



CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

CPAs / ADVISORS



HANCOCK REGIONAL HOSPITAL

TABLE OF CONTENTS DECEMBER 31, 2018 AND 2017

	Page
Report of Independent Auditors	1
Required Supplementary Information	
Management’s Discussion and Analysis (Unaudited).....	i
Consolidated Financial Statements	
Consolidated Balance Sheets.....	3
Consolidated Statements of Operations and Changes in Net Position	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements.....	8



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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Hancock Regional Hospital
Greenfield, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Hancock Regional Hospital and component units (the "Hospital"), a component unit of Hancock County, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations and changes in net position, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *Uniform Compliance Guidelines for Audits of Hospitals and State and Local Governments by Authorized Independent Public Accountants*, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Board of Trustees
Hancock Regional Hospital
Greenfield, Indiana

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Required Supplementary Information

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

Blue & Co., LLC

Indianapolis, Indiana
May 15, 2019

REQUIRED SUPPLEMENTARY INFORMATION

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

This section of Hancock Regional Hospital's (Hospital) annual consolidated financial statements presents background information and management's discussion and analysis of the Hospital's financial performance during the years ended December 31, 2018 and 2017. Please read it in conjunction with the Hospital's consolidated financial statements, which begin on page 3. Unless otherwise indicated, amounts are in thousands and are approximates.

FINANCIAL HIGHLIGHTS

- The Hospital reported an increase in net position of approximately \$15,782 or 7% for the year ended 2018.
- Operating income in 2018 compared to 2017 decreased by \$10,982 or 33%.
- Nonoperating expense in 2018 compared to income in 2017 decreased by \$11,751 or 167%.

USING THIS ANNUAL REPORT

The Hospital's consolidated financial statements consist of three statements—a Balance Sheet; a Statement of Operations and Changes in Net Position; and a Statement of Cash Flows. These consolidated financial statements and related notes provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation.

THE BALANCE SHEET AND STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION

Our analysis of the Hospital finances begins on page ii. One of the most important questions asked about the 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 Operations 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. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

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

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

THE STATEMENT OF CASH FLOWS

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance 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 Sheet on page 3. The Hospital's net position increased in 2018 by \$15,782 (7%) as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Position

	2018	2017	2018 - 2017 \$ Change	2016
Assets				
Current assets	\$ 157,940	\$ 140,302	\$ 17,638	\$ 116,630
Capital assets, net	75,015	71,390	3,625	79,711
Restricted and limited use assets	87,895	93,841	(5,946)	67,265
Other noncurrent assets	25,459	12,958	12,501	4,763
Total assets	<u>346,309</u>	<u>318,491</u>	<u>27,818</u>	<u>268,369</u>
Liabilities				
Current liabilities	91,745	79,709	12,036	68,175
Total liabilities	<u>91,745</u>	<u>79,709</u>	<u>12,036</u>	<u>68,175</u>
Net Position				
Net investment in capital assets	75,015	71,390	3,625	79,711
Donor restricted - expendable	7,212	6,639	573	5,196
Restricted nonexpendable	1,844	2,154	(310)	2,344
Unrestricted	170,493	158,599	11,894	112,943
Total net position	254,564	238,782	15,782	200,194
Total liabilities and net position	<u>\$ 346,309</u>	<u>\$ 318,491</u>	<u>\$ 27,818</u>	<u>\$ 268,369</u>

A significant component in the Hospital's assets is the increase in current assets, specifically cash and cash equivalents and net patient accounts receivable which increased by \$14,269 or 12.7% due to operations.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET POSITION

In 2018, the Hospital's change in net position decreased by \$22,806 compared to 2017 as shown in Table 2.

Table 2: Operating Results and Changes in Net Position

	2018	2017	2018 - 2017 \$ Change	2016
Operating Revenue				
Net patient service revenue	\$ 493,586	\$ 476,224	\$ 17,362	\$ 469,317
Other	9,992	8,965	1,027	7,660
Total operating revenue	503,578	485,189	18,389	476,977
Operating expenses				
Salaries and benefits	60,612	57,907	2,705	54,450
Medical supplies and drugs	56,100	49,046	7,054	48,161
Purchased services and medical fees	331,376	315,412	15,964	321,191
Depreciation and amortization	10,542	10,304	238	10,228
Hospital assessment fee	4,720	3,329	1,391	2,164
Other operating expense	18,058	16,039	2,019	14,995
Total operating expense	481,408	452,037	29,371	451,189
Operating income	22,170	33,152	(10,982)	25,788
Nonoperating income (expense)				
Noncapital contributions	2,358	2,019	339	1,310
Other nonoperating expense	(585)	(403)	(182)	(958)
Loss on disposal of capital assets	-0-	(4,708)	4,708	(14)
Investment income	(6,492)	10,124	(16,616)	5,514
Total nonoperating income (expense)	(4,719)	7,032	(11,751)	5,852
Change in net position before capital distributions	17,451	40,184	(22,733)	31,640
Capital distributions	(1,669)	(1,596)	(73)	(1,172)
Change in net position	15,782	38,588	(22,806)	30,468
Net position				
Beginning of year	238,782	200,194	38,588	169,726
End of year	\$ 254,564	\$ 238,782	\$ 15,782	\$ 200,194

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

SOURCES OF REVENUE

During 2018, the Hospital derived substantially all of its revenue from patient service and other related activities. Revenue includes, among other items, revenue from the Medicare and Medicaid programs, patients, insurance carriers, preferred provider organizations, and managed care programs.

