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January 23, 2013

Board of Directors
Howard Regional Health System
3500 S. Lafountain Street
Kokomo, IN 46904

We have reviewed the audit report prepared by Blue & Company, LLC, Independent Public Accountants, for the period January 1, 2012 to June 30, 2012. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Howard Regional Health System, as of June 30, 2012 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS



CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

JUNE 30, 2012

CPAs / ADVISORS



HOWARD REGIONAL HEALTH SYSTEM

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

We have audited the accompanying consolidated balance sheet of Howard Regional Health System (the System) as of June 30, 2012, and the related consolidated statements of revenues, expenses and changes in net position, and cash flows for the six month period then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources issued by the Indiana State Board of Accounts and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the System as of June 30, 2012, and its consolidated results of operations, changes in net position, and cash flows for the six month period then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the consolidated financial statements, an affiliation agreement between the System and Community Health Network, Inc. (CHNw) was effective on July 1, 2012. Under the affiliation agreement, CHNw assumed all debt of the System, and the System became part of the CHNw Obligated Group for purposes of debt renewal. The affiliation entity is named Community Howard Regional Health, Inc. (CHRH), and the net position of the System was, upon the dissolution of the System as a County and Municipal Government entity as of June 30, 2012, transferred to CHRH.

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

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

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information listed in the accompanying table of contents is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, changes in net position and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

November 29, 2012

REQUIRED SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2012

(with totals for years ended December 31, 2011 and 2010)

This section of Howard Regional Health System's (the System) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of the System's consolidated financial performance during the six month period ended June 30, 2012 with information for the years ended December 31, 2011 and 2010. This MD&A includes a discussion and analysis of the activities and results of the System, its blended component unit, Howard Regional Health System Foundation, and its majority owned subsidiaries as described in the notes to the consolidated financial statements. This MD&A should be read together with the consolidated financial statements included in this report.

Through the six month period ended June 30, 2012, the System consisted of two county-owned facilities and operated under the Indiana County Hospital Law, Indiana Code 16-22. The System has a licensed and staffed 150-bed acute regional hospital and a 30-bed regional rehabilitation hospital both located in Kokomo, Indiana serving a nine county region in north central Indiana. The System provides short-term inpatient and outpatient health care among other services.

Effective May 22, 2012, the Board of Trustees of the System, as well as the Howard County Council and Howard County Commissioners, passed a resolution to approve an affiliation with Community Health Network, Inc. (CHNw). The affiliation agreement was signed May 31, 2012 with an effective date of July 1, 2012.

As of July 1, 2012, CHNw assumed all debt of the System, and the System became part of the CHNw Obligated Group for purposes of debt renewal. The affiliation entity is named Community Howard Regional Health, Inc. (CHRH), and the net position of the System was, upon the dissolution of the System as a County and Municipal Government entity as of June 30, 2012, transferred to CHRH. Local governance is a key component of this agreement, requiring that a majority of the CHRH board members be residents of Howard County, an acute care hospital will be maintained in Howard County, and a plan will be created to develop CHRH into a regional medical center.

Through the reporting period presented in this report, the Board of County Commissioners of Howard County appointed the Governing Board of the System and a financial benefit/burden relationship existed between the County and the System. For these reasons, the System is considered a component unit of Howard County for the reporting period ended June 30, 2012.

Quality, patient safety and patient satisfaction continue to be priorities and are key components. Working with guidelines provided by state and national healthcare organizations, the System will continue to be committed to providing exceptional quality, patient-centered care.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) JUNE 30, 2012 (with totals for years ended December 31, 2011 and 2010)

FINANCIAL HIGHLIGHTS - JUNE 30, 2012

The System's total assets increased approximately \$40,000 from December 31, 2011. Assets whose use is limited increased approximately \$2.3 million while current assets and capital assets decreased by approximately \$2.2 million from December 31, 2011.

Total liabilities increased approximately \$660,000 from December 31, 2011 mainly related to timing of accounts payable and accrued expenses.

The System's net position decreased approximately \$620,000 or 1.1% through June 30, 2012.

The System reported operating income of approximately \$998,000 through June 30, 2012 for a return on total revenue of 1.2%.

During the six month period ended June 30, 2012, the System recognized a net increase in operating income of approximately \$1.1 million under the Hospital Assessment Fee Program.

USING THIS ANNUAL REPORT

The System's consolidated financial statements consist of the following statements – a Balance Sheet; a Statement of Revenues, Expenses and Changes in Net Position; and a Statement of Cash Flows. These consolidated financial statements and related notes provide information about the activities and the financial position of the System.

The Consolidated Balance Sheet includes all of the System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to System creditors (liabilities).

All of the current year's revenue earned and expenses incurred as well as other changes in net position are accounted for in the Consolidated Statement of Revenues, Expenses and Changes in Net Position.

Finally, the Consolidated Statement of Cash Flows' purpose is to provide information about the System's cash flows from operating activities, financing activities including capital additions, and investing activities. This statement provides information on the sources and uses of cash and the change in cash balance during the year.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2012

(with totals for years ended December 31, 2011 and 2010)

THE BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN NET POSITION

One of the most important questions asked about the System's finances is, "Is the System as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues and expenses and changes in net position report information about the System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the System's net position and changes in them. Think of the System's net position - the difference between assets and liabilities - as one way to measure the System's financial health, or financial position. Over time, increases or decreases in the System's net position are one indicator of whether its financial health is improving or deteriorating. Consider other nonfinancial factors, however, such as changes in the System's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the System.

Table 1 – Balance Sheets

	June 30, 2012	December 31, 2011	2012-2011 Change	December 31, 2010	2011-2010 Change
Current assets	\$ 50,577,998	\$ 51,705,094	\$ (1,127,096)	\$ 56,486,920	\$ (4,781,826)
Assets whose use is limited	10,051,079	7,757,054	2,294,025	7,826,641	(69,587)
Capital assets, net	88,383,804	89,474,289	(1,090,485)	90,013,218	(538,929)
Other assets	1,470,211	1,506,963	(36,752)	1,684,382	(177,419)
	<u>\$ 150,483,092</u>	<u>\$ 150,443,400</u>	<u>\$ 39,692</u>	<u>\$ 156,011,161</u>	<u>\$ (5,567,761)</u>
Current liabilities	\$ 27,204,668	\$ 25,256,256	\$ 1,948,412	\$ 22,076,422	\$ 3,179,834
Long-term liabilities	66,382,784	67,671,112	(1,288,328)	66,924,607	746,505
Total liabilities	93,587,452	92,927,368	660,084	89,001,029	3,926,339
Net position	56,895,640	57,516,032	(620,392)	67,010,132	(9,494,100)
	<u>\$ 150,483,092</u>	<u>\$ 150,443,400</u>	<u>\$ 39,692</u>	<u>\$ 156,011,161</u>	<u>\$ (5,567,761)</u>

Current assets decreased due to the net decrease in cash equivalents and investments of approximately \$3.3 million between periods offset by an increase of approximately \$1.5 in patient accounts receivable. Total assets increased approximately \$40,000 from December 31, 2011 to June 30, 2012.

Liabilities increased approximately \$660,000 from December 31, 2011 to June 30, 2012 mainly related to an increase in the interest rate swap liabilities of \$473,000.

Total assets as of December 31, 2011 compared to December 31, 2010 decreased approximately \$5.6 million due to a decrease in cash and cash equivalents.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) JUNE 30, 2012 (with totals for years ended December 31, 2011 and 2010)

Total liabilities as of December 31, 2011 compared to December 31, 2010 increased approximately \$3.9 million mainly as the result of an increase in accounts payable and the interest rate swap liabilities.

