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October 14, 2015

Board of Directors
Floyd Memorial Hospital and Health Services
1850 State Street
New Albany, IN 47150

We have reviewed the audit report prepared by BKD, LLP, Independent Public Accountants, for the period January 1, 2014 to December 31, 2014. 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 Floyd Memorial Hospital and Health Services, as of December 31, 2014 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.

Paul D. Joyce

Paul D. Joyce, CPA
State Examiner

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana

Auditor's Report and Financial Statements

December 31, 2014 and 2013

BKD LLP
CPAs & Advisors

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
December 31, 2014 and 2013

Contents

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Independent Auditor's Report

Board of Trustees
Floyd Memorial Hospital and Health Services
New Albany, Indiana

We have audited the accompanying balance sheets of Floyd Memorial Hospital and Health Services (Hospital), a component unit of Floyd County, Indiana, as of December 31, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital's preparation and fair presentation of the 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 Hospital'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 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 financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

BKD, LLP

Louisville, Kentucky
April 28, 2015

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Management's Discussion and Analysis
Years Ended December 31, 2014 and 20133

Introduction

This management's discussion and analysis of the financial performance of Floyd Memorial Hospital and Health Services (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2014, 2013 and 2012. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and investments, excluding restricted investments and amounts held by trustee for debt service, increased by $5,086,114, or 5.9% in 2014 as compared to 2013, and decreased by $14,937,292, or (14.8%) in 2013 as compared to 2012.
- The Hospital's net position decreased in the past year by $4,180,201, or (3%) as compared to 2013 when the Hospital's net position decreased by $846,330, or (0.6%) as compared to 2012.
- The Hospital reported operating income (loss) in 2014 of ($1,843,260), or (0.6%) of total operating revenues versus $368,886, or 0.1% of total operating revenues in 2013 and $11,921,267, or 4.5% of total operating revenues in 2012.
- Net nonoperating expenses increased by $755,317 in 2014 as compared to 2013 and increased $413,090 in 2013 as compared to 2012.
- Days cash on hand decreased to 116 in 2014 from 119 in 2013 and 152 in 2012.
- Debt service coverage ratio declined to 1.5 in 2014 from 1.9 in 2013 and from 3.2 in 2012.

Using This Annual Report

The Hospital's financial statements consist of three statements — a balance sheet, statement of revenues, expenses and changes in net position and statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital reports as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Position

The balance sheet and the statement of revenues, expenses and changes in net position report information about the Hospital's resources and activities for purposes of illustrating the effects of the past year's activity on the financial health of the Hospital. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. As the Hospital uses the accrual basis of accounting, current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Hospital's total net position — the difference between assets, deferred outflows of resources, liabilities and deferred inflows of resources — is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. The statement of cash flows illustrates the uses and sources of cash for the year.

The Hospital's Net Position

The Hospital's net position is the difference between assets, deferred outflows of resources, liabilities and deferred inflows of resources reported in the balance sheet. The Hospital's net position decreased by $4,180,201, or (3%) in 2014 versus 2013 and decreased by $846,330, or (0.6%) in 2013 versus 2012, as shown in Table 1.

Table 1: Balance Sheets Summary

	2014	2013	2012
Assets			
Patient accounts receivable, net	$ 38,154,806	$ 47,587,727	$ 33,096,166
Other current assets	33,313,090	25,201,688	40,631,501
Capital assets, net	115,696,301	121,155,030	119,793,616
Other noncurrent assets	83,309,956	85,773,760	83,760,137
Total assets	270,474,153	279,718,205	277,281,420
Deferred Outflows of Resources	17,567,062	18,488,807	19,409,774
Total assets and deferred outflows of resources	$ 288,041,215	$ 298,207,012	$ 296,691,194
Liabilities			
Long-term debt	$ 91,845,146	$ 95,170,568	$ 98,695,163
Other current and noncurrent liabilities	52,817,558	55,043,618	48,729,799
Fair value of interest rate swap agreement	8,454,270	6,182,805	10,118,289
Total liabilities	153,116,974	156,396,991	157,543,251
Deferred Inflows of Resources	1,587,464	4,293,043	784,635

	2014	2013	2012
Net Position			
Net investment in capital assets	$ 19,497,551	$ 21,470,467	$ 25,835,030
Restricted	6,462,200	6,424,439	6,177,966
Unrestricted	107,377,026	109,622,072	106,350,312
Total net position	133,336,777	137,516,978	138,363,308
Total liabilities, deferred inflows of resources and net position	$ 288,041,215	$ 298,207,012	$ 296,691,194

Total assets decreased $9,244,052, or (3.3%) in 2014 compared to 2013. Patient accounts receivable decreased by $9,432,921, or (19.8%) from 2013 to 2014, and increased $14,491,561, or 43.8% from 2012 to 2013.

Operating Results and Changes in the Hospital's Net Position

The Hospital's net position decreased by $4,180,201, or (3%) in 2014 compared to a decrease of $846,330, or (0.6%) in 2013. This decrease is made up of several components as shown in Table 2.

Table 2: Operating Results and Changes in Net Position

	2014	2013	2012
Operating Revenues			
Net patient service revenue	$ 291,417,867	$ 273,191,901	$ 259,113,591
Other operating revenues	4,962,382	5,373,947	7,891,379
Total operating revenues	296,380,249	278,565,848	267,004,970
Operating Expenses			
Salaries and wages and employee benefits	153,977,341	147,294,644	125,591,909
Purchased services and professional fees	55,300,587	42,776,712	46,624,334
Depreciation and amortization	13,736,088	13,424,077	11,606,306
Other operating expenses	75,209,493	74,701,529	71,261,154
Total operating expenses	298,223,509	278,196,962	255,083,703
Operating Income (Loss)	(1,843,260)	368,886	11,921,267

	2014	2013	2012
Nonoperating Revenues (Expenses)			
Investment income	$ 365,022	$ 1,956,325	$ 2,795,376
Noncapital grants and contributions	280,207	313,627	690,095
Interest expense	(5,146,909)	(5,200,248)	(5,311,716)
Other nonoperating revenues and expenses, net	1,998,902	1,182,835	491,874
Total nonoperating expenses	(2,502,778)	(1,747,461)	(1,334,371)
Capital Grants			
Capital grants	165,837	532,245	52,443
Total capital grants	165,837	532,245	52,443
Change in Net Position	$ (4,180,201)	$ (846,330)	$ 10,639,339

Operating Income (Loss)

The first component of the overall change in the Hospital's net position is its operating income or loss, identified as the difference between net patient service and other operating revenues and the expenses incurred to perform those services.

