

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Auditor's Report and Financial Statements
December 31, 2014 and 2013

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
December 31, 2014 and 2013

Contents

Independent Auditor’s Report..... 1

Management’s Discussion and Analysis 3

Financial Statements

 Balance Sheets 8

 Statements of Revenues, Expenses and Changes in Net Position..... 9

 Statements of Cash Flows 10

 Notes to Financial Statements..... 11

Independent Auditor's Report

Board of Trustees
Johnson Memorial Hospital
Franklin, Indiana

We have audited the accompanying balance sheets of Johnson Memorial Hospital, a component unit of Johnson 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 Johnson Memorial 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Johnson Memorial Hospital, a component unit of Johnson County, Indiana 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 the management's discussion and analysis 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

Indianapolis, Indiana
April 30, 2015

Johnson Memorial Hospital

A Component Unit of Johnson County, Indiana

Management's Discussion and Analysis

December 31, 2014 and 2013

Introduction

This management's discussion and analysis of the financial performance of Johnson Memorial Hospital (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2014 and 2013. The financial activities of the Hospital include those of its owned physician practices (Physician Services) and its operated long-term care facilities (Extended Services). This management discussion and analysis should be read in conjunction with the accompanying financial statements.

Financial Highlights

- Total cash and investments increased in 2014 by \$12,632,775 (31%) and increased in 2013 by \$9,171,497 (29%).
- The Hospital reported operating income in 2014 and 2013 of \$11,182,358 and \$9,741,344, respectively. The operating income in 2014 increased by 15% over the operating income reported in 2013. The operating income in 2013 increased by 111% from the operating income reported in 2012. In 2014 and 2013, the Hospital experienced continued growth in its long-term care operations.
- Net nonoperating revenues decreased by \$824,197 (115%) in 2014 compared to 2013 and increased by \$162,731 (29%) in 2013 compared to 2012. Both increases were primarily attributable to changes in market returns on investments.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a 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 is accounted for 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

One of the most important questions asked about any hospital's finances is "Is the hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net position report information about the Hospital'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. Using the accrual basis of accounting means that 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 Hospital's net position and changes in them. The Hospital's total net position—the difference between assets and liabilities—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. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheets. The Hospital's net position increased by \$11,074,964 (11%) in 2014 over 2013, and by \$10,458,147 (12%) in 2013 over 2012, as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2014	2013	2012
Assets			
Patient accounts receivable, net	\$ 36,216,693	\$ 34,361,582	\$ 18,388,794
Other current assets	24,531,867	25,429,484	19,894,077
Capital assets, net	46,991,040	46,784,783	47,747,196
Other noncurrent assets	48,956,327	36,421,694	21,273,656
	<u>\$ 156,695,927</u>	<u>\$ 142,997,543</u>	<u>\$ 107,303,723</u>
Liabilities			
Long-term debt	\$ -	\$ 1,166,583	\$ 1,969,597
Other current and noncurrent liabilities	44,565,900	40,775,897	14,737,210
Total liabilities	<u>44,565,900</u>	<u>41,942,480</u>	<u>16,706,807</u>
Net Position			
Net investment in capital assets	46,991,040	45,618,200	45,777,599
Unrestricted	65,138,987	55,436,863	44,819,317
Total net position	<u>112,130,027</u>	<u>101,055,063</u>	<u>90,596,916</u>
Total liabilities and net position	<u>\$ 156,695,927</u>	<u>\$ 142,997,543</u>	<u>\$ 107,303,723</u>

A significant change in the Hospital's assets in 2014 is the increase in patient accounts receivable of \$1,855,111 from \$34,361,582 at December 31, 2013 to \$36,216,693 at December 31, 2014. Net patient service revenues increased in 2014 by \$38,480,409 (16%) compared to 2013. These changes led to a decrease of five days of revenue at December 31, 2014 versus December 31, 2013. The increase in net patient service revenues and the increase in net patient accounts receivable were attributed to increases in the Extended Services operations. The decrease in days of revenue is attributable to changes in payer mix with the increase in Extended Services operations.

Other changes in the Hospital's assets in 2014 included an increase in other noncurrent assets of \$12,534,633 (34%) compared to 2013. This increase is attributed to increases in noncurrent cash and investments from supplemental Medicaid payments for the long-term care operations of the Hospital.