Net position decreased approximately \$620,000 from December 31, 2011 to June 30, 2012 mainly due to the unrealized loss in the interest rate swaps. As noted previously, the System experienced a gain on operations for the 6 months ended June 30, 2012. This was due not only to the impact of the Hospital Assessment Fee Program, but also to a continually improving operating picture during the period. The System also incurred substantial costs related to the transition to CHNw, which were expensed as incurred, and achieved a positive operating margin in spite of those expenses.

The December 31, 2011 net position decreased \$9.5 million from December 31, 2010 due to an operating loss, nonoperating revenues and expenses and the change in the unrealized loss in the interest rate swaps.

Table 2 – Statements of Revenues and Expenses and Changes in Net Position

	Six Months Ended June 30, 2012	Year Ended December 31, 2011	2012-2011 Change	Year Ended December 31, 2010	2011-2010 Change
Total revenues	\$ 80,368,968	\$ 149,134,270	\$ (68,765,302)	\$ 146,936,468	\$ 2,197,802
Salaries and benefits	34,364,503	69,652,551	(35,288,048)	75,558,806	(5,906,255)
Supplies and drugs	15,467,303	30,477,079	(15,009,776)	29,238,541	1,238,538
Purchased services	7,240,564	10,531,757	(3,291,193)	8,929,971	1,601,786
Depreciation and amortization	4,103,919	9,348,513	(5,244,594)	9,687,014	(338,501)
Hospital Assessment Fee Program	5,003,400	-0-	5,003,400	-0-	-0-
Other	13,191,002	27,187,228	(13,996,226)	27,907,752	(720,524)
Total operating expenses	<u>79,370,691</u>	<u>147,197,128</u>	<u>(67,826,437)</u>	<u>151,322,084</u>	<u>(4,124,956)</u>
Operating income (loss)	998,277	1,937,142	(938,865)	(4,385,616)	6,322,758
Nonoperating revenues (expenses), net	<u>(1,086,501)</u>	<u>(10,346,730)</u>	<u>9,260,229</u>	<u>(2,263,113)</u>	<u>(8,083,617)</u>
Change in net position before capital distributions	(88,224)	(8,409,588)	8,321,364	(6,648,729)	(1,760,859)
Capital distributions	<u>(532,168)</u>	<u>(1,084,512)</u>	<u>552,344</u>	<u>(806,176)</u>	<u>(278,336)</u>
Change in net position	(620,392)	(9,494,100)	8,873,708	(7,454,905)	(2,039,195)
Net position					
Beginning of period	<u>57,516,032</u>	<u>67,010,132</u>	<u>(9,494,100)</u>	<u>74,465,037</u>	<u>(7,454,905)</u>
End of period	<u>\$ 56,895,640</u>	<u>\$ 57,516,032</u>	<u>\$ (620,392)</u>	<u>\$ 67,010,132</u>	<u>\$ (9,494,100)</u>

Total revenues for the six months ended June 30, 2012 were approximately \$80.4 million with net patient service revenue comprising \$74.1 million of the total. Expenses were approximately \$79.4 million for 2012. Salaries and benefits constitute the majority of the expenses at approximately \$34.4 million. During 2012, the System recognized expense of \$5.0 million related to the Hospital Assessment Fee Program which began during 2012. Net nonoperating expense for 2012 was approximately \$1.1 million based mainly on interest expense and other items.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2012

(with totals for years ended December 31, 2011 and 2010)

Total revenues increased approximately \$2.2 million from December 31, 2010 to December 2011 mainly due to net patient service revenue and overall utilization. While gross patient service revenue increased \$24.3 million over 2010, contractual adjustments, charity care and bad debts increased \$22.7 million due to changes in payor mix and changes in overall utilization. Expenses decreased approximately \$4.1 million from 2010 to 2011 mainly through salaries and benefits as staffing was monitored based on overall utilization and efficiencies. Together, operating income (loss) increased \$6.3 million over 2010 to a total operating income of \$1.9 million in 2011.

Net nonoperating expense for 2011 was \$10.3 million, an increase of approximately \$8.1 million from 2010. The performance improvement project of approximately \$2.3 million and the unrealized loss on the interest rate swap agreement were the main contributing factors for the change from 2011 to 2010.

STATEMENT OF CASH FLOWS

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in the cash balance during the reporting period?"

A summary of cash flows follows:

Cash flows data	June 30, 2012	December 31, 2011	2012-2011 Change	December 31, 2010	2011-2010 Change
From operating activities	\$ 4,653,683	\$ 13,579,119	(8,925,436)	\$ 11,793,804	\$ 1,785,315
From capital and related financing activities	(6,810,658)	(19,164,383)	12,353,725	(13,777,348)	(5,387,035)
From investing activities	3,752,850	239,900	3,512,950	2,982,581	(2,742,681)
Change in cash and cash equivalents	<u>\$ 1,595,875</u>	<u>\$ (5,345,364)</u>	<u>\$ 6,941,239</u>	<u>\$ 999,037</u>	<u>\$ (6,344,401)</u>

Total cash and cash equivalents increased approximately \$1.6 million in 2012 with cash flows from operating activities generating \$4.7 million. Capital and related financing activities used cash of \$6.8 million mainly for property additions and payments on long term debt. Investing activities relate mainly to investment income and classification between investments and cash equivalents.

Changes from 2010 to 2011 were mainly in capital and related financing activities (a decrease of \$5.4 million).

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2012

(with totals for years ended December 31, 2011 and 2010)

SOURCES OF REVENUE

The System's revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the negotiated payment rates for such services. The gross charges typically do not reflect what is actually paid. The System has entered into agreements with third party payors, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates per diagnoses or discounts from gross charges. The System receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes.

Revenues from Medicare and Medicaid programs were 62% of gross revenues in 2012 and 2011. Legislative changes continue to limit or reduce the levels of payments from these programs. The approximate percentages of gross patient revenues were for the periods ended:

	June 30, 2012	December 31, 2011	December 31, 2010
Medicare	51%	51%	48%
Medicaid	11%	11%	12%
Blue Cross/Blue Shield	18%	20%	19%
Commercial	12%	12%	13%
Other	8%	6%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

CAPITAL ASSETS

	June 30, 2012	December 31, 2011	December 31, 2010
Land	\$ 1,002,878	\$ 1,002,878	\$ 1,002,878
Land improvements	6,617,870	6,617,870	6,567,713
Buildings and improvements	97,818,497	97,780,598	96,924,110
Equipment	62,968,010	62,527,181	63,614,006
Construction in progress	20,920,838	18,586,100	12,195,376
	<u>189,328,093</u>	<u>186,514,627</u>	<u>180,304,083</u>
Accumulated depreciation	<u>100,944,289</u>	<u>97,040,338</u>	<u>90,290,865</u>
	<u>\$ 88,383,804</u>	<u>\$ 89,474,289</u>	<u>\$ 90,013,218</u>

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2012

(with totals for years ended December 31, 2011 and 2010)

In 2012, gross additions to capital assets were approximately \$3.0 million before retirements of approximately \$202,000. This was due almost entirely to increases in construction in progress related to the new Hospital Information System, which went live in August of 2012. Depreciation expense was approximately \$4.1 million before retirements of approximately \$173,000 for a net decrease in capital assets of approximately \$1.1 million as of June 30, 2012.