The operating loss for 2014 was $1,843,260 as compared to an operating income of $368,886 for 2013 and $11,921,267 for 2012. The primary components of change in operating results are:

- An increase in net patient service revenue of $18,225,966, or 6.7% in 2014 due to a 25.8% increase in outpatient visits and a full year of the two long-term care facility ventures. In 2008, the Hospital implemented revenue cycle initiatives to identify net patient service revenue enhancement opportunities. These initiatives yielded increases in net patient revenue of $5,857,520 in 2014 and $3,670,690 in 2013.
- An increase in salaries and benefits of $6,682,697, or 4.5% in 2014 as compared to an increase of $21,702,735, or 17.3% in 2013. The increase resulted from additional Hospital outpatient volume, the full year impact of physician practices acquired in 2013, a full year of the second long-term care venture from 2013.
- An increase in supply and drug costs of $493,110, or 0.9% in 2014 and $1,753,570, or 3.2% in 2013.
- An increase in depreciation and amortization of $312,011, or 2.3% in 2014 and an increase of $1,817,771, or 15.7% in 2013.

Full-time equivalent employees increased to 2,170 in 2014 or 1.2% from 2,144 in 2013 and 1,779 in 2012. The 2014 and 2013 increases are primarily due to the annual impact of staff resulting from the acquisition of physician practices in 2013 and the 2012 and 2013 long-term care ventures.

The rate of health care inflation has a direct effect on the cost of services provided by the Hospital. Expenditures for medical supplies and prescription drugs are a major component of the Hospital's costs. In 2014, the costs totaled $57,107,328, or 19.1% of total operating expenses, resulting in an increase of $493,110, or 0.9% over 2013. In 2013, the costs totaled $56,614,218, or 20.4% of total operating expenses, resulting in an increase of $1,753,570, or 3.2% over 2012. In 2012, the costs totaled $54,860,648, or 21.5% of total operating expenses. Additionally, the costs increased in 2014 due to the full year of the second long-term care venture. In 2008, the Hospital implemented a clinical quality value analysis (CQVA) program, focused on the quality and cost-effectiveness of supplies. The CQVA program yielded savings of approximately $2,246,790 in 2014 compared to approximately $1,549,902 in 2013 and $1,414,062 in 2012.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income and interest expense. The Hospital recorded investment income of $365,022 in 2014 versus $1,956,325 in 2013. Interest expense decreased to $5,146,909 in 2014, or a 1% decrease over 2013 of $5,200,248, due to interest payments on existing bonds.

The Hospital's Cash Flows

Increases in cash flow in 2014 resulted from the decrease in patient accounts receivable. In 2013, cash flows decreased due to an increase in patient accounts receivable of $14,491,561 over 2012 due to the implementation of a new information system.

Capital Asset and Debt Administration

Capital Assets

At the end of 2014, the Hospital had $115,696,301 net invested in capital assets compared to $121,155,030 in 2013 for a decrease of $5,458,729, or (4.5%) from 2013 and an increase of $1,361,414, or 1.1% from 2013 to 2012.

Debt

At December 31, 2014, the Hospital had $96,198,750 in revenue bonds, notes payable and capital lease obligations outstanding.

In July 2012, the Hospital participated in the issuance of $47,245,000 Indiana Health Facility Financing Authority Hospital Refunding Revenue Bonds, Series 2012 Bonds (2012 Bonds), which bear interest at 68% of one-month London Interbank Offering Rate (LIBOR), plus 1.39%. The proceeds were primarily used for the advanced refunding of the 2008 bonds.

In December 2013, the Hospital accessed its line of credit in the amount of $1,000,000 to fund capital expenditures for the construction of an outpatient observation unit. Full repayment is anticipated in 2015.

Other Operating and Future Economic Factors

Indiana Hospital Assessment Fee Program

During 2012, the state of Indiana enacted the Hospital Assessment Fee (HAF) program to replace the disproportionate share hospital (DSH) program. The HAF program includes a state specific provider assessment fee to increase Medicaid payments to hospitals. The program was implemented retroactively to the beginning of the 2012 Indiana State Fiscal Year (July 1, 2011), and was in place through June 30, 2013. Therefore, the Hospital recorded a six-month impact of the HAF program during 2013. In 2014, the Indiana Legislature approved legislation re-instating the HAF program through June 30, 2017. The Hospital recorded $25,175,000 within net patient service revenues during 2014 versus $9,938,000 in 2013 and expensed assessment fees totaling $21,756,000 in 2014 versus $7,717,000.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the chief financial officer by telephoning 812.948.7402.