Operating Results and Changes in the Hospital's Net Position

In 2014, the Hospital's net position increased by \$11,074,964 (11%) compared to an increase in net position during 2013 of \$10,458,147 (12%), as shown in Table 2.

Table 2: Operating Results and Changes in Net Position

	2014	2013	2012
Operating Revenue			
Net patient service revenue	\$ 275,178,969	\$ 236,698,560	\$ 110,693,624
Other operating revenue	43,386,242	36,158,496	9,406,456
Total operating revenue	<u>318,565,211</u>	<u>272,857,056</u>	<u>120,100,080</u>
Operating Expenses			
Salaries and wages and employee benefits	41,994,668	44,962,639	45,544,827
Purchased services and professional fees	141,827,666	117,833,504	29,908,873
Depreciation and amortization	4,622,538	4,487,617	4,396,179
Other operating expenses	118,937,981	95,831,952	35,625,982
Total operating expenses	<u>307,382,853</u>	<u>263,115,712</u>	<u>115,475,861</u>
Operating Income	<u>11,182,358</u>	<u>9,741,344</u>	<u>4,624,219</u>
Nonoperating Revenue (Expenses)			
Investment income	478,194	1,524,648	1,119,599
Interest expense	(11,286)	(67,836)	(14,992)
Other	(574,302)	(740,009)	(550,535)
Total nonoperating revenue (expense)	<u>(107,394)</u>	<u>716,803</u>	<u>554,072</u>
Increase in Net Position	<u>\$ 11,074,964</u>	<u>\$ 10,458,147</u>	<u>\$ 5,178,291</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported operating income. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Johnson County and the surrounding area. The Hospital implements strong cost controls to provide sufficient resources to enable the facility to serve lower income and other residents.

Operating loss derived from Hospital and Physician Services in 2014 totaled \$35,834, which was an improvement of \$1,337,620 (97%) from operating losses reported in 2013 of \$1,373,454. Operating losses for 2013 decreased by \$3,511,082 (164%) as compared to 2012. The primary components of the changes in operating income and loss of the Hospital and Physician Services are:

- An increase in net patient service revenue of \$52,704 (0%) in 2014 compared to a decrease in 2013 of \$5,773,341 (7%).
- A decrease in salaries and wages and employee benefits of \$3,212,409 (7%) in 2014 compared to a decrease in salaries and wages and employee benefits in 2013 of \$1,049,655 (2%).

The changes in net patient service revenues above are a result of changes in the Hospital's volumes during the respective years. Additionally, in 2014, the Hospital received supplemental Medicaid payments under a state specific provider assessment program totaling \$5,932,000 compared to \$2,411,000 in 2013. These increases in net patient service revenue were partially offset by additional provider assessment fees of approximately \$5,017,000 in 2014 and \$2,603,000 in 2013. The Hospital also received Medicaid Disproportionate Share Hospital (DSH) payments approximating \$1,863,000 in 2014 compared to \$4,565,000 in 2013. Changes in operating expenses were a direct result of the Hospital managing expenses to fluctuations in patient volume.

Operating income derived from Extended Services in 2014 totaled \$11,218,192, which was an increase of \$103,394 (1%) from operating income reported in 2013 of \$11,114,798. The primary components of the changes in operating income for Extended Services are:

- An increase in net patient services revenue of \$38,427,705 (23%) from \$164,587,491 in 2013 to \$203,015,196 in 2014.
- An increase in other operating revenues of \$7,787,792 (23%) from \$33,680,035 in 2013 to \$41,467,827 in 2014. This increase is primarily attributed to an increase in supplemental Medicaid payments to the nursing facilities.
- An increase in purchased services of \$23,890,437 (21%) from \$114,685,644 in 2013 to \$138,576,081 in 2014.
- An increase in facility and equipment lease expense of \$6,477,032 (26%) from \$24,990,257 in 2013 to \$31,467,289 in 2013.

The changes above are a result of the Hospital's expansion in Extended Services operations in 2014. This expansion included the acquisition of the operations of an additional two nursing homes in 2014.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income and interest expense. The Hospital recognized a decrease in its investment return in 2014 compared to 2013, resulting primarily from changes in overall market returns.

The Hospital's Cash Flows

Changes in the Hospital's operating cash flows are consistent with changes in operating income and nonoperating revenues and expenses for 2014 and 2013, discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2014 and 2013, the Hospital had \$46,991,040 and \$46,784,783 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the financial statements. In 2014 and 2013, the Hospital purchased new equipment costing \$5,251,204 and \$4,160,629, respectively.