The table below presents the percentages of gross revenue for patient services by payor for the Hospital's acute care operations.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Medicare	53%	52%	53%
Medicaid	11%	11%	10%
Commercial	33%	33%	33%
Self-pay	3%	4%	4%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Hospital provides care to patients under payment arrangements with Medicare, Medicaid, and various managed care programs. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs as defined. Provisions have been made in the consolidated financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment. Total operating revenue increased \$18,389 or 4% in 2018 compared to 2017. This increase was primarily the result of an increase in volumes. Disproportionate Share Hospital Payment (DSH) for years 2018 and 2017 were \$1,826 and \$2,738, respectively.

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 the expenses incurred to perform those services. In each of the past two years, the Hospital has reported an operating gain. This is consistent with the Hospital's entire operating history. The Hospital's operations were begun in 1951 as a county owned and operated hospital under Indiana Code 16-22.

The decrease in the Hospital's operating income in 2018 of \$10,982 or 33% from 2017 was the result of the increase in operating expenses exceeding the increase in operating revenues. The Hospital increased gross charge rates by 5% for both years ended December 31, 2018 and 2017, respectively. More importantly, the Hospital's volumes increased. Total operating expenses increased \$29,731 or 6% in 2018 compared to 2017. The increase in operating expenses was the result of salaries and benefits, medical supplies and drugs, and purchased services and medical fees. Salaries and benefits increased due to an increase in full-time equivalents. Medical supplies and drugs increased due to an increase in pharmaceutical costs as well as services provided for oncology services. Purchased services and medical fees increased due to long-term care activity.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

The Hospital experienced statistical changes in the following areas:

Statistical Growth	2018	2017	2018 - 2017	
			% Increase / <Decrease>	2016
Patient Days	14,674	15,207	-3.50%	15,257
Diagnostic Imaging Procedures	68,265	65,948	3.51%	60,482
Laboratory Procedures	334,710	318,470	5.10%	309,233
Pharmaceutical Medication Units	356,910	431,470	-17.28%	426,792
Rehab Procedures	54,267	54,443	-0.32%	65,880
Home Health Units of Service	58,862	49,386	19.19%	39,840
Outpatient Clinic Procedures	8,736	8,250	5.89%	5,529

Excluded from net patient service revenue are charges for patient service waived under the Hospital's uncompensated care policy. Uncompensated care represents unreimbursed charges, both charity care and bad debt, incurred by the Hospital in providing uncompensated care to patients. Based on established rates, gross charges of \$4,998 were waived during 2018. This is a decrease compared to the previous year.

The Hospital sometimes provides care for patients who have little or no health insurance or other means of repayment. As discussed, this service to the community is consistent with the goals established for the Hospital when it was established in 1951. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the Hospital.

NONOPERATING INCOME AND EXPENSES

Nonoperating income and expenses are the result of changes in the Hospital's investment income, loss on disposal of capital assets, and other non-capital grants and contributions. The Hospital's investment income significantly decreased primarily due to market conditions during 2018. The Hospital incurred a loss on disposal of capital assets during 2017 due to the sale of capital assets from a long-term care facility to an outside third party. The Hospital's nonoperating income and expenses decreased in 2018 by \$11,751 from 2017.

GRANTS AND CONTRIBUTIONS

The Hospital receives operating grants from various state and federal agencies for specific programs. Operating grants received in 2018 totaled \$1,016 compared to \$977 in 2017.

Some of the significant grants received by the Hospital are:

- Tobacco Cessation – From Indiana State Department of Health for prevention of tobacco use

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

- Rural Health Clinic – Knightstown from Indiana State Department of Health – for rural health clinic operations in Knightstown
- Critical Needs Expansion – From Hancock Regional Hospital Foundation
- Women’s Health Center – from Hancock Regional Hospital Foundation
- New Cancer Center Service line – from Hancock Regional Hospital Foundation

THE HOSPITAL’S CASH FLOWS

Changes in the Hospital’s cash flows are consistent with changes in operating income and nonoperating income and expenses as discussed earlier. The following is a summary of cash flows:

Table 3: Statements of Cash Flow

	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>2016</u>
Net cash flows from				
Operating activities	\$ 32,974	\$ 46,639	\$ (13,665)	\$ 30,972
Noncapital financing activities	1,773	1,617	156	351
Capital and related financing	(13,909)	(3,580)	(10,329)	(13,038)
Investing	<u>(12,898)</u>	<u>(42,374)</u>	<u>29,476</u>	<u>(9,473)</u>
Change in cash and cash equivalents	<u>\$ 7,940</u>	<u>\$ 2,302</u>	<u>\$ 5,638</u>	<u>\$ 8,812</u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

During 2018, the Hospital’s net capital assets increased by approximately \$3,625. This compares to a decrease of approximately \$8,321 for 2017 compared to 2016. The increase in 2018 was due to construction projects to expand the Hospital’s operations in Hancock County. The decrease in 2017 was due to a significant amount of capital asset disposals.