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Balance Sheets
December 31, 2014 and 2013

Assets and Deferred Outflows of Resources

	2014	2013
Current Assets		
Cash and cash equivalents	$ 22,460,462	$ 14,239,600
Restricted investments – current	2,059,977	2,018,856
Patient accounts receivable, net of allowance; 2014 – $22,348,000; 2013 – $23,274,000	38,154,806	47,587,727
Estimated amounts due from third-party payers	-	1,100,414
Supplies	5,346,088	4,787,373
Prepaid expenses and other current assets	3,446,563	3,055,445
Total current assets	71,467,896	72,789,415
Noncurrent Cash and Investments		
Internally designated	68,330,646	71,465,394
Held by trustee for debt service	6,462,200	6,424,439
	74,792,846	77,889,833
Less amount required to meet current obligations	2,059,977	2,018,856
	72,732,869	75,870,977
Capital Assets, Net	115,696,301	121,155,030
Other Assets		
Other	10,577,087	9,902,783
Total assets	270,474,153	279,718,205
Deferred Outflows of Resources	17,567,062	18,488,807
Total assets and deferred outflows of resources	$ 288,041,215	$ 298,207,012

Liabilities, Deferred Inflows of Resources and Net Position

	2014	2013
Current Liabilities		
Current maturities of long-term debt	$ 4,353,604	$ 4,513,995
Payable to suppliers and contractors	12,387,478	14,275,497
Payable to employees (including payroll taxes and benefits)	14,693,871	15,121,173
Estimated amounts due to third-party payers	1,295,292	-
Accrued expenses	5,044,026	4,987,408
Payable to Northgate Surgery Center	318,084	467,291
Total current liabilities	38,092,355	39,365,364
Fair Value of Interest Rate Swap Agreement	8,454,270	6,182,805
Long-Term Debt	91,845,146	95,170,568
Accrued Pension and Other Long-Term Liabilities	14,725,203	15,678,254
Total liabilities	153,116,974	156,396,991
Deferred Inflows of Resources	1,587,464	4,293,043
Net Position		
Net investment in capital assets	19,497,551	21,470,467
Restricted	6,462,200	6,424,439
Unrestricted	107,377,026	109,622,072
Total net position	133,336,777	137,516,978
Total liabilities, deferred inflows of resources and net position	$ 288,041,215	$ 298,207,012

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2014 and 2013

	2014	2013
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2014 – $29,461,000; 2013 – $32,877,000	$ 291,417,867	$ 273,191,901
Other	4,962,382	5,373,947
Total operating revenues	296,380,249	278,565,848
Operating Expenses		
Salaries and benefits	153,977,341	147,294,644
Purchased services and professional fees	55,300,587	42,776,712
Supplies	57,107,328	56,614,218
Other expenses	18,683,261	18,087,311
Depreciation and amortization	13,736,088	13,424,077
Gain on sale of property and equipment	(581,096)	-
Total operating expenses	298,223,509	278,196,962
Operating Income (Loss)	(1,843,260)	368,886
Nonoperating Revenues (Expenses)		
Investment income	365,022	1,956,325
Interest expense	(5,146,909)	(5,200,248)
Noncapital grants and contributions	280,207	313,627
Gain on investment in equity investees	1,998,902	1,182,835
Total nonoperating expenses	(2,502,778)	(1,747,461)
Deficiency of Revenues Over Expenses Before Capital Grants	(4,346,038)	(1,378,575)
Capital Grants	165,837	532,245
Decrease in Net Position	(4,180,201)	(846,330)
Net Position, Beginning of Year	137,516,978	138,363,308
Net Position, End of Year	$ 133,336,777	$ 137,516,978

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	$ 302,776,977	$ 256,150,352
Payments to suppliers and contractors	(133,338,996)	(113,319,389)
Payments to employees	(154,214,548)	(142,991,852)
Other receipts, net	4,962,382	5,373,947
Net cash provided by operating activities	20,185,815	5,213,058
Noncapital Financing Activities		
Noncapital grants and contributions	280,207	313,627
Net cash provided by noncapital financing activities	280,207	313,627
Capital and Related Financing Activities		
Capital grants	165,837	532,245
Interest payments on long-term obligations	(4,692,748)	(4,735,631)
Principal paid on long-term debt and capital leases	(3,513,585)	(3,808,647)
Purchase of capital assets	(8,316,373)	(15,161,796)
Borrowings under line of credit	-	1,000,000
Net cash used in capital and related financing activities	(16,356,869)	(22,173,829)
Investing Activities		
Proceeds from disposition of investments	19,697,894	27,330,235
Purchase of investments	(18,298,700)	(28,883,643)
Interest and dividends on investments	2,062,815	1,320,410
Proceeds from sale of capital assets	649,700	-
Net cash provided by (used in) investing activities	4,111,709	(232,998)
Increase (Decrease) in Cash and Cash Equivalents	8,220,862	(16,880,142)
Cash and Cash Equivalents, Beginning of Year	14,239,600	31,119,742
Cash and Cash Equivalents, End of Year	$ 22,460,462	$ 14,239,600

See Notes to Financial Statements

	2014	2013
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities		
Operating income (loss)	$ (1,843,260)	$ 368,886
Depreciation and amortization	13,736,090	13,424,077
Provision for uncollectible accounts	29,461,443	32,876,671
Gain on disposition of assets	(581,096)	-
Changes in operating assets and liabilities		
Patient accounts receivable	(20,028,522)	(47,368,232)
Estimated amounts due to/from third-party payers	2,395,706	(2,549,988)
Accounts payable and accrued expenses	(3,147,116)	7,642,719
Prepaid assets, supplies and other assets	192,570	818,925
Net cash provided by operating activities	$ 20,185,815	$ 5,213,058
Supplemental Cash Flows Information		
Property, plant and equipment additions in accounts payable	$ 344,105	$ 524,480
Change in fair value of interest rate swap agreements	$ (2,271,465)	$ 3,935,484

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

Nature of Operations and Reporting Entity

Floyd Memorial Hospital and Health Services (Hospital) is an acute care hospital located in New Albany, Indiana. The Hospital is a component unit of Floyd County (County) and the Board of County Commissioners appoints members to the board of trustees of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Floyd County and the surrounding six county areas.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets, liabilities and deferred inflows and outflows of resources from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (primarily federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, such as county appropriations, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position is available.

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2014 and 2013, cash equivalents consisted primarily of money market accounts.

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, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the two preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

The investments in equity investees are reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

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

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line half-year convention method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	2 - 25 years
Buildings and leasehold improvements	5 - 40 years
Equipment	2 - 20 years

The Hospital capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. There was no interest capitalized and incurred for the years ended December 31, 2014 and 2013.