Debt

At December 31, 2014, the Hospital had no outstanding debt. At December 31, 2013, the Hospital had \$1,166,583 in the form of a commercial bank loan and capital lease obligations outstanding. The Hospital issued no new debt in 2014 or 2013.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers 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 Hospital's Chief Financial Officer by telephoning (317) 736-3300.

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

Assets

	<u>2014</u>	<u>2013</u>
Current Assets		
Cash and cash equivalents	\$ 6,505,230	\$ 6,665,832
Patient accounts receivable, net of allowance; 2014 - \$7,072,474 and 2013 - \$5,636,727	36,216,693	34,361,582
Other receivables	11,950,592	14,153,255
Estimated amounts due from third-party payers	3,094,230	1,251,552
Supplies	1,460,066	1,653,162
Prepaid expenses and other	1,521,749	1,705,683
Total current assets	<u>60,748,560</u>	<u>59,791,066</u>
Noncurrent Cash and Investments		
Internally designated	45,472,986	32,677,099
Held by Foundation	1,646,532	1,649,042
	<u>47,119,518</u>	<u>34,326,141</u>
Capital Assets, Net	<u>46,991,040</u>	<u>46,784,783</u>
Investment in Affiliate	<u>1,836,809</u>	<u>2,095,553</u>
Total assets	<u>\$ 156,695,927</u>	<u>\$ 142,997,543</u>

Liabilities and Net Position

Current Liabilities		
Current maturities of long-term debt	\$ -	\$ 785,323
Accounts payable	36,006,185	33,066,377
Accrued expenses	8,559,715	7,709,520
Total current liabilities	<u>44,565,900</u>	<u>41,561,220</u>
Long-Term Debt		
Total liabilities	<u>-</u>	<u>381,260</u>
	<u>44,565,900</u>	<u>41,942,480</u>
Net Position		
Net investment in capital assets	46,991,040	45,618,200
Unrestricted	65,138,987	55,436,863
Total net position	<u>112,130,027</u>	<u>101,055,063</u>
Total liabilities and net position	<u>\$ 156,695,927</u>	<u>\$ 142,997,543</u>

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

	2014	2013
Operating Revenue		
Net patient service revenue, net of provision for uncollectible accounts of \$11,829,689 in 2014 and \$8,595,010 in 2013	\$ 275,178,969	\$ 236,698,560
Other operating revenue	43,386,242	36,158,496
Total operating revenue	318,565,211	272,857,056
Operating Expenses		
Salaries and wages	34,342,291	36,737,090
Employee benefits	7,652,377	8,225,549
Medical professional fees	1,037,834	869,090
Purchased services	140,789,832	116,964,414
Medical supplies and drugs	20,880,384	16,502,293
Other supplies	959,627	1,150,054
Facility and equipment leases	32,519,579	25,465,343
Insurance	3,406,845	3,025,930
Repairs and maintenance	5,499,864	4,811,381
Utilities	6,213,075	4,432,433
Hospital assessment fee	5,017,023	2,603,101
Other	44,441,584	37,841,417
Depreciation and amortization	4,622,538	4,487,617
Total operating expenses	307,382,853	263,115,712
Operating Income	11,182,358	9,741,344
Nonoperating Revenues (Expenses)		
Investment income	478,194	1,524,648
Interest expense	(11,286)	(67,836)
Rental expense, net	(386,240)	(518,999)
Foundation expense	(175,373)	(159,630)
Other nonoperating expense	(12,689)	(61,380)
Total nonoperating revenues (expense)	(107,394)	716,803
Excess of Revenues Over Expenses and Increase in Net Position	11,074,964	10,458,147
Net Position, Beginning of Year	101,055,063	90,596,916
Net Position, End of Year	\$ 112,130,027	\$ 101,055,063