LONG TERM DEBT

As of June 30, 2012, the System had \$61.6 million in short term and long term notes, bonds and capital leases outstanding, a decrease from the \$63.3 million as of December 31, 2011. The decrease relates to the regular principal payments with no additional borrowings. More detailed information about the System's long term debt is presented in the notes to the consolidated financial statements.

ECONOMIC OUTLOOK

Management believes that the healthcare industry operating margins will continue to be under significant pressure, due to both changes in payor mix and also downward pressure on reimbursements from the Medicare and Medicaid programs as well as Commercial Insurers. The ongoing challenge facing the System and the entire healthcare market is to continue to provide quality patient care in a competitive environment and to attain reasonable rates for the services it provides while managing its costs. One of the biggest challenges facing the System and all healthcare systems is the recruitment and retention of physicians, both primary care and specialty based. For these reasons, as well as the prospect of continued challenges under the health reform law and other governmental programs, the System believes that its affiliation with CHNw is a positive development to better address these challenges.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the System at 3500 South Lafountain Street, Kokomo, Indiana 46904, (765) 453-0702.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEET JUNE 30, 2012

ASSETS

Current assets

Cash and cash equivalents	\$ 7,240,783
Investments	14,901,687
Patient accounts receivable, net of estimated uncollectibles of \$8,330,000	18,487,610
Other receivables	2,807,644
Inventories and other current assets	6,190,274
Current portion of assets whose use is limited	<u>950,000</u>
Total current assets	50,577,998

Assets whose use is limited

Internally designated	10,311,328
Held by trustee	88,871
Donor restricted	<u>600,880</u>
Total assets whose use is limited	11,001,079
Less current portion	<u>950,000</u>
Noncurrent portion of assets whose use is limited	10,051,079

Capital assets, net

88,383,804

Other assets

1,470,211

Total assets

\$ 150,483,092

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEET JUNE 30, 2012

LIABILITIES AND NET POSITION

Current liabilities

Accounts payable and accrued expenses	\$ 10,491,354
Accrued liabilities	7,605,741
Other current liabilities	2,463,980
Estimated third party settlements	1,919,061
Current portion of revenue bonds payable	950,000
Current portion of loans payable	917,300
Current portion of capital lease obligations	<u>2,857,232</u>
Total current liabilities	27,204,668

Long term debt

Revenue bonds payable	44,470,000
Capital lease obligations	2,750,492
Loans payable	<u>9,695,057</u>
Total long term debt	56,915,549

Interest rate swap liabilities

9,467,235

Total liabilities

93,587,452

Net position

Net investment in capital assets	26,666,243
Designated	
For debt service	88,871
Expendable for capital improvements	<u>10,311,328</u>
Total designated net position	10,400,199
Restricted - donor restricted	600,880
Unrestricted	<u>17,050,535</u>
Net position - controlling interest	54,717,857
Non-controlling interest	<u>2,177,783</u>
Total net position	<u>56,895,640</u>

Total liabilities and net position

\$ 150,483,092

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION SIX MONTH PERIOD ENDED JUNE 30, 2012

Revenues	
Net patient service revenue	\$ 74,046,607
Other	6,322,361
Total revenues	<u>80,368,968</u>
Operating expenses	
Salaries and wages	28,516,435
Employee benefits	5,848,068
Medical professional fees	3,551,294
Medical supplies and drugs	15,467,303
Purchased services	7,240,564
Equipment rentals	3,847,737
Utilities and telephone	1,462,528
Insurance	525,246
Depreciation and amortization	4,103,919
Hospital Assessment Fee Program	5,003,400
Other	3,804,197
Total expenses	<u>79,370,691</u>
Operating income	998,277
Nonoperating revenues (expenses)	
Investment income	1,430,640
Interest expense	(1,589,044)
Unrealized loss on interest rate swaps	(473,147)
Other nonoperating expenses	(454,950)
Total nonoperating revenues (expenses), net	<u>(1,086,501)</u>
Change in net position before capital distributions	(88,224)
Capital distributions	<u>(532,168)</u>
Change in net position	(620,392)
Less amount attributable to non-controlling interest	36,161
Change in net position attributable to controlling interest	<u>\$ (584,231)</u>
Change in net position	\$ (620,392)
Net position, beginning of period	<u>57,516,032</u>
Net position, end of period	<u>\$ 56,895,640</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENT OF CASH FLOWS SIX MONTH PERIOD ENDED JUNE 30, 2012

Operating activities

Cash received from patients and third party payors	\$ 67,512,058
Cash paid to vendors for goods and services	(33,938,335)
Cash paid for employee wages and benefits	(35,242,401)
Other receipts, net	6,322,361
Net cash flows from operating activities	<u>4,653,683</u>

Capital and related financing activities

Acquisition and construction of capital assets	(3,015,246)
Loss on disposal of property and equipment	(31,498)
Distributions to non-controlling interest	(532,168)
Cash paid for interest on long term debt	(1,589,044)
Principal payments on long term debt	(1,642,702)
Net cash flows from capital and related financing activities	<u>(6,810,658)</u>

Investing activities

Investment income	1,430,640
Investment in affiliated companies, net	36,752
Other nonoperating revenues and expenses	(454,950)
Purchases of investments and assets whose use is limited	(2,086,355)
Sales of investments and assets whose use is limited	4,826,763
Net cash flows from investing activities	<u>3,752,850</u>
Net change in cash and cash equivalents	1,595,875

Cash and cash equivalents

Beginning of period	<u>8,223,497</u>
End of period	<u>\$ 9,819,372</u>

Reconciliation of cash and cash equivalents

Included in cash and cash equivalents	\$ 7,240,783
Included in investments	474,321
Included in assets whose use is limited - internally designated	2,015,397
Included in assets whose use is limited - held by trustee	88,871

Cash and cash equivalents, end of period

\$ 9,819,372

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENT OF CASH FLOWS SIX MONTH PERIOD ENDED JUNE 30, 2012

Reconciliation of operating income to net cash flows from operating activities

Operating income	\$	998,277
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization		4,103,919
Bad debts		7,785,598
Changes in operating assets and liabilities		
Patient accounts receivable		(9,326,914)
Other receivables		(246,135)
Estimated third party settlements		10,167
Inventory and other assets		(369,228)
Accounts payable and accrued expenses		1,129,275
Accrued liabilities and other liabilities		(877,898)
Other current liabilities		1,446,622
Net cash flows from operating activities	\$	<u>4,653,683</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Howard Regional Health System (the System) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code (IC) 16-22. The System provides short-term inpatient and outpatient health care among other services. The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present the System (primary government) and its significant component units. The component units discussed below are included in the System's reporting entity because of the significance of their operational or financial relationships with the System. Blended component units, although legally separate entities are in substance part of the government's operations and exist solely to provide services for the government; data from these units is consolidated with data of the primary government.

Basis of Consolidation

Howard Regional Health System Foundation, Inc. (the Foundation) is a blended component unit of the System. The Foundation is a separate not-for-profit entity organized to support the operations of the System. Financial statements for the Foundation can be obtained by contacting the Foundation office.

Other component units included in the consolidated financial statements based on the System's control of these entities are:

- Howard Regional Specialty Care, LLC (Specialty Care)
- Midwest Racquetball, Inc. dba Kokomo Sports Center
- Howard Community Surgery Center, LLC (Surgery Center)
- The Imaging Center of North Central Indiana, Inc. (Imaging Center)
- Andrew J. Mandery, MD, LLC (Mandery)

All significant intercompany transactions have been eliminated in the consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Use of Estimates

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

Enterprise Fund Accounting

The System utilizes the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

During 2012, the System adopted Statement of Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of GASB No. 20 for business-type activities to apply post November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities that so elected can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement. GASB No. 62 has been applied retrospectively and had no impact on the System's net position, changes in net position or financial reporting disclosures.