Other Assets

Split-Dollar Life Insurance Policies. Other assets include the cumulative paid premiums under split-dollar life insurance policies for certain employees of the Hospital. The Hospital will receive the cumulative premiums upon the death of currently insured employees.

Investment in Joint Ventures. The investment in joint ventures is accounted for by the equity method of accounting and is further described in Note 5.

Deferred Amounts on Refunding

Deferred amounts on refunding, which are included in deferred outflows of resources on the balance sheets, represent losses incurred in connection with the refunding of long-term debt. Such losses are being amortized over the shorter of the term of the respective original debt or the term of the new debt using the straight-line method.

Other Long-Term Liabilities

Other long-term liabilities consist of deferred compensation agreements with key employees. The agreements are to be funded with proceeds from operations.

Interest Rate Swap Agreement

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

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments, such as social security and Medicare taxes computed using rates in effect at that date. The estimated compensated absences liability expected to be paid more than one year after the balance sheet date is included in other long-term liabilities.

Net Position

Net position of the Hospital is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted net position represents noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position is the remaining net position that does not meet the definition of the net investment in capital assets or restricted net position.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides charity care to patients who are unable to pay for services. The amount of charity care is included in net patient service revenue and is not separately classified from the provision for uncollectible accounts.

Income Taxes

The Hospital has been recognized as exempt from income taxes under Section 501(c) and Section 115 as an essential government function of the county, and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Electronic Health Records Incentive Program

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

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

In 2014, the Hospital completed the second-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately $1,597,000, which is included in other operating revenues in the statement of revenues, expenses and changes in net position.

In 2013, the Hospital completed the first-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately $2,500,000, which is included in other operating revenues in the statement of revenues, expenses and changes in net position.

Note 2: Net Patient Service Revenue

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

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate per discharge for inpatient services and outpatient fee for services.

The Hospital received approximately $25,175,000 and $9,938,000 during 2014 and 2013, respectively, due to the enactment of a state specific provider assessment program to increase Medicaid payments to hospitals. This revenue is recorded within net patient service revenue in the statements of revenues, expenses and changes in net position for 2014 and 2013. The Hospital paid approximately $21,756,000 and $7,717,000 into this Medicaid program for 2014 and 2013, respectively, which is recorded as an operating expense in the statements of revenues, expenses and changes in net position. The provider assessment program expired on June 30, 2013.

In March 2014, the CMS approved the provider assessment fee program retroactively to July 1, 2013. During 2014, the Hospital recognized an estimated $9,938,000 of Medicaid reimbursement and $7,913,000 of provider assessment fee pertaining to the period July 1, 2013, to December 31, 2013.

The Hospital also qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana law and, as such, is eligible to receive supplemental Medicaid payments. The amounts of these supplemental payments are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care and various other factors. Supplemental payments have been made by the state of Indiana and the Hospital records such amounts as revenue when it has been reasonably determined that the funds will be received. The Hospital recognized approximately $1,248,366 and $2,708,239 within patient service revenue related to this supplemental payment program for the years ended December 31, 2014 and 2013, respectively. At December 31, 2014 and 2013, respectively, $1,248,366 and $2,708,239 is recorded as a receivable within estimated amounts due to/from third parties. This represents management’s best estimate of DSH funds due to the Hospital as of December 31, 2014, which are typically paid in arrears.

Approximately 59% and 56% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2014 and 2013, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that, in the event of a bank failure, a government's deposit may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Deposits with financial institutions in the state of Indiana at year-end were entirely insured by the Federal Deposit Insurance Corporation (FDIC) or by the Indiana Public Deposit Insurance Fund (IPDIF). This includes any deposit accounts issued or offered by a qualifying financial institution. Accordingly, all deposits in excess of FDIC levels are covered by the IPDIF and considered collateralized.

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury, U.S. agencies and instrumentalities and in bank repurchase agreements.

At December 31, 2014 and 2013, the Hospital had the following investments and maturities:

2014

Type	Fair Value	Maturities in Years: Less Than One	One to Five	Six to 10	More Than 10
Money market mutual funds	$ 7,880,552	$ 7,880,552	$ -	$ -	$ -
U.S. agencies	16,075,917	2,124,982	12,005,675	-	1,945,260
Mutual funds	50,836,377	50,836,377	-	-	-
	$ 74,792,846	$ 60,841,911	$ 12,005,675	$ -	$ 1,945,260

2013

Type	Fair Value	Maturities in Years: Less Than One	One to Five	Six to 10	More Than 10
Money market mutual funds	$ 9,018,188	$ 9,018,188	$ -	$ -	$ -
U.S. agencies	17,121,437	-	17,121,437	-	-
Mutual funds	51,750,208	51,750,208	-	-	-
	$ 77,889,833	$ 60,768,396	$ 17,121,437	$ -	$ -

Interest Rate Risk – Interest rate risk is the risk of fair value losses arising from rising interest rates. The Hospital does not have a formal policy to limit its interest rate risk. The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). At December 31, 2014 and 2013, the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated Aaa by Moody's Investor Services.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. At December 31, 2014 and 2013, the Hospital held no investments in repurchase agreements.