HANCOCK REGIONAL HOSPITAL

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2018 AND 2017

The change in capital assets is outlined in the following table:

	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>2016</u>
Land	\$ 718	\$ 718	\$ -0-	\$ 1,241
Land improvements	7,803	7,803	-0-	8,457
Building and fixed equipment	124,429	121,638	2,791	123,267
Major moveable equipment	88,748	83,908	4,840	82,953
Construction in progress	<u>4,191</u>	<u>1,166</u>	<u>3,025</u>	<u>277</u>
Total capital assets	225,889	215,233	10,656	216,195
Less accumulated depreciation	<u>150,874</u>	<u>143,843</u>	<u>7,031</u>	<u>136,484</u>
	<u>\$ 75,015</u>	<u>\$ 71,390</u>	<u>\$ 3,625</u>	<u>\$ 79,711</u>

Capital assets, net increased as additions exceeded disposals and depreciation. More detailed information about the Hospital's capital assets is presented in the notes to the consolidated financial statements.

DEBT

The Hospital does not have any long-term debt obligations.

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. If you have questions about this report or need additional financial information, contact the Hospital Chief Financial Officer's Office, 801 N State Street, Greenfield, IN 46140.

HANCOCK REGIONAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2018 AND 2017

ASSETS

	2018	2017
Current assets		
Cash and cash equivalents	\$ 71,667,374	\$ 63,727,455
Investments	1,649,717	1,797,854
Patient accounts receivable, net	54,857,198	48,529,127
Inventories and other current assets	29,765,850	26,247,300
Total current assets	<u>157,940,139</u>	<u>140,301,736</u>
Assets whose use is limited		
Board designated funds	80,683,499	87,202,036
Donor restricted funds	7,211,658	6,638,843
Total assets whose use is limited	<u>87,895,157</u>	<u>93,840,879</u>
Capital assets		
Land and land improvements	8,521,042	8,520,726
Buildings and fixed equipment	124,428,598	121,637,934
Major movable equipment	88,747,550	83,907,538
Construction in progress	4,191,806	1,166,758
Total capital assets	<u>225,888,996</u>	<u>215,232,956</u>
Less accumulated depreciation	150,874,423	143,842,791
Capital assets, net	<u>75,014,573</u>	<u>71,390,165</u>
Other assets	<u>25,458,715</u>	<u>12,958,316</u>
Total assets	<u>\$ 346,308,584</u>	<u>\$ 318,491,096</u>

See accompanying notes to consolidated financial statements

HANCOCK REGIONAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2018 AND 2017

LIABILITIES AND NET POSITION

	2018	2017
Current liabilities		
Accounts payable and other liabilities	\$ 79,277,938	\$ 69,298,282
Accrued salaries and related liabilities	5,365,435	5,643,122
Estimated third-party settlements	7,101,754	4,767,435
Total current liabilities	<u>91,745,127</u>	<u>79,708,839</u>
Total liabilities	91,745,127	79,708,839
Net position		
Net investment in capital assets	75,014,573	71,390,165
Donor restricted expendable	7,211,658	6,638,843
Restricted nonexpendable	1,844,618	2,153,951
Unrestricted	<u>170,492,608</u>	<u>158,599,298</u>
Total net position	<u>254,563,457</u>	<u>238,782,257</u>
Total liabilities and net position	<u><u>\$ 346,308,584</u></u>	<u><u>\$ 318,491,096</u></u>

See accompanying notes to consolidated financial statements

HANCOCK REGIONAL HOSPITAL

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Operating revenue		
Net patient service revenue	\$ 493,585,834	\$ 476,223,600
Other operating revenue	9,991,757	8,965,249
Total operating revenue	503,577,591	485,188,849
Operating expenses		
Salaries and wages	50,286,677	46,833,705
Employee benefits	10,325,216	11,073,360
Professional medical fees	2,826,318	3,054,532
Supplies and drugs	56,099,925	49,046,317
Purchased services	328,549,565	312,357,773
Utilities and insurance	10,870,168	9,960,096
Depreciation and amortization	10,542,366	10,304,464
Hospital assessment fee	4,720,176	3,329,379
Other	7,188,177	6,078,487
Total operating expenses	481,408,588	452,038,113
Operating income	22,169,003	33,150,736
Nonoperating income (expense), net		
Noncapital contributions	2,358,150	2,018,853
Other nonoperating expense	(584,864)	(401,570)
Loss on disposal of capital assets	-0-	(4,707,508)
Investment income	(6,491,835)	10,123,689
Total non-operating income (expense), net	(4,718,549)	7,033,464
Change in net position before capital distributions	17,450,454	40,184,200
Capital distributions - noncontrolling interest	(1,669,254)	(1,595,670)
Change in net position	15,781,200	38,588,530
Net position		
Beginning of year	238,782,257	200,193,727
End of year	\$ 254,563,457	\$ 238,782,257