Also during 2012, System adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. GASB No. 63 has been applied retrospectively and had no impact on the System's net position, changes in net position or financial reporting disclosures other than the change in terminology from net assets to net position.

Investments

Certificates of deposit, demand deposits, money market funds and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at contract value which approximates fair value.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Mutual funds are reported at fair value. Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating income in the consolidated statement of revenues, expenses and changes in net position.

Patient Accounts Receivable and Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The System is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The System is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG).

The System is reimbursed for Medicare 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. At the System's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

These programs have audited the year-end cost report filed with the Medicare program through December 31, 2006 with differences reflected as deductions from revenue in 2012. Amounts for unresolved cost reports for 2007 through 2012 are reflected in estimated third-party settlements on the consolidated balance sheet. The difference between computed reimbursement amounts and interim reimbursement amounts is reflected as a receivable from or payable to the third-party program. No cost reports were settled during 2012.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges less an allowance for contractual adjustments and interim payment advances. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the System's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

Inventories

Inventories are valued at the lower of cost or market with cost being determined using weighted-average method. Inventories consist primarily of medical supplies and pharmaceuticals.

Assets Whose Use is Limited

Assets whose use is limited are stated at fair value in the consolidated financial statements. These assets include investments designated by the System's Board of Trustees for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service and capital expenditures. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities and mutual funds.

Investment income, to the extent not capitalized, is reported as nonoperating income in the consolidated statement of revenues, expenses and changes in net position.

Charity Care

The System provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy on a sliding scale on the basis of financial need. Because the System does not pursue collection of approved charity care balances, the charges are not reflected in net revenue. Rather, charges approved for charity are posted to gross revenue and subsequently written off as a charity adjustment before the resulting net patient service revenue.

Of the System's total expenses reported (approximately \$79,371,000 during the six month period ended June 30, 2012) an estimated \$2,492,000 arose from providing services to charity patients during the six month period ended June 30, 2012. 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 associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Systems' total expenses divided by gross patient service revenue.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The System provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and fixed equipment	4-50 years
Major moveable equipment	5-15 years

Net Position

Net position of the System is classified in various components. Net position - net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net position consists of debt service, capital improvement and other designations and held by the Foundation. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Non-controlling Interest

Non-controlling interests represent the portion of net position that is attributable to investors that are external to and not included in the System's consolidated financial statements.

Consolidated Statement of Revenues, Expenses and Changes in Net Position

The System's consolidated statement of revenues, expenses and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services which is the Hospital's principal activity. Contributions and investment income are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, excluding interest costs and other debt related costs.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Consolidated Statement of Cash Flows

For the purposes of the consolidated statement of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of 90 days or less from the date of purchase.

Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No interest was capitalized for the six month period ended June 30, 2012.

Bond Issue Costs

The System provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs net of accumulated amortization were approximately \$538,000 as of June 30, 2012. Annual amortization expense related to bond issue costs is approximately \$31,000.

Income Taxes

The System is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The System is exempt from federal income tax under Section 115 of the Internal Revenue Code of 1986 as a not-for-profit organization under Section 501(c)(3). As such, the System is generally exempt from income taxes. As a governmental entity, the System is not required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

The Foundation and Imaging Center, blended component units of the System, are tax-exempt organizations under Internal Revenue Code 501(c)(3). As such, the Foundation and Imaging Center are generally exempt from income taxes. However, the Foundation and Imaging Center are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

The blended component units of Specialty Care, Surgery Center and Mandery are organized as limited liability companies, whereby net taxable income is taxed directly to the members and not these entities. Thus, the consolidated financial statements do not include any provision for Federal or state income taxes.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

The blended component unit of Kokomo Sports Center is a corporation subject to Federal and state income taxes. Income taxes for this entity is provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxed currently due plus deferred taxes. However, the effects of recording a deferred tax provision have been deemed immaterial and have not been recorded in the accompanying consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System (and its affiliates) and recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by various Federal and state taxing authorities. Management has analyzed the tax positions taken by the System and has concluded that as of June 30, 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 System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

These entities have filed their federal and state income tax returns for periods through December 31, 2011. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

Compensated Absences

The System's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 480 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheet.

Litigation

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

Risk Management

The System 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; employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were approximately \$329,000 for the six month period ended June 30, 2012.

Medical Malpractice Claims

The System 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 System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries a claims made basis insurance policy covering the System's \$250,000 of exposure per claim.

Electronic Health Records (EHR) Incentive Payments

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

The System recognizes EHR incentive payments as grant income when there is reasonable assurance that the System 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. EHR incentive income is included in other revenue in the consolidated statement of revenues, expenses and changes in net position. 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 System as prescribed by the programs, subject to future audits and may be subject to repayment upon a determination of noncompliance.

During the six month period ended June 30, 2012, the System did not recognize income related to EHR incentive payments.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Subsequent Events

The System evaluates events or transactions occurring subsequent to 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 November 29, 2012.

2. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements.

A summary of the reimbursement arrangements with major third-party payors is as follows:

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment System). 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. The System's classification of patients under the Prospective Payment System and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid and Hospital Assessment Fee Program

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

During 2012, Hospital Assessment Fee (HAF) Program for the period July 1, 2011 through June 30, 2013 was approved by Centers for Medicare & Medicaid Services retroactive to July 1, 2011. The purpose of the HAF Program is to fund the State

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana hospitals as reflected in the HAF Program expense reported in the consolidated statement of revenues, expenses and changes in net position. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates. During 2012, the System recognized HAF Program expense of approximately \$5,003,000 which resulted in Medicaid rate increases of approximately \$6,134,000.

Other Payors

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

The following is a summary of net patient service revenue for the six month period ended June 30, 2012:

Inpatient routine services	\$ 16,586,093
Inpatient ancillary services	48,286,241
Outpatient ancillary services	<u>125,853,041</u>
Gross patient service revenue	190,725,375
Contractual allowance	102,905,637
Charity care	5,987,533
Bad debts	<u>7,785,598</u>
Deductions from revenue	<u>116,678,768</u>
Net patient service revenue	<u><u>\$ 74,046,607</u></u>

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not collect amounts deemed to be charity care, they are not reported as revenue.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

3. INVESTMENTS

Investments are recorded at fair value and consist of the following as of June 30, 2012:

Cash and cash equivalents	\$ 474,321
Mutual funds - equities	6,878,130
Mutual funds - fixed income	7,549,236
	<u>\$ 14,901,687</u>

4. ASSETS WHOSE USE IS LIMITED

The classification of assets whose use is limited includes:

Internally designated - Amounts transferred by the System's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the System buildings as authorized by IC 16-22-3-13.

Held by trustee - System funds deposited with a trustee and limited as to use in accordance with the requirements of a trust indenture for debt service and capital construction.

Donor restricted - Funds held by the Foundation which are restricted by donors.

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets limited as to use includes the following as of June 30, 2012:

Internally designated	
Cash and cash equivalents	\$ 2,015,397
Mutual funds - equities	3,693,359
Mutual funds - fixed income	4,602,572
	<u>10,311,328</u>
Held by trustee	
Cash and cash equivalents	88,871
Donor restricted	
Mutual funds - equities	600,880
Total assets whose use is limited	<u>\$ 11,001,079</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

5. DEPOSITS AND INVESTMENTS

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are generally carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and mutual funds.

