 percent for each eligible employee. The employee may contribute up to 15 percent with a maximum of 6 percent being matched at a rate of 50 percent. For the years ended December 31, 2013 and 2012, the amount of pension expense was $1,941,927 and $1,912,602, respectively.

## 12. DEFERRED COMPENSATION AGREEMENTS

Previously, the Hospital maintained an informal deferred compensation plan whereby amounts were withdrawn from participating physicians' pay and held by the Hospital until such time that the participating physicians retired. The Hospital no longer offers this plan, but still records a liability for any amounts which were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both $39,601 and $80,580 at December 31, 2013 and 2012, respectively.

The Hospital funded an executive deferred compensation plan. The plan accumulated cash value over time. The Hospital recorded an asset and liability amount equal to the market value of the deferred compensation plan. The Hospital no longer offers this plan. The deferred compensation asset and liability amounts under this agreement were $-0- and $919,536 at December 31, 2013 and 2012, respectively.

Previously, the Hospital maintained a deferred compensation plan for a select group of key management employees. Under the terms of the plan, the Hospital contributed 4 percent of a participant's compensation, as defined in the agreement, each calendar quarter. The Hospital no longer offers this plan, but still records a liability for any amounts that were unpaid at year-end. The deferred compensation asset and liability amounts under this agreement were both $83,439 and $87,786 at December 31, 2013 and 2012, respectively.

## 13. PROFESSIONAL LIABILITY INSURANCE

The Indiana Medical Malpractice Act (the "Act"), IC 34-18, provides a maximum recovery of $250,000 for an occurrence of malpractice and $1,250,000 for an injury or death of a patient due to an act of malpractice. The Act requires physicians to maintain medical malpractice liability insurance in the minimum amount of $250,000 per occurrence and $750,000 in the annual aggregate and hospitals to maintain medical malpractice liability insurance in the minimum amount of $250,000 per occurrence and $5,000,000 for hospitals with less than 100 occupied beds. The Hospital's insurance policies conform to the Act. The Act also requires the Hospital to pay a surcharge to the State Patient's Compensation Fund. This fund may be used to pay medical malpractice claims in excess of the annual aggregate amount noted above, under certain terms and conditions.

The Hospital maintains professional liability insurance through a multiprovider reciprocal risk retention group (the "Group"), in which premiums are accrued based on the Group's experience to date. This provides protection from liability in amounts not to exceed as follows:

| | 2013 | 2012 |
|---|---|---|
| Hospital per occurrence | $ 250,000 | $ 250,000 |
| Hospital aggregate | $ 5,000,000 | $ 5,000,000 |
| Group umbrella aggregate | $ 10,000,000 | $ 10,000,000 |
| Group first additional umbrella aggregate | 10,000,000 | 10,000,000 |
| Group second additional umbrella aggregate | 10,000,000 | 10,000,000 |
| Total Group umbrella aggregate | $ 30,000,000 | $ 30,000,000 |

Liabilities for incurred but not reported losses at December 31, 2013 and 2012 are not determinable; however, in management's opinion, such liabilities, if any, will not have a material effect on the Hospital's financial position and its malpractice and general liability insurance is adequate to cover losses, if any. Should the policies not be renewed or replaced with appropriate insurance coverage, claims based upon occurrences during these terms, but reported subsequently, will be uninsured. The Hospital intends to continue carrying such insurance.

## 14. HOSPITAL ASSESSMENT FEE

During 2012, the Hospital Assessment Fee ("HAF") Program for the period July 1, 2011 through June 30, 2013 was approved by Centers for Medicare & Medicaid Services ("CMS") retroactive to July 1, 2011. During March 2014, the HAF program was reinstated by CMS retroactive to July 1, 2013. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share ("DSH") payments for Indiana hospitals as reflected as Hospital assessment fee reported in the consolidated statements of operations. Previously, the State share was funded by government entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates. The Hospital recognized HAF program expense of $4,026,986 and $4,454,745 at December 31, 2013 and 2012, respectively.