Concentration of Credit Risk – The Hospital places no limit on the amount that may be invested in any one qualified issuer. At December 31, 2014 and 2013, the Hospital had no investments in corporate bonds.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets at December 31, 2014 and 2013, as follows:

	2014	2013
Carrying value		
Deposits	$ 22,460,462	$ 14,239,600
Investments	74,792,846	77,889,833
	$ 97,253,308	$ 92,129,433

Included in the following balance sheet captions:

	2014	2013
Cash and cash equivalents	$ 22,460,462	$ 14,239,600
Restricted investments – current	2,059,977	2,018,856
Noncurrent cash and investments	72,732,869	75,870,977
	$ 97,253,308	$ 92,129,433

Investment Income

Investment income for the years ended December 31, 2014 and 2013, consisted of:

	2014	2013
Interest and dividend income	$ 2,062,815	$ 1,320,410
Net increase (decrease) in fair value of investments	(1,697,793)	635,915
	$ 365,022	$ 1,956,325

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31, 2014 and 2013, consisted of:

	2014	2013
Medicare	$ 12,655,179	$ 18,604,639
Medicaid	7,353,224	7,832,214
Other third-party payers	19,312,791	19,094,183
Patients	21,181,288	25,331,101
	60,502,482	70,862,137
Less allowance for uncollectible accounts	22,347,676	23,274,410
	$ 38,154,806	$ 47,587,727

Note 5: Investments in Uncombined Entities

The investments in uncombined entities are accounted for on the equity method. The equity earnings of the uncombined entities are accounted for on the equity method and are included in nonoperating revenues. Investments in uncombined entities consist of a 33.33% interest in Southern Indiana Rehabilitation Hospital (an acute rehabilitation hospital), a 48% interest in Kleinert, Kutz Associates Surgery Center, LLC (KKA), d/b/a Northgate Surgery Center, LLC (Joint Venture) (an outpatient surgery center), a 11% interest in Indiana Healthcare Reciprocal Risk Retention Group (Risk Retention Group) (a medical malpractice insurance captive) and a 50% interest in Northgate Medical Imaging, LLC, d/b/a Priority Imaging (an outpatient diagnostic imaging center).

Guarantees

The Hospital guarantees certain third-party debt and capital leases of unconsolidated affiliated organizations.

At December 31, 2014 and 2013, the Hospital has guaranteed 33% of the $750,000 and $1,350,000, respectively, outstanding debt of Southern Indiana Rehabilitation Hospital. The debt was paid off in March 2015.

At December 31, 2014 and 2013, the Hospital has guaranteed 50% of the $69,227 and $204,564, respectively, for a line of credit, note and capital leases of Northgate Medical Imaging, LLC.

Note 6: Capital Assets

Capital assets activity for the years ended December 31, 2014 and 2013, were:

	2014				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 6,327,121	$ -	$ (68,604)	$ -	$ 6,258,517
Land improvements	3,677,108	10,664	-	-	3,687,772
Buildings and leasehold improvements	131,591,308	337,271		3,282,211	135,210,790
Equipment	144,179,992	5,868,905		173,918	150,222,815
Construction in progress	3,292,048	1,919,158		(3,456,129)	1,755,077
	289,067,577	8,135,998	(68,604)	-	297,134,971
Less accumulated depreciation					
Land improvements	3,102,253	93,457	-	-	3,195,710
Buildings and leasehold improvements	58,302,490	3,635,565	-	-	61,938,055
Equipment	106,507,804	9,797,101	-	-	116,304,905
Total accumulated depreciation	167,912,547	13,526,123	-	-	181,438,670
Capital assets, net	$ 121,155,030	$ (5,390,125)	$ (68,604)	$ -	$ 115,696,301

	2013				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 6,327,121	$ -	$ -	$ -	$ 6,327,121
Land improvements	3,667,561	9,547	-	-	3,677,108
Buildings and leasehold improvements	130,993,475	152,831	-	445,002	131,591,308
Equipment	132,940,562	11,239,430	-	-	144,179,992
Construction in progress	570,834	3,166,216	-	(445,002)	3,292,048
	274,499,553	14,568,024	-	-	289,067,577
Less accumulated depreciation					
Land improvements	3,001,336	100,917	-	-	3,102,253
Buildings and leasehold improvements	54,642,017	3,660,473	-	-	58,302,490
Equipment	97,062,584	9,445,220		-	106,507,804
Total accumulated depreciation	154,705,937	13,206,610	-	-	167,912,547
Capital assets, net	$ 119,793,616	$ 1,361,414	$ -	$ -	$ 121,155,030

Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance from Risk Retention Group under a claims-made policy. The Hospital pays an annual premium to Risk Retention Group for its torts insurance coverage. The Risk Retention Group's governing agreement specifies that the Risk Retention Group will be self-sustaining through member premiums and will re-insure through commercial carriers for claims in excess of stop-loss amounts. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no liabilities were recorded at December 31, 2014 and 2013. It is possible this estimate could change materially in the near term.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured. However, the *Indiana Malpractice Act* (Act) limits professional liability for claims prior to July 1, 1999, to a maximum recovery of $750,000 per occurrence ($3,000,000 annual aggregate), $100,000 of which would be paid through malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund (Fund). For claims on or after July 1, 1999, the maximum recovery is $1,250,000 per occurrence ($7,500,000 annual aggregate), $250,000 of which would be paid through insurance coverage and the remainder by the Fund.

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of $125,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is possible the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during the years ended December 31, 2014 and 2013, is summarized as follows:

	2014	2013
Balance, beginning of year	$ 1,052,612	$ 1,318,521
Current year claims incurred and changes in estimates for claims incurred in prior years	14,677,797	13,108,816
Claims and expenses paid	(14,576,189)	(13,374,725)
Balance, end of year	$ 1,154,220	$ 1,052,612

Note 9: Long-Term Obligations

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31, 2014 and 2013:

	2014				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 2010	$ 51,625,000	$ -	$ 1,810,000	$ 49,815,000	$ 1,895,000
Series 2012	46,050,000	-	940,000	45,110,000	990,000
Note payable	308,714	-	308,714	-	-
Line of credit	1,000,000	-	-	1,000,000	1,000,000
Capital lease obligations	1,260,918	-	454,871	806,047	468,604
	100,244,632	-	3,513,585	96,731,047	4,353,604
Less					
Unamortized bond discount	560,069	-	27,772	532,297	-
Total long-term debt obligations	$ 99,684,563	$ -	$ 3,485,813	$ 96,198,750	$ 4,353,604