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

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	\$ 271,481,180	\$ 220,725,772
Payments to suppliers and contractors	(252,431,786)	(186,833,818)
Payments to employees	(41,144,473)	(43,146,781)
Other receipts, net	41,253,035	25,044,764
Net cash provided by operating activities	19,157,956	15,789,937
Capital and Related Financing Activities		
Principal paid on long-term debt	(1,166,583)	(803,014)
Interest paid on long-term debt	(11,286)	(67,836)
Purchase of capital assets	(5,251,204)	(4,160,629)
Net cash used in capital and related financing activities	(6,429,073)	(5,031,479)
Investing Activities		
Investment income	383,551	223,139
Purchase of investments	(12,698,734)	(12,897,255)
Proceeds from disposition of investments	-	1,085,000
Purchase of equity investment in affiliate	-	(2,371,600)
Other	(574,302)	(740,009)
Net cash used in investing activities	(12,889,485)	(14,700,725)
Decrease in Cash and Cash Equivalents	(160,602)	(3,942,267)
Cash and Cash Equivalents, Beginning of Year	6,665,832	10,608,099
Cash and Cash Equivalents, End of Year	\$ 6,505,230	\$ 6,665,832
Reconciliation of Operating Income to Net Cash		
Operating income	\$ 11,182,358	\$ 9,741,344
Depreciation and amortization	4,622,538	4,487,617
Provision for uncollectible accounts	11,829,689	8,595,010
Changes in operating assets and liabilities:		
Patient accounts receivable	(13,684,800)	(24,567,798)
Estimated amounts due from third-party payers	(1,842,678)	(46,212)
Accounts payable and accrued expenses	3,790,003	26,254,457
Other assets and liabilities	3,260,846	(8,674,481)
Net cash provided by operating activities	\$ 19,157,956	\$ 15,789,937

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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

Nature of Operations and Reporting Entity

Johnson Memorial Hospital (Hospital) is an acute care hospital located in Franklin, Indiana. The Hospital is a component unit of Johnson County, Indiana (County) and the Board of County Commissioners appoints members to the Board of Trustees of the Hospital pursuant to the provision of Indiana Code 16-22-2-2. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Johnson County area. It also operates a home health agency and owns several physician practices (Physician Services), which provide outpatient services to patients in the same geographic area.

The Hospital operates a number of long-term care facilities through various lease agreements, which are reported in the Hospital's extended services division (Extended Services). These facilities provide inpatient and therapy services throughout their respective geographic areas and support the Hospital's mission to provide quality care and services to the facilities' residents. The facilities are managed by third parties under various management agreements. The revenues from operations are the property of the Hospital and the Hospital is responsible for the associated operating expenses and working capital requirements.

In accordance with GASB Statement No. 61, the financial statements include the financial statements of Johnson County Health Foundation, Inc. (Foundation). The Foundation's purpose is to provide philanthropic support through fundraising and other activities for the acquisition of equipment, facility development and support of programs at the Hospital, and has therefore been reported as a blended component unit.

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 and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Investment income, rental activities 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 are available.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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 with various financial institutions.

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; medical malpractice; 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 three 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

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition are carried at amortized cost. The investment in affiliate is 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 and the net change for the year in the fair value of investments carried at fair value.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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 estimated allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. Adjustments to the provision for uncollectible accounts related to prior periods decreased net patient service revenue by \$1,000,000 and \$1,200,000 in 2014 and 2013, respectively.

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 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	15 years
Buildings and leasehold improvements	4 - 50 years
Equipment	5 - 15 years

Compensated Absences

Hospital policies permit most employees to accumulate vacation benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. These cash payments are limited based upon existing Hospital paid time off policies that restrict the amount of earned vacation pay that can be paid out at the time of termination. Employees earn these benefits at different rates depending on their years of service. 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. 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 is expected to be paid within one year of the balance sheet date, and is therefore included in current liabilities.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Net Position

Net position of the Hospital is classified in two components. Net investment in capital assets consist 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. Unrestricted net position is remaining assets less remaining liabilities that do not meet the definition of net investment in capital assets.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were approximately \$5,961,000 and \$5,854,000 for 2014 and 2013, respectively. Estimated cost based on the Hospital's records was \$2,078,000 and \$2,000,000 for 2014 and 2013, respectively.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. In addition, the Hospital has been exempt from taxes under Section 501(c)(3) of the Internal Revenue Code. However, the Hospital is subject to federal income tax on any unrelated business taxable income. With a few exceptions, the Hospital is no longer subject to U.S. federal examinations by tax authorities for years before 2011.

The Foundation is exempt from federal income taxes under Section 501(c)(3) and 509(a)(2) of the U.S. Internal Revenue Code and a similar provision of state law. However, the Foundation is subject to federal income tax on any unrelated business taxable income. The Foundation files federal tax returns in the U.S. federal jurisdiction. With a few exceptions, the Foundation is no longer subject to U.S. federal examinations by tax authorities for years before 2011.