## 15. OPERATING LEASES

The Hospital leases certain equipment under noncancelable operating leases expiring in various years through 2014. Minimum future rental payments under these noncancelable operating leases as of December 31, 2013, are as follows:

| Year Ending December 31, | Amount |
|---|---|
| 2014 | $ 22,355 |

The Hospital incurred $395,065 and $513,562 in total rent expense for the years ended December 31, 2013 and 2012, respectively, under both cancelable and noncancelable leases.

## 16. CONCENTRATIONS OF CREDIT RISK

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

## 17. FUNCTIONAL EXPENSES

The Hospital provides general healthcare services to residents within its geographic area. Expenses related to providing these services are broken down as follows for the years ended December 31, 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| Healthcare services | $106,952,205 | $ 90,641,222 |
| General and administrative | 14,725,205 | 12,705,934 |
| | $121,677,410 | $ 103,347,156 |

## 18. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates its fair value based on short term maturities of those items.

Assets Whose Use is Limited

These assets are reported in the consolidated balance sheets at fair value. The fair value amounts are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable, Accrued Payroll and Payroll Withholdings, and Accrued Expenses

The carrying amounts reported in the consolidated balance sheets for accounts payable, accrued payroll and payroll withholdings, and accrued expenses approximate their fair value based upon short maturities of those items.

Estimated Third-Party Payor Settlements

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates its fair value because they are expected to be settled in the near future.

Long-Term Debt and Obligations Under Capital Leases

The carrying amount and fair value reported in the consolidated balance sheets for the combined amounts of long-term debt and obligations under capital leases were based on incremental borrowing rates available to similar entities with similar credit ratings. The combined carrying amounts and fair value of long-term debt and obligations under capital leases were $99,282,091 and $105,406,444, respectively, for 2013 and $98,424,645 and $99,059,513, respectively, for 2012.

Deferred Compensation Liabilities and Life Insurance Policies

The carrying amount reported in the consolidated balance sheets for deferred compensation liabilities approximates its fair value based on quoted market prices, if available, or is estimated using quoted market prices for similar securities. The carrying amount reported in the consolidated balance sheets for life insurance policies approximates its fair value based on the cash surrender value of the insurance policies.

## 19. CONTINGENCIES

Legal proceedings and claims

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

Discounted receivables

The Hospital has entered into a contract with a collection company to sell at a discount patient accounts receivable balances meeting a minimum credit score by 18 percent, with recourse. Should all or a portion of the discounted patient accounts receivable balances prove to be uncollectible by the collection company based on the terms outlined in the contract agreement, the Hospital is obligated to buy back the remaining unpaid patient accounts receivable balance net of the 18 percent collection fee/discount amount. The Hospital estimates the amount of patient accounts it anticipates being required to buy back from the collection company and records a liability and recognizes bad debt expense based on the estimate. The Hospital's liability estimate is calculated based on its historical losses and other factors unique to the service area and the healthcare industry and is included in accounts payable on the consolidated balance sheets. The Hospital recorded patient accounts receivable recourse liability amounts in accounts payable on the consolidated balance sheets at December 31, 2013 and 2012 totaling $372,750 and $176,612, respectively.

## 20. COMMITMENTS

As of December 31, 2013, the Hospital has construction and renovation project commitments as follows:

| Project | Expected Date of Completion | Estimated Total Cost of Project | Costs Incurred as of December 31, 2013 |
|---|---|---|---|
| Hilltop Cancer Center | 2015 | $ 11,000,000 | $ 402,002 |
| Meditech EHR Migration | 2014 | 550,000 | 466,818 |
| All others | Various | 150,000 | 31,438 |
| | | $ 11,700,000 | $ 900,258 |

## 21. RELATED PARTY TRANSACTIONS

River Valley Financial Bank

A Hospital Board member is the spouse of the President and Chief Executive Officer of River Valley Financial Bank. At December 31, 2013 and 2012, the Hospital had the following related party transactions with River Valley Financial Bank:

| | 2013 | 2012 |
|---|---|---|
| Deposits | $ 7,401,548 | $ 11,787,470 |
| Investments | $ 1,000,000 | $ 1,000,000 |
| Interest income | $ 72,996 | $ 48,612 |
| Interest expense | $ 9,208 | $ 10,409 |

CPAS / ADVISORS

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