	2013				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue Bonds					
Series 2010	$ 53,355,000	$ -	$ 1,730,000	$ 51,625,000	$ 1,810,000
Series 2012	46,960,000	-	910,000	46,050,000	940,000
Note payable	1,035,386	-	726,672	308,714	308,714
Line of credit	-	1,000,000	-	1,000,000	1,000,000
Capital lease obligations	1,702,893	-	441,975	1,260,918	455,281
	103,053,279	1,000,000	3,808,647	100,244,632	4,513,995
Less					
Unamortized bond discount	587,843	-	27,774	560,069	-
Total long-term debt obligations	$ 102,465,436	$ 1,000,000	$ 3,780,873	$ 99,684,563	$ 4,513,995

The following is a summary of other long-term obligations for the Hospital for the years ended December 31, 2014 and 2013:

	2014				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 15,064,402	$ 2,912,813	$ 3,252,012	$ 14,725,203	$ -
Other long-term liabilities	613,852	-	613,852	-	-
Total other long-term obligations	$ 15,678,254	$ 2,912,813	$ 3,865,864	$ 14,725,203	$ -

	2013				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Accrued pension liabilities	$ 14,439,581	$ 3,104,406	$ 2,479,585	$ 15,064,402	$ -
Other long-term liabilities	536,337	77,515	-	613,852	-
Total other long-term obligations	$ 14,975,918	$ 3,181,921	$ 2,479,585	$ 15,678,254	$ -

Revenue Bonds Payable

The Hospital has revenue bonds payable with the Indiana Healthcare Facility Financing Authority (Authority). The Master Trust Indenture requires certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the balance sheets. The Master Trust Indenture also places limits on the incurrence of additional borrowings and requires that certain measures of financial performance be maintained so long as the bonds are outstanding.

Series 2010

In April 2010, the Hospital participated in the issuance of $56,570,000 Indiana Health Facility Financing Authority Hospital Refunding Revenue Bonds, Series 2010 Bonds (2010 Bonds), which bear interest at rates ranging from 3.000% to 5.375%. The proceeds were primarily used for the advanced refunding of the 1998 and 2003B Bonds. The 2010 Bonds are subject to retirement in varying principal amounts through 2034. The bonds are secured by the gross revenues of the Hospital and the assets restricted under the bond indenture agreement.

Series 2012

In July 2012, the Hospital participated in the issuance of $47,245,000 Indiana Health Facility Financing Authority Hospital Refunding Revenue Bonds, Series 2012 Bonds (2012 Bonds), which bear interest at 68% of one-month London Interbank Offering Rate (LIBOR) rate, plus 1.39% (1.50% at December 31, 2014). Under the trust indenture, the 2012 Bonds were issued between the Indiana Finance Authority and The Bank of New York Mellon Trust Company and in conjunction with the trust indenture, a loan agreement was entered into for the proceeds of the sale of the 2012 Bonds to be loaned to the Hospital. The proceeds were primarily used for the advanced refunding of the 2008 Bonds. The 2012 Bonds are subject to retirement in varying principal amounts through 2036 as noted in the Master Note Series 2012. The bonds are secured by the gross revenues of the Hospital and the assets restricted under the bond indenture agreement. The sole bond holder of the Series 2012 Bonds, Branch Banking & Trust Bank, entered into a contract of purchase and promissory note for a 10-year term.

Note Payable

In 2011, the Hospital entered into an unsecured note payable related to a primary care practice acquisition. The note totaled $2,231,000, payable quarterly over three years with 4% annual interest. The note was paid in full in 2014.

Capital Lease Obligations

The Hospital is obligated under leases for certain medical equipment that are accounted for as capital leases. The lease agreements bear interest at various amounts up to 4.40%. The net book value of assets under capital leases at December 31, 2014 and 2013, totaled $638,898 and $1,064,835, respectively.

The debt service requirements for long-term obligations as of December 31, 2014, were as follows:

	Total to be Paid	Principal	Interest
2015	$ 7,515,678	$ 4,353,604	$ 3,162,074
2016	6,387,274	3,352,443	3,034,831
2017	6,096,239	3,185,000	2,911,239
2018	6,125,558	3,340,000	2,785,558
2019	6,124,350	3,470,000	2,654,350
2020–2024	30,895,536	19,735,000	11,160,536
2025–2029	31,694,296	24,180,000	7,514,296
2030–2034	33,775,492	30,965,000	2,810,492
2035–2036	4,203,920	4,150,000	53,920
	$ 132,818,343	$ 96,731,047	$ 36,087,296

Note 10: Line of Credit

The Hospital has an unsecured open-ended demand line of credit in the amount of $5,000,000 with a bank. Amounts outstanding under the line of credit bear interest at the 30-day LIBOR, plus 1.25% adjusted monthly. There were $1,000,000 and $1,000,000 of borrowings on the line of credit at December 31, 2014 and 2013, respectively.

Note 11: Interest Rate Swap Agreement

Objective of the Interest Rate Swap Agreement

The Hospital's asset/liability strategy is to have a mixture of fixed- and variable-rate debt to take advantage of market fluctuations. As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations and to lower its borrowing costs when compared against fixed-rate debt at the time of issuance, the Hospital entered into interest rate swap agreements in connection with its 2003A Bonds and 2003B Bonds. The original intention of the swap agreements was to effectively change the Hospital's variable interest rate on the 2003A Bonds and 2003B Bonds to a synthetic fixed rate of 4.05%.

The 2003A Bonds were defeased in December 2008 and related swap agreement was redesignated to a portion of the 2008 Bonds. The 2003B Bonds were defeased in April 2010 and the related swap agreement was terminated at the time of the issuance of the 2010 Bonds.

The 2008 Bonds were defeased in July 2012; however, the swap agreement remained. In accordance with GASB No. 53, in connection with the debt refunding, the deferred outflows related to the accumulation of changes in fair value of the swap agreement, were included in deferred amounts on refunding. Changes in fair value of the swap agreement subsequent to the refunding are recorded in deferred inflows, in accordance with hedge accounting prescribed by GASB No. 53.