Foundation

The Foundation is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating. Separate financial statements of the Foundation may be obtained through contacting their office at 1101 W. Jefferson Street, Suite V, Franklin, IN 46131.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Electronic Health Records Incentive Program

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

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period. During 2014 and 2013, the Hospital recognized approximately \$840,000 and \$1,388,000, respectively, which are included in other operating revenues in the statements of revenues, expenses and changes in net position.

Reclassifications

Certain reclassifications have been made for the 2013 financial statements to conform to the 2014 financial statement presentation. The reclassifications had no effect on the change in financial position.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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. Net patient service revenue is reported at the estimated net realizable amounts from patients, residents, 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. 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. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare administrative contractor.

Long-term care services rendered to Medicare program beneficiaries are paid under a prospectively determined payment system on a per diem basis based on each resident's health at admission. Medicare reimburses for 100 days of skilled nursing facility care subject to certain eligibility requirements.

Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to the service provided and the patient diagnosis.

Long-term care services rendered to Medicaid program beneficiaries are paid on a per diem basis.

Approximately 66% and 65% of net patient service revenue are 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.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

The Hospital received approximately \$5,932,000 and \$2,411,000 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 \$5,017,000 and \$2,603,000 into this Medicaid program for 2014 and 2013, which is recorded as an operating expense in the statements of revenues, expenses and changes in net position. During 2014, this program was re-instated retroactively to July 1, 2013 and the program is scheduled to sunset on June 30, 2017. There is no assurance this program will continue to be implemented in the future.

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 \$1,863,000 and \$4,565,000 within net 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, \$2,847,000 and \$1,536,000 of the amounts due are accrued as receivable in estimated amounts due from third-party payers. This represents management's best estimate of the remaining DSH funds due to the Hospital for each fiscal year, which are typically paid in arrears.

The long-term care operations of the Hospital qualify for supplemental Medicaid payments through the Upper Payment Limit (UPL) program. The UPL is established to pay qualifying providers the difference between what Medicare would have paid and what Medicaid actually paid. The UPL is distributed through an intergovernmental transfer (IGT) arrangement. The Hospital is responsible for funding the IGT for the long-term care operations. Revenue associated with the UPL program is recorded net of IGT payments made to the program and are included in other operating revenue. The Hospital recognized approximately \$41,425,000 and \$34,240,000 related to this supplement payment program for the years ended December 31, 2014 and 2013, respectively, which is included in other operating revenue in the statements of revenues, expenses and changes in net position. At December 31, 2014 and 2013, \$10,312,000 and \$12,690,000 are accrued and included in other receivables.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, HMOs 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.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

The following is a summary of net patient service revenue for 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Patient service revenue		
Inpatient	\$ 47,117,053	\$ 48,142,269
Outpatient	132,948,835	129,014,068
Long-term care operations	207,515,320	165,812,821
Gross patient service revenue	<u>387,581,208</u>	<u>342,969,158</u>
Deductions from revenue		
Contractual allowances	94,611,110	91,821,220
Bad debts	11,829,689	8,595,010
Charity care	5,961,440	5,854,368
Total deductions from revenue	<u>112,402,239</u>	<u>106,270,598</u>
Net patient service revenue	<u>\$ 275,178,969</u>	<u>\$ 236,698,560</u>

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 deposits 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 Depository 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 are considered collateralized.

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest in certain deposit accounts, mutual funds, repurchase agreements and pooled investment funds as authorized by Indiana Code 16-22-3-20.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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

December 31, 2014					
Type	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 43,686	\$ 43,686	\$ -	\$ -	\$ -
Mutual funds - equities	4,351,609	4,351,609	-	-	-
Equities	9,027,633	9,027,633	-	-	-
Fixed income	473,555	473,555	-	-	-
	<u>\$ 13,896,483</u>	<u>\$ 13,896,483</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

December 31, 2013					
Type	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 27,949	\$ 27,949	\$ -	\$ -	\$ -
Mutual funds - equities	7,177,011	7,177,011	-	-	-
Equities	1,489,547	1,489,547	-	-	-
Fixed income	25,723	25,723	-	-	-
	<u>\$ 8,720,230</u>	<u>\$ 8,720,230</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Hospital does not have a formal investment policy for credit risk. At December 31, 2014 and 2013, the Hospital's investments were not rated.