The System's investments generally are reported at fair value. The System had the following investments and maturities, all of which were held in the System's name by custodial banks that are agents of the System:

	June 30, 2012				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equities	\$ 11,172,369	\$ 11,172,369	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	12,151,808	12,151,808	-0-	-0-	-0-
	<u>\$ 23,324,177</u>	<u>\$ 23,324,177</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

Interest rate risk – The System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

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

Concentration of credit risk – The System maintains its investments, which at times may exceed federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on investments.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Deposits and investments consist of the following as of June 30, 2012:

Carrying amount	
Deposits	\$ 9,819,372
Mutual funds - equities	11,172,369
Mutual funds - fixed income	12,151,808
	<u>\$ 33,143,549</u>
Included in the balance sheet captions	
Cash and cash equivalents	\$ 7,240,783
Investments	14,901,687
Internally designated	10,311,328
Held by trustee	88,871
Donor restricted	600,880
	<u>\$ 33,143,549</u>

6. FAIR VALUE MEASUREMENTS

The System's investments, assets whose use is limited and interest rate swaps are reported at fair value in the accompanying consolidated balance sheet.

Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction, which requires an entity to maximize the use of observable inputs when measuring fair value.

The following provides a description of the three levels of inputs that may be used to measure fair value under the standard, the types of the System's assets whose is limited that fall under each category and the valuation methodologies used to measure these investments at fair value.

Level 1 Fair Value Measurements

Inputs to the valuation methodology are quoted prices available in the active markets for identical investments as of the reporting date.

The fair value of mutual funds is based on quoted net asset values of the shares held by the System at year-end. The net asset value is based on the value of the underlying assets owned by the fund, minus its liabilities and then divided by the number of shares outstanding. The net asset value is quoted in an active market.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Level 2 Fair Value Measurements

Inputs to the valuation methodology are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date and fair value can be determined through the use of models or other valuation methodologies.

The fair value of the interest rate swaps is based on expected cash flows over the life of the trade.

Level 3 Fair Value Measurements

Inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability and the reporting entity makes estimates and assumptions related to the pricing of the asset or liability including assumptions regarding risk.

The preceding methods used to measure fair value may produce an amount that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets and liabilities measured at fair value on a recurring basis follows:

	June 30, 2012			
	Total	Level 1	Level 2	Level 3
Assets				
Mutual funds				
Small growth	\$ 374,139	\$ 374,139	\$ -0-	\$ -0-
Mid-cap growth	370,577	370,577	-0-	-0-
Large growth	2,988,039	2,988,039	-0-	-0-
Small blend	528,689	528,689	-0-	-0-
Large value	4,359,799	4,359,799	-0-	-0-
Foreign	775,736	775,736	-0-	-0-
Bond	10,003,626	10,003,626	-0-	-0-
Other	3,923,572	3,923,572	-0-	-0-
Total mutual funds	23,324,177	\$ 23,324,177	\$ -0-	\$ -0-
Cash equivalents	2,578,589			
	<u>\$ 25,902,766</u>			
Investments on balance sheet	\$ 14,901,687			
Assets whose use is limited on balance sheet	11,001,079			
	<u>\$ 25,902,766</u>			
Liabilities				
Interest rate swaps	\$ 9,467,235	\$ -0-	\$ 9,467,235	\$ -0-

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

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

Cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements: The carrying amount reported in the consolidated balance sheet for cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements approximate fair value based on short term maturity.

Long term debt: Fair value of the System's variable rate revenue bonds is based on current traded value. The carrying value of loans payable and capital lease obligations approximates fair value based on incremental borrowing rates of similarly rated entities.

7. CAPITAL ASSETS

A summary of capital assets for 2012 follows:

	December 31, 2011	Additions	Retirements	Transfers	June 30, 2012
Land	\$ 1,002,878	\$ -0-	\$ -0-	\$ -0-	\$ 1,002,878
Land improvements	6,617,870	-0-	-0-	-0-	6,617,870
Buildings and improvements	97,780,598	93,556	(57,014)	1,357	97,818,497
Equipment	62,527,181	586,475	(144,766)	(880)	62,968,010
Construction in progress	18,586,100	2,335,215	-0-	(477)	20,920,838
Total capital assets	<u>186,514,627</u>	<u>3,015,246</u>	<u>(201,780)</u>	<u>-0-</u>	<u>189,328,093</u>
Less accumulated depreciation					
Land improvements	3,088,751	275,782	-0-	-0-	3,364,533
Buildings and improvements	45,708,741	1,659,701	(40,031)	-0-	47,328,411
Equipment	48,242,846	2,138,750	(130,251)	-0-	50,251,345
Total accumulated depreciation	<u>97,040,338</u>	<u>4,074,233</u>	<u>(170,282)</u>	<u>-0-</u>	<u>100,944,289</u>
Capital assets, net	<u>\$ 89,474,289</u>	<u>\$ (1,058,987)</u>	<u>\$ (31,498)</u>	<u>\$ -0-</u>	<u>\$ 88,383,804</u>

Included in construction in progress is the System-wide Electronic Health Record project which began in 2010 and was placed in service during August 2012. The System has no significant contractual commitments related to construction in progress at June 30, 2012.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

8. LONG TERM DEBT

The System has the following bond issues outstanding with the Indiana Financing Authority (IFA) and other local financial institutions as of June 30, 2012:

- Series 2005A and 2005B IFA Revenue Bonds, original issue \$30,000,000, Series 2005A and \$20,000,000, Series 2005B, both due through January 2035, variable interest rates of approximately 0.20% for Series 2005A and 0.13% for Series 2005B as of June 30, 2012.
- Loans payable with local financial institutions, due through 2025 at fixed and variable interest rates ranging from 1.73% to 5.15% as of June 30, 2012, secured by System revenues.
- Capital lease obligations with imputed interest rates ranging from 3.50% to 6.43% executed for property and equipment are due in monthly or quarterly installments of varying amounts from \$3,194 to \$751,211 including interest, due through 2015. The total cost of the property and equipment (including construction in progress) under capital leases approximated \$12,307,000 as of June 30, 2012 and is listed as security for the obligations. The associated accumulated depreciation was \$-0- as of June 30, 2012. Capital lease assets included in construction in progress were not placed in service as of June 30, 2012 while other capital lease assets were fully depreciated as of June 30, 2012.

The System has two available letters of credit totaling approximately \$45,400,000 with financial institutions for the Series 2005A and 2005B Bonds. The letters of credit are intended to provide credit enhancement and liquidity support for the System's tax-exempt bonds. The letters of credit are collateralized by the System's gross revenues as well as designated assets.

In May 2012, the System and CHNw approved the Definitive Agreement for CHNw to acquire the assets and liabilities of the System with a signing date of May 31, 2012 and an effective date of July 1, 2012. On the effective date, CHNw assumed all debt of the System, and the System became part of the CHNw Obligated Group for purposes of debt renewal. Under the debt restructure, the letters of credit will expire in 2015.

There were no balances outstanding on the letters of credit as of June 30, 2012. The debt agreements require the System to maintain certain financial ratios and restrictive covenants. As of June 30, 2012, the System was in compliance with certain financial ratios and covenants.