Terms

The 2003A swap agreement was entered into on November 10, 2003, and is scheduled to expire on March 1, 2034, and required no initial net cash receipt or payment by the Hospital. The agreement provides for the Hospital to receive interest from the counterparty at 70.00% of the one-month LIBOR and to pay interest to the counterparty at a fixed rate of 4.17% on notional amounts of $31,050,000 and $31,625,000 at December 31, 2014 and 2013, respectively. Beginning in 2009, the notional amount of the swap agreement declines by a corresponding amount each time a principal payment is scheduled to become due on the associated debt until the notional amount reaches $2,650,000 at the termination of the swap agreement. Under the swap agreement, the Hospital pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Fair Value

As of December 31, 2014 and 2013, the swap agreement had a fair value of ($8,454,270) and ($6,182,805), respectively, calculated using the par-value method, *i.e.*, the fixed rate on the swap agreement was compared with the current fixed rates that could be achieved in the marketplace should the swap agreement be unwound. The fixed-rate components were valued by discounting the fixed-rate cash flows using the current yield to maturity of a comparable bond. The variable-rate components were assumed to be at par value because the interest rates reset to the market rate at every reset date. The fair value was then calculated by subtracting the estimated market value of the fixed components from the established market value of the variable components. The fair value of the swap agreement is recognized in long-term liabilities. Through the date of the defeasance of the 2008 Bonds, the swap agreement was an effective hedging instrument and therefore the offsetting balance was reflected as a deferred outflow of resources on the Hospital's balance sheets. The cumulative amount of changes in fair value through the date of the 2008 Bond defeasance ($10,902,924) was included in the loss on defeasance, which is reported in deferred outflows of resources.

Subsequent to the defeasance, hedge accounting was resumed and changes in fair value of the interest rate swap agreement were ($2,271,465) and $3,935,484 and are reflected in deferred inflows of resources as of December, 2014 and 2013, respectively.

Credit Risk

The swap agreement's fair value represented the Hospital's credit exposure to the counterparty as of December 31, 2014. Should the counterparty to this transaction fail to perform according to the terms of the swap agreement, the Hospital has a maximum possible loss equivalent to the swap agreement's fair value at that date. As of December 31, 2014, the Hospital was not exposed to credit risk because the swap agreement had a negative fair value. The swap agreement counterparty was rated A by Fitch Ratings, A- by Standard & Poor's and Baa by Moody's Investors Service as of December 31, 2014 and 2013. To mitigate the potential for credit risk, if the counterparty's credit quality rating falls below the current rating for at least two of the three rating agencies, the fair value of the swap agreement is to be fully collateralized by the counterparty with U.S. Treasury obligations to be held by a third-party custodian on behalf of the Hospital. The Hospital does not currently have a policy of requiring the counterparty to post collateral in the event the Hospital becomes exposed to credit risk. The Hospital does not currently have a policy requiring a master netting agreement with the counterparty and does not currently have such an agreement in place.

Basis Risk

The interest rate swap agreement exposes the Hospital to basis risk should the relationship between LIBOR and the auction rate set by the Hospital's remarketing agent change in a manner adverse to the Hospital. If an adverse change occurs in the relationship between these rates, the expected cost savings may not be realized.

Termination Risk

The Hospital or the counterparty may terminate the interest rate swap agreement if the other party fails to perform under the terms of the contract. If the interest rate swap agreement is terminated, the variable-rate bonds would no longer have a synthetic fixed rate of interest. Also, if the interest rate swap agreement has a negative fair value at the time of termination, the Hospital would be liable to the counterparty for a payment equal to the interest rate swap agreement's fair value.

Swap Payments and Associated Debt

Using rates as of December 31, 2014, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term are set forth in the table below. As rates vary, variable-rate interest payments and net swap payments will vary.

Years Ending December 31	2012 Bonds Principal	2012 Bonds Interest	Hedging Derivative Instrument, Net	Total to be Paid
2015	$ 990,000	$ 668,112	$ 1,214,433	$ 2,872,545
2016	1,025,000	653,041	1,187,383	2,865,424
2017	1,110,000	637,041	1,159,994	2,907,035
2018	1,140,000	620,319	1,130,915	2,891,234
2019	1,180,000	602,861	1,099,807	2,882,668
2020–2024	8,135,000	2,702,838	4,813,684	15,651,522
2025–2029	12,095,000	1,931,156	2,954,499	16,980,655
2030–2034	15,285,000	895,565	695,396	16,875,961
2035–2036	4,150,000	53,920	-	4,203,920
	$ 45,110,000	$ 8,764,853	$ 14,256,111	$ 68,130,964

Note 12: Billing Under Arrangement

As disclosed in Note 5, since 2007, the Hospital has a 48% interest in Northgate Surgery Center, LLC, formerly known as KKA Surgery Center, LLC, which has been accounted for on the equity method. This Joint Venture with Kleinert Kutz and Associates LLC (holder of the other 52% interest), was created for the purpose of offering greater surgical capacity to Hospital patients. As part of the Joint Venture, the Hospital has entered into a billing under arrangement agreement, in which nongovernmental program patient revenues are billed under the Hospital's employer identification number (EIN) and 95% of net patient revenue is remitted to the Joint Venture as a management fee, inclusive of all operating expenses and costs associated with the services being rendered. For the years ended December 31, 2014 and 2013, net patient service revenue related to the Joint Venture was $4,694,706 and $4,333,140, respectively, and associated management fee expense was $4,696,939 and $4,343,258, respectively. At December 31, 2014 and 2013, net patient accounts receivable related to the Joint Venture was $560,321 and $620,705, respectively, and accounts payable to the counterparty of the Joint Venture, KKA, was $318,084 and $467,291, respectively.

Note 13: Operating Leases

The Hospital has entered into various operating leases for office space and medical equipment expiring at various years through 2023. Rent expense was $6,682,098 and $7,055,971 for the years ended December 31, 2014 and 2013, respectively.