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. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk - The Hospital places no limit on the amount that may be invested in any one issuer.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

	<u>2014</u>	<u>2013</u>
Carrying value:		
Deposits	\$ 39,728,265	\$ 32,271,743
Investments	<u>13,896,483</u>	<u>8,720,230</u>
	<u><u>\$ 53,624,748</u></u>	<u><u>\$ 40,991,973</u></u>
Included in the following balance sheets captions:		
Cash and cash equivalents	\$ 6,505,230	\$ 6,665,832
Noncurrent cash and investments		
Internally designated	45,472,986	32,677,099
Held by Foundation	<u>1,646,532</u>	<u>1,649,042</u>
	<u><u>\$ 53,624,748</u></u>	<u><u>\$ 40,991,973</u></u>

Investment Income

Investment income for the years ended December 31 consisted of:

	<u>2014</u>	<u>2013</u>
Interest, dividends and realized gains	\$ 383,551	\$ 223,139
Net increase in fair value of investments	<u>94,643</u>	<u>1,301,509</u>
	<u><u>\$ 478,194</u></u>	<u><u>\$ 1,524,648</u></u>

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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 consisted of:

	<u>2014</u>	<u>2013</u>
Medicare	\$ 8,097,748	\$ 8,564,539
Medicaid	9,350,594	5,562,414
Other third-party payers	13,986,204	9,053,598
Patients	<u>11,854,621</u>	<u>16,817,758</u>
	43,289,167	39,998,309
Less allowance for uncollectible accounts	<u>7,072,474</u>	<u>5,636,727</u>
	<u>\$ 36,216,693</u>	<u>\$ 34,361,582</u>

Note 5: Investment in Affiliate

In 2013, the Hospital invested \$2,371,600 for a 49% ownership in CHN/JMH Ventures, LLC, a company formed to provide diagnostic imaging services and outpatient rehabilitative services at a medical office complex in Johnson County. This investment is accounted for under the equity method of accounting.

Financial position and results of operations of CHN/JMH Ventures, LLC are summarized below:

	<u>2014</u>	<u>2013</u>
Current assets	\$ 1,640,993	\$ 2,018,968
Property and other long-term assets, net	<u>3,530,454</u>	<u>4,356,328</u>
Total assets	5,171,447	6,375,296
Current liabilities	<u>1,568,921</u>	<u>2,228,041</u>
Members' equity	<u>\$ 3,602,526</u>	<u>\$ 4,147,255</u>
Revenues	\$ 2,822,070	\$ 542,805
Net loss	\$ (544,728)	\$ (692,345)

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. In addition, the Hospital is a qualified health care provider under the Indiana Medical Malpractice Act and is fully insured under a claims-made policy on a fixed premium basis. The Indiana Medical Malpractice Act limits a qualified provider's liability for an occurrence to the amount of required insurance. The Indiana patient compensation fund is liable for the excess up to an overall damage cap. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claims 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 such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

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 individual employee amount of \$300,000 per year. 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 reasonably possible that 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 2014 and 2013 is summarized as follows:

	<u>2014</u>	<u>2013</u>
Balance, beginning of year	\$ 450,000	\$ 600,000
Current year claims incurred and changes in estimates for claims incurred in prior years	4,338,198	4,502,479
Claims and expenses paid	<u>(4,338,198)</u>	<u>(4,652,479)</u>
Balance, end of year	<u>\$ 450,000</u>	<u>\$ 450,000</u>

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Note 9: Long-Term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the year ended December 31, 2013.

	2013				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt:					
Commercial bank loan	\$ 1,724,397	\$ -	\$ (692,068)	\$ 1,032,329	\$ 717,358
Capital lease obligations	245,200	-	(110,946)	134,254	67,965
Total long-term debt	<u>\$ 1,969,597</u>	<u>\$ -</u>	<u>\$ (803,014)</u>	<u>\$ 1,166,583</u>	<u>\$ 785,323</u>

During 2014, the remaining long-term obligations of the Hospital were paid in full and no amounts were outstanding at December 31, 2014.