See accompanying notes to consolidated financial statements

HANCOCK REGIONAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Operating activities		
Cash received from patients and third party payors	\$ 489,592,082	\$ 471,888,403
Cash paid to employees for wages and benefits	(60,889,580)	(57,212,344)
Cash paid to vendors for goods and services	(405,720,351)	(377,002,412)
Other operating receipts	9,991,757	8,965,249
Net cash from operating activities	32,973,908	46,638,896
Noncapital financing activities		
Noncapital contributions	2,358,150	2,018,853
Other nonoperating	(584,864)	(401,570)
Net cash from noncapital financing activities	1,773,286	1,617,283
Capital and related financing activities		
Acquisition and construction of capital assets	(12,346,007)	(8,312,866)
Loss on disposal of capital assets	-0-	4,707,508
Proceeds on disposal of capital assets	106,361	1,621,464
Capital distributions - noncontrolling interest	(1,669,254)	(1,595,670)
Net cash from capital and related financing activities	(13,908,900)	(3,579,564)
Investing activities		
Other assets	(12,500,399)	(8,195,532)
Investment income	(6,491,835)	10,123,689
Other changes in assets whose use is limited, net	6,093,859	(44,302,905)
Net cash from investing activities	(12,898,375)	(42,374,748)
Net change in cash and cash equivalents	7,939,919	2,301,867
Cash and cash equivalents		
Beginning of year	63,727,455	61,425,588
End of year	\$ 71,667,374	\$ 63,727,455

See accompanying notes to consolidated financial statements

HANCOCK REGIONAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 22,169,003	\$ 33,150,736
Adjustment to reconcile operating income to net cash from operating activities		
Depreciation and amortization	10,542,366	10,304,464
Bad debts	12,122,423	10,976,962
Changes in assets and liabilities		
Patient accounts receivable	(18,450,494)	(16,887,786)
Other current assets	(3,518,550)	(2,438,871)
Accounts payable and other liabilities	8,052,528	9,263,043
Accrued salaries and related liabilities	(277,687)	694,721
Estimated third-party settlements	2,334,319	1,575,627
Net cash from operating activities	<u>\$ 32,973,908</u>	<u>\$ 46,638,896</u>
 Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents:		
In current assets	<u>\$ 71,667,374</u>	<u>\$ 63,727,455</u>
 Supplementary disclosure of cash flows information		
Acquisition and construction of capital assets in accounts payable	\$ 1,927,128	\$ -0-

See accompanying notes to consolidated financial statements

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Hancock Regional Hospital (HRH) is an acute-care hospital located in Greenfield, Indiana, organized for the purpose of providing healthcare services to the residents of Hancock County and the surrounding communities. HRH also provides long-term healthcare services. Hancock Regional Hospital is a county owned facility operated under the Indiana County Hospital Law, Indiana Code 16-22. The Board of County Commissioners of Hancock County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between Hancock County and HRH. For these reasons, HRH is considered a component unit of Hancock County.

Pursuant to the provision of long-term care, HRH owns the operations of several long-term care facilities by way of an arrangement with the managers of the facilities. These facilities provide inpatient and therapy services. Generally, gross revenues from the operations of the long-term care facilities are the property of HRH and HRH is responsible for the associated operating expenses and working capital requirements. While the management and related lease agreements are in effect, the performance of all activities of the managers shall be on behalf of HRH and HRH retains the authority and legal responsibility for the operations of the facilities.

Specifically, HRH entered into lease agreements with the long-term care facilities to lease the facilities managed by the managers. Concurrently, HRH entered into agreements with the managers to manage the leased facilities. As part of the agreements, HRH will pay the managers a management fee to continue managing the facilities on behalf of HRH in accordance with the terms of the agreements. The agreements expire at various times and are generally automatically extended for successive terms unless appropriately terminated. All parties involved can terminate the agreement without cause with a written notice.

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present HRH and its blended component units, collectively referred to as the "Hospital". The component units discussed below are included in HRH's reporting entity because of the significance of their operation or financial relationship with HRH. A blended component unit, although a legally separate entity is in substance part of the primary government unit's operations and exists solely or primarily to provide services to or for HRH.