Future minimum lease payments at December 31, 2014, are:

2015	$ 5,729,474
2016	4,579,941
2017	3,877,646
2018	3,012,819
2019	2,274,002
2020–2023	4,752,181
Future minimum lease payments	$ 24,226,063

Note 14: Defined Benefit Pension Plan

Plan Description

The Hospital’s defined benefit pension plan is a single-employer defined benefit pension plan administered by the plan’s board of trustees who are appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The authority to establish and amend benefit provisions is set forth in Indiana Code 16-22-3-11. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the plan actuary at Transamerica Retirement Solutions, 24 Prime Park Way, Suite 400, Natick, MA 01760 or by calling 508.903.6015.

Effective May 1, 2010, the plan was amended to freeze the traditional benefit formula and modify the benefit formula for employees employed or re-employed on or after May 1, 2010. These benefits will now accrue under an account-based formula.

Funding Policy

The authority to establish and amend obligations of plan members is established by the written agreement between the Hospital's board of trustees and the plan administrator. Plan members are required to contribute 0% of their annual covered salary. The Hospital is required to contribute at an actuarially determined rate. The Hospital's annual required contributions for 2014 and 2013 were $3,072,291 and $3,257,269, respectively, and contributions made to the plan for 2014 and 2013 were $3,252,012 and $2,479,585, respectively.

Annual Pension Cost and Net Pension Obligation

The Hospital's annual pension cost and net pension obligation to the plan for December 31, 2014 and 2013, were as follows:

	2014	2013
Annual required contribution	$ 3,072,291	$ 3,257,269
Interest on net pension obligation	1,054,508	1,010,771
Adjustment to annual required contribution	(1,213,986)	(1,163,634)
Annual pension cost	2,912,813	3,104,406
Contributions made	(3,252,012)	(2,479,585)
Increase (decrease) in net pension obligation	(339,199)	624,821
Net pension obligation at beginning of the year	15,064,402	14,439,581
Net pension obligation at end of the year	$ 14,725,203	$ 15,064,402

Funded Status and Funding Progress

As of May 1, 2014, the most recent actuarial valuation date, the plan was 65% funded. The actuarial accrued liability for benefits was $47,885,513 and the actuarial value of assets was $31,174,237, resulting in an unfunded actuarial accrued liability (UAAL) of $16,711,276. The covered payroll (annual payroll of active employees covered by the plan) was $88,332,419 and the ratio of the UAAL to the covered payroll was 19%.

As of December 31, 2014, the fair value of the pension trust fund assets had decreased to $21,109,777.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

The annual required contribution for 2014 was determined as part of an actuarial valuation on May 1, 2014, using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 7.0% investment rate of return (net of administrative expenses) and (b) projected salary increases of 3.5% per year. The actuarial value of assets was determined using market value. The UAAL is being amortized on a level dollar basis over a 30-year period.

Three Year Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2012	$ 2,758,796	90%	$ 14,439,581
December 31, 2013	$ 3,104,406	80%	$ 15,064,402
December 31, 2014	$ 2,912,813	85%	$ 14,725,203

Note 15: Defined Contribution Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital’s required contributions, determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the County Commissioners of Floyd County, Indiana. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital’s governing body. Contributions made by plan members at December 31, 2014 and 2013, were $5,230,473 and $5,045,750, or 5%, respectively, of total payroll for both years. Contributions made by the Hospital at December 31, 2014 and 2013, were $1,481,629 and $1,389,686, or 1%, respectively, of total payroll for both years.

Note 16: Deferred Outflows and Inflows of Resources

The Hospital's deferred outflows and inflows for December 31, 2014 and 2013, were as follows:

	2014	2013
Deferred Outflows of Resources		
Loss on bond defeasance	$ 17,567,062	$ 18,488,807
Deferred Inflows of Resources		
Cumulative changes in fair value of resumed swap	$ 2,448,654	$ 4,720,119
Accumulated amortization of prior terminated swap liability	(861,190)	(427,076)
	$ 1,587,464	$ 4,293,043

Note 17: Long-Term Care Facility

Effective September 1, 2012, and April 1, 2013, the Hospital entered into ventures with long-term care facilities, Lincoln Hills of New Albany and Newburgh Health Care and Residential Center (Newburgh), respectively. In connection with these ventures, the Hospital acquired the operations of the long-term care facilities, leased the real estate and simultaneously entered into a management agreement with the former operator. Terms of these agreements are perpetual with clauses providing for separation with, or without, cause. The revenues and expenses associated with the operations of Lincoln Hills from September 1, 2012, and of Newburgh from April 1, 2013, are within the financial statements of the Hospital.

Subsequent to year-end, the Hospital terminated its agreement with Newburgh, effective April 30, 2015. Additionally, the Hospital entered into a venture with Diversicare of Providence effective February 1, 2015.

Note 18: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

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

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 7.

Incurred, But Not Reported, Employee Health Insurance Claims

Estimates of incurred, but not reported, health insurance claims are described in Note 8.

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 19: Patient Protection and Affordable Care Act

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

Subsequent to December 31, 2014, the state of Indiana received CMS approval to expand the Healthy Indiana Plan in consideration of Medicaid expansion.

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

Supplementary Information

Floyd Memorial Hospital and Health Services
A Component Unit of Floyd County, Indiana
Schedule of Funding Progress
December 31, 2014 and 2013

Required Supplementary Information

Schedule of funding progress for defined employee pension plan consisted of the following:

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) – Entry Age b	Unfunded AAL (UAAL) b-a	Funded Ratio a/b	Covered Payroll c	UAAL as a Percentage of Covered Payroll (b-a)/c
May 1, 2012	$ 30,092	$ 51,972	$ 21,880	58%	$ 73,977	30%
May 1, 2013	$ 29,427	$ 51,631	$ 22,204	57%	$ 79,412	28%
May 1, 2014	$ 31,174	$ 47,886	$ 16,712	65%	$ 88,332	19%