Note 10: Designated Net Position

At December 31, 2014 and 2013, unrestricted net position amounts have been designated by the Hospital's Board for funded depreciation and other matters. Designated net position amounts remain under the control of the Board, which may, at its discretion, later use these net position amounts for other purposes. Designated net position at December 31 consisted of:

	2014	2013
Funded depreciation	\$ 12,987,386	\$ 12,893,523
Other board designated	<u>32,485,600</u>	<u>19,783,576</u>
Total designated net position	<u>\$ 45,472,986</u>	<u>\$ 32,677,099</u>

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Note 11: Long-Term Care Operating Leases and Management Agreements

The Hospital has entered into various agreements to lease the facilities and equipment for the operation of 35 nursing homes. Along with each lease agreement, the Hospital has also entered into management agreements with the facilities' previous managers (Managers) to continue to operate the facilities. These agreements expire at various times through November 2019 and include optional one to two year extensions. The management agreements include optional termination clauses by either party if material changes in circumstances, as defined in the agreement, occur. The leases include termination clauses where the lease shall automatically end at the termination of the management agreement between the Hospital and the Managers.

The lease agreements call for monthly base rent payments as outlined in the agreements. Several facilities include annual rent increases of 2%. Rental expense approximated \$31,467,000 and \$24,990,000 in 2014 and 2013, respectively. Future minimum rent payments at December 31 are as follows:

2015	\$ 30,956,518
2016	30,564,764
2017	20,656,011
2018	3,582,279
2019	<u>802,122</u>
Future minimum lease payments	<u><u>\$ 86,561,694</u></u>

The management agreements include management fees consisting of base management fees, subordinated management fees and incentive management fees. These amounts are based on the net patient service revenue of the individual facilities. Subordinate and incentive management fees are to be paid only if sufficient working capital exists on an aggregate basis for each group of homes managed by individual Managers. The agreements also call for quality, royalty and capital improvement fees to be paid to the Managers at amounts based on the occupancy of each facility. Management and other fees approximated \$18,026,000 and \$21,520,000 in 2014 and 2013, respectively, and are included in purchased services on the statements of revenues, expenses and changes in net position.

The Hospital has granted a security interest in all patient accounts receivable approximating \$20,598,000 at December 31, 2014 for the 29 facilities operated by a single Manager.

In 2013, the Hospital has entered into an agreement with a third-party to monitor quality measures at all of its nursing facilities. Expenses incurred under this agreement in 2014 and 2013 approximated \$4,454,000 and \$3,367,000, respectively. These expenses are included with expenses of Extended Services as they pertain to the operations of the nursing facilities.

Subsequent to December 31, 2014, the Hospital entered into lease and management agreements for the operations of two additional nursing homes. The lease agreements expire in May 2018 and call for base monthly rentals approximating \$105,000 with two percent annual increases. The management agreements carry the same term as the lease agreements and include management fee arrangements similar to all other agreements.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

Note 12: 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 Hospital Board. The plan provides retirement and death 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. The Hospital is required to match 50% of the employee contribution up to 3% of employee's compensation. In addition, the Hospital may make a discretionary contribution as determined by the Hospital Board. Hospital expense related to the employer contributions to the plan was \$908,925 and \$1,056,000 for 2014 and 2013, respectively.

Note 13: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 14: 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 that the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products.

Johnson Memorial Hospital
A Component Unit of Johnson County, Indiana
Notes to Financial Statements
December 31, 2014 and 2013

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, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional. In 2015, the state of Indiana expanded its Medicaid program with the implementation of the Healthy Indiana Plan (HIP) 2.0. Under HIP 2.0, the first \$2,500 of beneficiary medical expenses are reimbursed from special savings accounts funded partly by the state and partly by the beneficiary. The impact of Medicaid expansion under the HIP 2.0 program on the overall reimbursement to the Hospital cannot be quantified at this point.

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 that 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.

Note 15: Blended Component Unit

The financial statements include the blended component unit accounts of the Foundation as discussed in Note 1. The following is a financial summary of the component unit as of December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Current assets	\$ 147,793	\$ 143,625
Noncurrent cash and investments	<u>1,646,532</u>	<u>1,649,042</u>
Total assets	<u>\$ 1,794,325</u>	<u>\$ 1,792,667</u>
Total liabilities	\$ 3,018	\$ 4,162
Net position	<u>1,791,307</u>	<u>1,788,505</u>
Total liabilities and net position	<u>\$ 1,794,325</u>	<u>\$ 1,792,667</u>
Revenues	\$ 178,175	\$ 489,306
Expenses	<u>(175,373)</u>	<u>(289,321)</u>
Change in net position	2,802	199,985
Net position, beginning of year	<u>1,788,505</u>	<u>1,588,520</u>
Net position, end of year	<u>\$ 1,791,307</u>	<u>\$ 1,788,505</u>