In the event of liquidity drawing, the System will reimburse the banks in installments through the due dates unless the bonds are remarketed, redeemed or purchased at which time the liquidity advance is due.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

The liquidity drawing due date for the Series 2005A letter of credit is 367 days after the liquidity drawing in 24 equal monthly installments. The liquidity drawing due date for the Series 2005B letter of credit is 367 days after the liquidity drawing. Reimbursements of other than liquidity drawings are due on the date such drawings are honored. Accounting guidance requires long term debt backed by a letter of credit to be reported as current if the letter of credit does not provide a long term financing option for liquidity drawings.

A summary of long term debt for 2012 follows:

	December 31, 2011	Borrowings	Payments	June 30, 2012	Current Portion
2005 IFA Revenue Bonds	\$ 46,335,000	\$ -0-	\$ (915,000)	\$ 45,420,000	\$ 950,000
Loans payable	11,168,743	-0-	(556,386)	10,612,357	917,300
Capital lease obligations	5,779,040	-0-	(171,316)	5,607,724	2,857,232
Total long term debt	<u>\$ 63,282,783</u>	<u>\$ -0-</u>	<u>\$ (1,642,702)</u>	<u>\$ 61,640,081</u>	<u>\$ 4,724,532</u>

The System has interest rate swap agreements related to the Series 2005A and 2005B Bonds. The interest rate swap agreements do not affect the obligation of the System under the indenture to repay principal and interest on the Series 2005A and 2005B Bonds. However, during the term of the swap agreements, the System effectively pays a fixed rate on a portion of the debt. A portion of the debt service requirements to maturity for the Series 2005A and 2005B Bonds are based on that fixed rate. The System will be exposed to variable rates if the counterparty to the swaps defaults or the swap agreements are terminated.

A termination of the swap agreements may also result in the System making or receiving a termination payment. As of June 30, 2012, the variable rates on the Series 2005A and 2005B Bonds were lower than the swap agreements fixed rates. Thus, the amounts reported in the interest rate swap, net column of the below table reflect the difference between the variable rate and swap fixed rate.

See the footnote on Derivative Instruments – Interest Rate Swaps for additional information.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Scheduled maturities for the years subsequent to June 30, 2012 are as follows:

Years Ending June 30,	Principal	Interest	Interest Rate Swap, Net	Total
2013	\$ 4,724,532	\$ 579,415	\$ 1,483,185	\$ 6,787,132
2014	2,737,489	481,650	1,451,175	4,670,314
2015	2,305,745	416,897	1,417,928	4,140,570
2016	1,847,712	486,236	1,383,608	3,717,556
2017	1,712,885	427,679	1,348,215	3,488,779
2018-2022	9,667,822	1,581,769	6,162,998	17,412,589
2023-2027	11,183,896	571,411	4,992,818	16,748,125
2028-2032	14,170,000	258,859	2,918,933	17,347,792
2033-2035	13,290,000	67,938	280,995	13,638,933
	<u>\$ 61,640,081</u>	<u>\$ 4,871,854</u>	<u>\$ 21,439,855</u>	<u>\$ 87,951,790</u>

The System has lines of credit with local financial institutions. The lines bear interest at rates ranging from a fixed rate of 5% to a variable rate of prime less .25%. Outstanding draws are due on demand and are collateralized by System assets. There were no borrowings outstanding on the lines of credit as of June 30, 2012.

9. DERIVATIVE INSTRUMENTS – INTEREST RATE SWAPS

Derivative Instruments

The System adheres to GASB No. 53, Accounting and Financial Reporting for Derivative Instruments. The guidance requires governmental entities to evaluate each derivative instrument to determine whether the instrument is an effective hedge.

For those instruments deemed to be an effective hedge, governmental entities are required to practice hedge accounting and the instrument continues to be reevaluated at the end of each future reporting period. Under hedge accounting, the fair value of the instrument is recorded on the consolidated balance sheet with the offsetting entry to deferred outflows or deferred inflows, which also reported on the consolidated balance sheet.

For those instruments deemed to be an ineffective hedge, governmental entities are required to practice investment accounting and the instruments are not evaluated in future reporting periods. Once deemed ineffective, the instrument is considered ineffective for the remainder of its term. Under investment accounting, the fair value of the instrument is recorded on the consolidated balance sheet with the offsetting entry posted to investment income.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

During 2010, the System's interest rate swap agreements were determined to be ineffective hedges. Therefore, the interest rate swap agreements are ineffective through the remainder of the term. As a result, the fair value of the instruments have been recorded as other long term liabilities in the consolidated balance sheet with the offsetting entry recorded under nonoperating revenues (expenses) in the consolidated statement of revenues, expenses and changes in net position.

Contracts

The System has two interest rate swap agreements in effect as of June 30, 2012 for the IFA Hospital Revenue Bonds, Series 2005A and 2005B.

Objectives and Strategies for Using Derivatives

As a means to manage the risk associated with interest rate risk on its variable rate debt, the System entered into interest rate swaps agreements in connection with its IFA Hospital Revenue Bonds, Series 2005A and 2005B. The intention of the swap agreements was to effectively change the System's variable interest rate on the Series 2005A and 2005B Bonds to fixed rate of 3.55%.

Terms, Fair Values and Credit Risk

The swap agreements relate to the Series 2005A and 2005B Bonds with original notional amounts of \$30,000,000 and \$10,000,000, respectively. The counter party is the same for each swap agreement. The terms and fair values of the outstanding swaps as of June 30, 2012 are as follows:

<u>Original Notional Amount</u>	<u>Current Notional Amount</u>	<u>Effective Date</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fair Value</u>	<u>Termination Date</u>
\$30,000,000	\$27,250,000	10/3/2005	3.550%	0.169%	\$(7,099,114)	1/1/2035
\$10,000,000	\$9,085,000	10/3/2005	3.550%	0.169%	(2,368,121)	1/1/2035
					<u>\$(9,467,235)</u>	

As of June 30, 2012, the negative fair values of the agreements may be countered by reductions in total interest payments under the swap agreements should the variable rates on the 2005A and 2005B Series bonds increase. The variable rate on the swaps is 70% of the USD-LIBOR BBA and resets monthly.

The counter party is rated A2 by Moody's Investor Service, A- by Standard & Poor's and A by Fitch Ratings.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

Basis Risk

The swaps variable rates are pegged to USD-LIBOR-BBA index. The Series 2005A and 2005B Bonds variable rates are determined through remarketing. Therefore basis risk relating to the swaps could be significant.

Termination Risk

The System or the counter party may terminate the swaps if the other party fails to perform under the terms of the contracts. If at the time of termination, the swaps have a negative fair value, the System could be liable to the counter party for a payment equal to the swaps' fair values. As of June 30, 2012, the System was not in compliance with certain terms of the swap contracts. The System obtained a waiver from the counter party as of June 30, 2012.

Swap Payments and Associated Debt

Using rates as of June 30, 2012, debt service requirements of the variable rate debt and net swap payments of the Series 2005A and 2005B Bonds, assuming current interest rates remain the same for the term of the bonds are disclosed in the Long Term Debt note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

The System has determined the swaps to be ineffective hedges. Accordingly, the fair value of the swaps have been recorded and subsequent changes in fair value will be recorded in the consolidated balance sheet with the offsetting entry recorded under nonoperating revenues (expenses) in the consolidated statement of revenues, expenses and changes in net position.