Blended Component Units

The accompanying consolidated financial statements include the accounts of Hancock Regional Hospital Foundation, Inc. (Foundation), a separate not-for-profit entity organized to support the operations of HRH. The accompanying consolidated financial statements also include the accounts of the Blended Component Unit – Hancock Regional Surgery Center, LLC (HRSC) and O3PureMed, LLC (O3PureMed); both are separate limited liability companies. All significant intercompany transactions have been eliminated for financial reporting purposes.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

HRSC was formed for the purpose of owning and operating a multi-specialty ambulatory surgery facility that provides the medical, management and administrative support necessary for licensed physicians to perform non-emergency surgical procedures on an outpatient basis. HRH's membership interest in HRSC is 51%. HRH maintains substantial participation in the operations of HRSC in addition to an economic interest in HRSC's financial position.

O3PureMed was formed for the purpose of operating a medical and infectious waste treatment facility. HRH's membership interest in O3PureMed is 100%.

The separate financial statements for each of the entities discussed above may be obtained through contacting management of HRH. All entities contained in the consolidated financial statements are collectively referred to as the "Hospital".

Use of Estimates

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

Measurement Focus and Basis of Accounting

The consolidated financial statements are reported using the economic resources measurement focus and on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid assets with maturity dates of 90 days or less when purchased. The Hospital maintains its cash in accounts, which at times, may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Patient Accounts Receivable and Net Patient Service Revenue

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. Management estimates an allowance for doubtful accounts receivable based on an evaluation of historical losses, current economic conditions, and other factors unique to the Hospital's customer base.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

A summary of the payment arrangements with major third-party payors follows.

The Hospital is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The Hospital is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG).

The Hospital is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At HRH's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

These programs have audited the year-end cost report filed with the Medicare program through December 31, 2013. There were no significant differences reflected as deductions from revenue during 2018 and 2017. Amounts for unresolved cost reports for 2014 through 2018 are reflected in estimated third-party settlements on the consolidated balance sheets.

The Hospital participates in the Indiana Hospital Assessment Fee (HAF) Program. The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana hospitals as reflected in the Hospital Assessment Fee reported in the consolidated statements of operations and changes in net position. Previously, the State's share was funded by governmental entities through intergovernmental transfers.

The Medicaid enhanced payments relate to both fee for service and managed care claims. Under the HAF Program, the enhanced Medicaid payments follow the patients and are realized through increased Medicaid rates. During 2018 and 2017, HRH recognized HAF Program expense of approximately \$4,720,000 and \$3,329,000, respectively. The Medicaid rate increases under the HAF Program are included in net patient service revenue in the consolidated statements of operations and changes in net position.

Net revenue from the Medicare and Medicaid programs accounted for approximately 83 percent of the Hospital's net patient revenue for the years ended 2018 and 2017. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

The Hospital recognized revenue related to the Medicaid Disproportionate Share Hospital and the Upper Payment Limitation programs of approximately \$1,800,000 and \$2,700,000 for the years ended December 31, 2018 and 2017, respectively. These amounts are reimbursements for providing care to the uninsured and underinsured and are included in net patient service revenue within the consolidated statements of operations and changes in net position.

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

Charity Care

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

Of the Hospital's total expenses (excluding subsidiaries and long-term care operations) reported within the consolidated statements of operations and changes in net position, an estimated \$1,783,000 and \$2,273,000 arose from providing services to charity patients during 2018 and 2017, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses divided by gross patient service revenue.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market. Inventory at year-end consists mainly of pharmaceuticals and medical supplies.

Assets Whose Use is Limited and Investments

Assets whose use is limited include investments designated by HRH's Board of Trustees for internal purposes, investments and other assets restricted by donors for a specific purpose and investments held by trustees for debt service and continued construction projects.

Assets whose use is limited and investments consist of money market funds and mutual funds that are reported at fair value. Assets whose use is limited and investments also consist of certificates of deposit which are recorded at contract value. Interest, dividends, and gains and losses, both realized and unrealized, are included in nonoperating income when earned.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities, which exceed \$1,000 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The Hospital provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The ranges of useful lives in computing depreciation include the following:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	8-15 years
Buildings and fixed equipment	5-40 years
Major movable equipment	3-20 years

Costs of Borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No amounts were capitalized as of December 31, 2018 and 2017.

Other Assets

Other assets primarily consist of investments in other entities and land held for investment and future use.

Income Taxes

HRH is a governmental instrumentality organized under Title 16, Article 22, of the Indiana statutes. The Hospital is exempt from federal income tax under Section 115 of the Internal Revenue Code of 1986. As such, HRH is exempt from federal income tax as a unit of local government. No income tax filings are required of the Hospital as it is a governmental instrumentality.

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

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and recognize a tax liability if the Hospital has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Management has analyzed the tax positions taken by the Hospital and has concluded that as of December 31, 2018 and 2017, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

HRSC and O3PureMed are organized as a limited liability company, whereby net taxable income is taxed directly to the members of the limited liability company. Thus, the consolidated financial statements do not include any provision for federal or state income taxes related to HRSC or O3PureMed.

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

Advertising and Community Relations

The Hospital records advertising and promotion expense in the period incurred. Total expense for advertising and promotion was approximately \$796,000 and \$748,000 for 2018 and 2017, respectively.