Following is an analysis of the recording of the interest rate swap agreements:

Nonoperating revenues (expenses)	
Unrealized loss on interest rate swaps	<u>\$ (473,147)</u>
Other long term liabilities	
Interest rate swaps	<u>\$ 9,467,235</u>

See the Fair Value Measurements and Long Term Debt footnotes for additional information.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

10. PENSION PLAN

The System has a defined contribution pension plan as authorized by IC 16-22-3-11 covering eligible employees who are at least 21 years of age and work 1,000 hours in a plan year. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The current employer contribution rate is 2% of annual covered payroll. The plan was established by written agreement between the System's Board of Trustees and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan.

The System provides matching contribution to their 403(b) tax deferred annuity plan for any eligible employee who elects to participate. Participants are generally allowed to participate on the first day of the month on or after becoming an employee. The System matches participant deferrals up to 2% of a participants' eligible compensation.

Total pension expense for the six month period ended June 30, 2012 was approximately \$751,000, and is reported in employee benefits in the consolidated statement of revenues, expenses and changes in net position.

11. COMMITMENTS AND CONTINGENCIES

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Leases expire through December 2012. Total rental expense for the six month period ended June 30, 2012 for all operating leases was approximately \$2,080,100.

Minimum payments under non-cancellable operating lease agreements through December 2012 approximate \$250,000.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

12. CONCENTRATIONS

The System is located in Kokomo, Indiana. The System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements.

The mix of gross receivables and gross revenues from patients and third-party payors as of and for the six month period ended June 30, 2012 was as follows:

	<u>Receivables</u>	<u>Revenues</u>
Medicare	34%	51%
Medicaid	13%	11%
Blue Cross	12%	18%
Other third party payors	13%	12%
Self-pay	28%	8%
	<u>100%</u>	<u>100%</u>

The blended component units of the System maintain cash in accounts, which at times may exceed federally insured limits. The blended component units have not experienced any losses in such accounts. The blended component units believe that it is not exposed to any significant credit risk on cash and cash equivalents.

13. SELF-FUNDED HEALTH INSURANCE

The System is self-funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$150,000 per year with an overall aggregate of \$7,500,000.

Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Self-funded health insurance and related expenses were approximately \$2,959,000 for the six month period ended June 30, 2012, and are recorded in employee benefits in the consolidated statement of revenues, expenses and changes in net position. A progression of unpaid claims for 2012 follows:

Unpaid claims, beginning of period	\$ 1,099,107
Incurred claims and changes in estimates	2,958,942
Claim payments	<u>(2,958,942)</u>
Unpaid claims, end of period	<u>\$ 1,099,107</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

14. INVESTMENTS IN AFFILIATED COMPANIES

North Central Indiana Linen Service, Inc.

The System owns 33% of North Central Indiana Linen Service. The investment is accounted for under the equity method and is recorded in other assets on the consolidated balance sheet. Summarized financial information as of June 30, 2012 and the six month period then ended follows:

Assets	\$	1,221,148
Liabilities	\$	149,909
Equity	\$	1,071,239
Revenue	\$	631,140
Expenses	\$	588,224
Net income	\$	42,916

15. ACCOUNTING FOR NON-CONTROLLING INTEREST

The following depicts the changes in consolidated net position attributable to the controlling financial interest of the System and the non-controlling interest as of June 30, 2012:

	Controlling Interest	Non-controlling Interest	Total
Net position balances			
December 31, 2011	\$ 55,302,088	\$ 2,213,944	\$ 57,516,032
Change in net position before capital distributions	(584,231)	496,007	(88,224)
Capital distributions	-0-	(532,168)	(532,168)
Change in net position	(584,231)	(36,161)	(620,392)
June 30, 2012	<u>\$ 54,717,857</u>	<u>\$ 2,177,783</u>	<u>\$ 56,895,640</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2012

16. STATE AND LOCAL AWARDS

During the six month period ended June 30, 2012, the System recorded the following state and local awards:

<u>Grantor</u>	<u>Grant Identification</u>	<u>Amount</u>
Indiana Division of Mental Health and Addiction & Affiliated Service Providers of Indiana Managed care provider agreement	A55-9-34-11-HO-2710	\$ 1,034,930
Indiana State Department of Health Community Health Centers	A70-2-079548	63,084
Tipton County	Not applicable	48,292
Clinton County	Not applicable	83,210
Howard County	Not applicable	<u>320,747</u>
Total state and local awards		<u>\$ 1,550,263</u>

State and local awards are reported in the consolidated statement of revenues, expenses and changes in net position under other revenue.

17. SUBSEQUENT EVENT - SYSTEM AFFILIATION

In May 2012, both the System and CHNw boards approved the Definitive Agreement for CHNw to acquire the assets and liabilities of the System. On May 22, 2012, the Board of Trustees of the System as well as the Howard County Council and Howard County Commissioners, passed a resolution to approve the affiliation, with a signing date of May 31, 2012 and an effective date of July 1, 2012. On the effective date, CHNw assumed all debt of the System, and the System became a part of the CHNw Obligated Group for purposes of debt renewal. The affiliation entity was named Community Howard Regional Health, Inc. (CHRH), and the net position of the System was transferred to CHRH. Local governance is a key component of this agreement, requiring that a majority of the CHRH board members be residents of Howard County, an acute care hospital will be maintained in Howard County, and a plan will be created to develop CHRH into a Regional Medical Center.

SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS JUNE 30, 2012

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
ASSETS									
Current assets									
Cash and cash equivalents	\$ 4,495,743	\$ 199,391	\$ 1,269,841	\$ 65,274	\$ 1,156,943	\$ 37,467	\$ 16,124	\$ -0-	\$ 7,240,783
Investments	12,689,761	2,211,926	-0-	-0-	-0-	-0-	-0-	-0-	14,901,687
Patient accounts receivable, net	16,578,428	-0-	1,181,312	-0-	-0-	588,277	139,593	-0-	18,487,610
Other receivables	8,940,111	20,711	10,103	14,564	435,338	-0-	-0-	(6,613,183)	2,807,644
Inventories and other current assets	5,482,654	-0-	239,625	20,917	418,788	28,290	-0-	-0-	6,190,274
Current portion of assets whose use is limited	950,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	950,000
Total current assets	49,136,697	2,432,028	2,700,881	100,755	2,011,069	654,034	155,717	(6,613,183)	50,577,998
Assets whose use is limited									
Internally designated	10,311,328	-0-	-0-	-0-	-0-	-0-	-0-	-0-	10,311,328
Held by trustee	-0-	88,871	-0-	-0-	-0-	-0-	-0-	-0-	88,871
Donor restricted	-0-	600,880	-0-	-0-	-0-	-0-	-0-	-0-	600,880
Total assets whose use is limited	10,311,328	689,751	-0-	-0-	-0-	-0-	-0-	-0-	11,001,079
Less current portion	950,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	950,000
Noncurrent portion	9,361,328	689,751	-0-	-0-	-0-	-0-	-0-	-0-	10,051,079
Capital assets, net	82,259,797	-0-	1,392,288	597,636	361,175	3,732,024	40,884	-0-	88,383,804
Other assets	989,304	60,171	565,097	-0-	-0-	-0-	-0-	(144,361)	1,470,211
Total assets	<u>\$ 141,747,126</u>	<u>\$ 3,181,950</u>	<u>\$ 4,658,266</u>	<u>\$ 698,391</u>	<u>\$ 2,372,244</u>	<u>\$ 4,386,058</u>	<u>\$ 196,601</u>	<u>\$ (6,757,544)</u>	<u>\$ 150,483,092</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS JUNE 30, 2012