Compensated Absences

The Hospital's employees earn time off at varying rates depending on years of service. The estimated amount of unused earned time off is reported as a liability in consolidated financial statements.

Net Position

The net position of the Hospital is classified in four components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net position amounts are expendable noncapital net position that must be used for a particular purpose, as specified by creditors or donors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. Restricted nonexpendable net position includes the noncontrolling interests owned by external investors. Unrestricted net position is the remaining net position that does not meet the definition of invested in capital assets net of related debt or restricted.

Donor Restricted Net Position

Restricted funds include donations to the Foundation that have been restricted by donors for a specific purpose. Generally, these donations are for additions to Hospital property and equipment. Transfers are made to unrestricted funds as expenditures are made in accordance with the donor restrictions.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Operating Revenues and Expenses

The Hospital's statement of operations and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services which is the Hospital's principal activity. Contributions, investment income, fund development costs and certain other non-healthcare activities are reported as nonoperating revenues (expenses). Operating expenses are all expenses incurred to provide health care services, other than financing costs. Transactions with Hancock County and external investors are shown below nonoperating revenues (expenses).

Contributions

From time to time, the Hospital receives contributions from individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Contributions may be restricted either for specific operating purposes or for capital purposes.

Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Litigation

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

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. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Accounting for Noncontrolling Interest

The Hospital has classified the noncontrolling interest as a component of restricted nonexpendable net position in the consolidated balance sheets. Noncontrolling interests represent the portion of the net position that is attributable to investors that are external to and not included in the Hospital's consolidated financial statements.

Reclassification

Certain amounts in the prior year consolidated financial statements have been reclassified for comparative purposes to conform to the current year presentation. The reclassifications had no effect on the previously reported net position and change in net position.

Subsequent Events

The Hospital evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are available to be issued which is May 15, 2019.

Recently Issued Accounting Standard

GASB Statement No. 87, *Leases*, issued June 2017, will be effective for periods beginning after December 15, 2019. This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset.

The Hospital is presently evaluating the effects that this statement will have on its future consolidated financial statements, including related disclosures.

2. INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Board Designated Funds

The Hospital funds depreciation expense to meet the capital equipment needs of the facility. Depreciation is funded totally, with expenditures for capital equipment and debt principal payments reducing the funded depreciation balance. The Hospital designates other investments to fund specific projects. All interest earned by the funded depreciation and other board designated investment accounts are left to accumulate as an addition to the funds.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Donor Restricted Funds

The Hospital has assets, which have been donated for a specific purpose. The following represents assets whose use is limited and investments as of December 31, 2018 and 2017:

	2018	2017
Board designated funds	\$ 80,683,499	\$ 87,202,036
Donor restricted funds	7,211,658	6,638,843
Total assets whose use is limited	87,895,157	93,840,879
Investments	1,649,717	1,797,854
	<u>\$ 89,544,874</u>	<u>\$ 95,638,733</u>

The following represents the makeup of assets whose use is limited and investments as of December 31, 2018 and 2017:

	2018	2017
Money market funds	\$ 2,491,656	\$ 1,225,775
Certificates of deposit	350,657	350,667
Common stocks	3,064,222	2,598,924
Mutual funds - equities	51,226,263	58,522,549
Mutual funds - fixed income	32,412,076	32,940,818
	<u>\$ 89,544,874</u>	<u>\$ 95,638,733</u>

The common stocks are held by the Foundation.

3. DEPOSITS AND INVESTMENTS

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

Investments are carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Assets whose use is limited investments consist of cash equivalents, certificates of deposit and mutual funds.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

The Hospital's investments generally are reported at fair value. As of December 31, 2018 and 2017, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial financial institutions that are agents of the Hospital.

December 31, 2018					
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Money market funds	\$ 2,491,656	\$ 2,491,656	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	350,657	350,657	-0-	-0-	-0-
Common stocks	3,064,222	3,064,222	-0-	-0-	-0-
Mutual funds - equities	51,226,263	51,226,263	-0-	-0-	-0-
Mutual funds - fixed income	32,412,076	32,412,076	-0-	-0-	-0-
	\$ 89,544,874	\$ 89,544,874	\$ -0-	\$ -0-	\$ -0-

December 31, 2017					
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Money market funds	\$ 1,225,775	\$ 1,225,775	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	350,667	350,667	-0-	-0-	-0-
Common stocks	2,598,924	2,598,924	-0-	-0-	-0-
Mutual funds - equities	58,522,549	58,522,549	-0-	-0-	-0-
Mutual funds - fixed income	32,940,818	32,940,818	-0-	-0-	-0-
	\$ 95,638,733	\$ 95,638,733	\$ -0-	\$ -0-	\$ -0-

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

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

Concentration of credit risk - The Hospital places no limit on the amount it may invest in any one issuer. The Hospital maintains its investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments. The Hospital does have a formal policy regarding credit and concentration of credit risks.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Deposits and investments consist of the following as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Carrying amount		
Deposits	\$ 71,667,374	\$ 63,727,455
Investments	89,544,874	95,638,733
	<u>\$ 161,212,248</u>	<u>\$ 159,366,188</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 71,667,374	\$ 63,727,455
Investments	1,649,717	1,797,854
Board designated funds	80,683,499	87,202,036
Donor restricted funds	7,211,658	6,638,843
	<u>\$ 161,212,248</u>	<u>\$ 159,366,188</u>

4. FAIR VALUE MEASUREMENTS

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

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels during 2018 and 2017.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2018 and 2017.