LIABILITIES AND NET POSITION	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
Current liabilities									
Accounts payable and accrued expenses	\$ 9,726,574	\$ -0-	\$ 408,549	\$ 1,854,775	\$ 563,954	\$ 3,191,840	\$ 1,148,137	\$ (6,402,475)	\$ 10,491,354
Accrued liabilities	6,993,246	-0-	509,186	-0-	-0-	103,309	-0-	-0-	7,605,741
Other current liabilities	2,331,919	1,879	128,511	175,379	-0-	-0-	-0-	(173,708)	2,463,980
Estimated third party settlements	1,919,061	-0-	-0-	-0-	-0-	-0-	-0-	-0-	1,919,061
Current portion of revenue bonds payable	950,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	950,000
Current portion of loans payable	600,272	-0-	-0-	-0-	-0-	317,028	-0-	-0-	917,300
Current portion of capital lease payable	2,503,146	-0-	-0-	-0-	-0-	354,086	-0-	-0-	2,857,232
Total current liabilities	25,024,218	1,879	1,046,246	2,030,154	563,954	3,966,263	1,148,137	(6,576,183)	27,204,668
Long term debt									
Loans payable	9,101,495	99,690	-0-	37,000	-0-	493,872	-0-	(37,000)	9,695,057
Capital lease payable	2,099,935	-0-	-0-	-0-	-0-	710,324	-0-	(59,767)	2,750,492
Revenue bonds payable	44,470,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	44,470,000
Total long term debt	55,671,430	99,690	-0-	37,000	-0-	1,204,196	-0-	(96,767)	56,915,549
Interest rate swap liabilities	9,467,235	-0-	-0-	-0-	-0-	-0-	-0-	-0-	9,467,235
Total liabilities	90,162,883	101,569	1,046,246	2,067,154	563,954	5,170,459	1,148,137	(6,672,950)	93,587,452
Net position									
Net investment in capital assets	22,534,949	(39,519)	1,392,288	560,636	361,175	1,856,714	-0-	-0-	26,666,243
Designated									
For debt service	-0-	88,871	-0-	-0-	-0-	-0-	-0-	-0-	88,871
Expendable for capital improvements	10,311,328	-0-	-0-	-0-	-0-	-0-	-0-	-0-	10,311,328
Total designated net position	10,311,328	88,871	-0-	-0-	-0-	-0-	-0-	-0-	10,400,199
Restricted - donor restricted	-0-	600,880	-0-	-0-	-0-	-0-	-0-	-0-	600,880
Unrestricted	18,737,966	2,430,149	2,219,732	(1,929,399)	1,447,115	(2,641,115)	(951,536)	(2,262,377)	17,050,535
Net position - controlling interest	51,584,243	3,080,381	3,612,020	(1,368,763)	1,808,290	(784,401)	(951,536)	(2,262,377)	54,717,857
Non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	-0-	2,177,783	2,177,783
Total net position	51,584,243	3,080,381	3,612,020	(1,368,763)	1,808,290	(784,401)	(951,536)	(84,594)	56,895,640
Total liabilities and net position	<u>\$ 141,747,126</u>	<u>\$ 3,181,950</u>	<u>\$ 4,658,266</u>	<u>\$ 698,391</u>	<u>\$ 2,372,244</u>	<u>\$ 4,386,058</u>	<u>\$ 196,601</u>	<u>\$ (6,757,544)</u>	<u>\$ 150,483,092</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2012

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
Revenues									
Net patient service revenue	\$ 62,550,970	\$ -0-	\$ 7,025,535	\$ -0-	\$ 3,361,094	\$ 676,452	\$ 432,556	\$ -0-	\$ 74,046,607
Other	6,341,461	5,912	377,559	304,662	-0-	8,881	-0-	(716,114)	6,322,361
Total revenues	<u>68,892,431</u>	<u>5,912</u>	<u>7,403,094</u>	<u>304,662</u>	<u>3,361,094</u>	<u>685,333</u>	<u>432,556</u>	<u>(716,114)</u>	<u>80,368,968</u>
Operating expenses									
Salaries and wages	23,379,428	-0-	3,552,936	-0-	1,146,639	437,432	-0-	-0-	28,516,435
Employee benefits	4,959,643	-0-	867,445	-0-	-0-	20,980	-0-	-0-	5,848,068
Medical professional fees	3,082,556	-0-	293,715	10,502	-0-	154,937	9,584	-0-	3,551,294
Medical supplies and drugs	13,810,868	-0-	407,676	17,602	1,097,890	107,564	25,703	-0-	15,467,303
Purchased services	5,917,848	-0-	369,162	252,524	128,706	154,074	513,998	(95,748)	7,240,564
Equipment rentals	3,229,101	-0-	564,453	10,428	474,653	157,543	28,041	(616,482)	3,847,737
Utilities and telephone	1,143,911	-0-	184,823	27,272	29,611	69,726	7,185	-0-	1,462,528
Insurance	454,472	-0-	31,140	6,292	15,030	18,312	-0-	-0-	525,246
Depreciation and amortization	3,641,608	-0-	113,384	45,581	85,846	217,500	-0-	-0-	4,103,919
Hospital Assessment Fee Program	5,003,400	-0-	-0-	-0-	-0-	-0-	-0-	-0-	5,003,400
Other	3,478,093	-0-	81,399	29,724	126,175	56,626	32,180	-0-	3,804,197
Total expenses	<u>68,100,928</u>	<u>-0-</u>	<u>6,466,133</u>	<u>399,925</u>	<u>3,104,550</u>	<u>1,394,694</u>	<u>616,691</u>	<u>(712,230)</u>	<u>79,370,691</u>
Operating income (loss)	791,503	5,912	936,961	(95,263)	256,544	(709,361)	(184,135)	(3,884)	998,277
Nonoperating revenues (expenses)									
Investment income	1,253,147	176,794	-0-	-0-	699	-0-	-0-	-0-	1,430,640
Interest expense	(1,569,473)	-0-	-0-	(45)	-0-	(23,410)	-0-	3,884	(1,589,044)
Unrealized loss on interest rate swaps	(473,147)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	(473,147)
Other nonoperating revenues (expenses)	(639,629)	(127,315)	797	-0-	-0-	-0-	(1,759)	312,956	(454,950)
Nonoperating revenues (expenses), net	<u>(1,429,102)</u>	<u>49,479</u>	<u>797</u>	<u>(45)</u>	<u>699</u>	<u>(23,410)</u>	<u>(1,759)</u>	<u>316,840</u>	<u>(1,086,501)</u>
Change in net assets before capital distributions and contributions	(637,599)	55,391	937,758	(95,308)	257,243	(732,771)	(185,894)	312,956	(88,224)
Capital distributions	-0-	-0-	(585,000)	-0-	(634,399)	-0-	-0-	687,231	(532,168)
Capital contributions	-0-	-0-	-0-	-0-	-0-	278,744	-0-	(278,744)	-0-
Change in net assets	(637,599)	55,391	352,758	(95,308)	(377,156)	(454,027)	(185,894)	721,443	(620,392)
Net assets									
Beginning of period	52,221,842	3,024,990	3,259,262	(1,273,455)	2,185,446	(330,374)	(765,642)	(806,037)	57,516,032
End of period	<u>\$ 51,584,243</u>	<u>\$ 3,080,381</u>	<u>\$ 3,612,020</u>	<u>\$ (1,368,763)</u>	<u>\$ 1,808,290</u>	<u>\$ (784,401)</u>	<u>\$ (951,536)</u>	<u>\$ (84,594)</u>	<u>\$ 56,895,640</u>

See report of independent auditors on pages 1 and 2.