- *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Common stocks*: Valued at the closing price reported on the active market on which the individual securities are traded.
- *Money market funds*: Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV) however, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

The following table sets forth by level, within the hierarchy, the Hospital's assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 and 2017.

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Assets				
Investments and assets whose use is limited				
Mutual funds - equities				
Large blend	\$ 19,031,322	\$ 19,031,322	\$ -0-	\$ -0-
Large growth	13,790,768	13,790,768	-0-	-0-
Large value	9,815,309	9,815,309	-0-	-0-
Medium blend	2,575,257	2,575,257	-0-	-0-
Medium growth	416,777	416,777	-0-	-0-
Medium value	1,520,444	1,520,444	-0-	-0-
Small blend	304,278	304,278	-0-	-0-
Small growth	310,425	310,425	-0-	-0-
Small value	3,461,683	3,461,683	-0-	-0-
Total mutual funds - equities	<u>51,226,263</u>	<u>51,226,263</u>	-0-	-0-
Mutual funds - fixed income				
High yield bond	1,554,520	1,554,520	-0-	-0-
Intermediate term bond	24,725,703	24,725,703	-0-	-0-
Short-term bond	6,131,853	6,131,853	-0-	-0-
Total mutual funds - fixed income	<u>32,412,076</u>	<u>32,412,076</u>	-0-	-0-
Common stocks				
Consumer goods	441,247	441,247	-0-	-0-
Energy	119,358	119,358	-0-	-0-
Financial	256,007	256,007	-0-	-0-
Healthcare	280,027	280,027	-0-	-0-
Real estate	25,199	25,199	-0-	-0-
Services	175,220	175,220	-0-	-0-
Technology	461,496	461,496	-0-	-0-
Utilities	56,068	56,068	-0-	-0-
Other	1,249,600	1,249,600	-0-	-0-
Total common stocks	<u>3,064,222</u>	<u>3,064,222</u>	-0-	-0-
Money market funds	2,491,656	-0-	2,491,656	-0-
		<u>\$ 83,638,339</u>	<u>\$ 2,491,656</u>	<u>\$ -0-</u>
Certificates of deposit *	350,657			
	<u>\$ 89,544,874</u>			

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Assets				
Investments and assets whose use is limited				
Mutual funds - equities				
Large blend	\$ 22,955,742	\$ 22,955,742	\$ -0-	\$ -0-
Large growth	12,442,796	12,442,796	-0-	-0-
Large value	13,628,730	13,628,730	-0-	-0-
Medium growth	3,539,349	3,539,349	-0-	-0-
Medium growth	438,762	438,762	-0-	-0-
Medium value	455,574	455,574	-0-	-0-
Small blend	354,489	354,489	-0-	-0-
Small growth	349,862	349,862	-0-	-0-
Small value	4,355,830	4,355,830	-0-	-0-
Other (global, commodities, and index)	1,415	1,415	-0-	-0-
Total mutual funds - equities	58,522,549	58,522,549	-0-	-0-
Mutual funds - fixed income				
High yield bond	1,733,686	1,733,686	-0-	-0-
Intermediate term bond	25,821,320	25,821,320	-0-	-0-
Short-term bond	5,385,812	5,385,812	-0-	-0-
Total mutual funds - fixed income	32,940,818	32,940,818	-0-	-0-
Common stocks				
Consumer goods	472,967	472,967	-0-	-0-
Energy	139,145	139,145	-0-	-0-
Financial	272,779	272,779	-0-	-0-
Healthcare	270,392	270,392	-0-	-0-
Industrials	18,562	18,562	-0-	-0-
Real estate	25,761	25,761	-0-	-0-
Services	125,229	125,229	-0-	-0-
Technology	471,516	471,516	-0-	-0-
Utilities	55,899	55,899	-0-	-0-
Other	746,674	746,674	-0-	-0-
Total common stocks	2,598,924	2,598,924	-0-	-0-
Money market fund	1,225,775	-0-	1,225,775	-0-
		<u>\$ 94,062,291</u>	<u>\$ 1,225,775</u>	<u>\$ -0-</u>
Certificates of deposit *	350,667			
	<u>\$ 95,638,733</u>			

* Certificates of deposit are reported at contract value

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

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

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

5. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities as of December 31, 2018 and 2017 is as follows:

	2018	2017
Patient accounts receivable		
Receivable from patients and their insurance carriers	\$ 32,159,888	\$ 28,507,144
Receivable from Medicare	31,167,259	24,908,956
Receivable from Medicaid	3,666,543	8,925,122
Receivable from long-term care operations	37,811,281	33,453,280
Total patient accounts receivable	<u>104,804,971</u>	<u>95,794,502</u>
Less contractual allowances	(37,884,848)	(36,102,359)
Less allowance for uncollectible amounts	(12,062,925)	(11,163,016)
Patient accounts receivable, net	<u>\$ 54,857,198</u>	<u>\$ 48,529,127</u>
Accounts payable and accrued expenses		
Payable to employees (including payroll taxes and benefits)	\$ 5,365,435	\$ 5,643,122
Payable to suppliers and other accrued expenses	<u>79,277,938</u>	<u>69,298,282</u>
Total accounts payable and accrued expenses	<u>\$ 84,643,373</u>	<u>\$ 74,941,404</u>

6. INVESTMENTS IN AFFILIATES

HRH owns 50% of Hancock Physician Network, LLC (Network) and has recorded the investment on the equity method of accounting in the amount of \$1,646,060 and \$708,107 as of December 31, 2018 and 2017, respectively. This investment is included within other assets in the consolidated financial statements. HRH paid the Network approximately \$5,765,000 and \$4,459,000 during 2018 and 2017, respectively, for management and other operating expenses.

HRH received approximately \$5,734,000 and \$5,109,000 for 2018 and 2017, respectively from the Network for rental, housecleaning and related income. HRH contributed capital of approximately \$7,510,000 and \$6,239,000 to the Network during 2018 and 2017, respectively.

HRH has a receivable from the Network of approximately \$1,052,000 and \$3,541,000 as of December 31, 2018 and 2017, respectively. The Hospital has a payable to the Network of approximately \$477,000 and \$1,069,000 as of December 31, 2018 and 2017, respectively. HRH expects to continue providing capital contributions to the Network at a commensurate level with its past experience.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

HRH also owns 50% of a Physician Hospital Organization (PHO), approximately 43% of Suburban Home Health, LLC, and approximately 49% of Parkway, LLC. HRH has recorded these investments in affiliates on the equity method of accounting within other assets in the consolidated financial statements. HRH also owns 2% of St. Vincent Heart Center of Indiana, Inc.

The separate financial statements for each of the entities above may be obtained through contacting management of HRH.

7. CAPITAL ASSETS

Capital assets consist of the following as of December 31, 2018 and 2017:

	Balance December 31, 2017	Additions	Retirements	Transfers	Balance December 31, 2018
Land	\$ 718,083	\$ 316	\$ -0-	\$ -0-	\$ 718,399
Land improvements	7,802,643	-0-	-0-	-0-	7,802,643
Buildings and fixed equipment	121,637,934	1,829,769	(22,405)	983,300	124,428,598
Major movable equipment	83,907,538	8,413,497	(3,594,690)	21,205	88,747,550
Construction in progress	1,166,758	4,029,553	-0-	(1,004,505)	4,191,806
Total capital assets	<u>215,232,956</u>	<u>14,273,135</u>	<u>(3,617,095)</u>	<u>-0-</u>	<u>225,888,996</u>
Less accumulated depreciation					
Land improvements	(5,059,267)	(415,727)	1,623	-0-	(5,473,371)
Buildings and fixed equipment	(76,510,284)	(4,301,391)	747	-0-	(80,810,928)
Major movable equipment	(62,273,240)	(5,825,248)	3,508,364	-0-	(64,590,124)
Total accumulated depreciation	<u>(143,842,791)</u>	<u>(10,542,366)</u>	<u>3,510,734</u>	<u>-0-</u>	<u>(150,874,423)</u>
Capital assets, net	<u>\$ 71,390,165</u>	<u>\$ 3,730,769</u>	<u>\$ (106,361)</u>	<u>\$ -0-</u>	<u>\$ 75,014,573</u>
	Balance December 31, 2016	Additions	Retirements	Transfers	Balance December 31, 2017
Land	\$ 1,241,194	\$ -0-	\$ (523,111)	\$ -0-	\$ 718,083
Land improvements	8,457,308	-0-	(654,665)	-0-	7,802,643
Buildings and fixed equipment	123,267,332	2,455,854	(4,494,086)	408,834	121,637,934
Major movable equipment	82,952,827	4,495,148	(3,603,011)	62,574	83,907,538
Construction in progress	276,302	1,361,864	-0-	(471,408)	1,166,758
Total capital assets	<u>216,194,963</u>	<u>8,312,866</u>	<u>(9,274,873)</u>	<u>-0-</u>	<u>215,232,956</u>
Less accumulated depreciation					
Land improvements	(5,056,771)	(447,825)	445,329	-0-	(5,059,267)
Buildings and fixed equipment	(73,070,075)	(4,591,981)	1,151,772	-0-	(76,510,284)
Major movable equipment	(58,357,382)	(5,264,658)	1,348,800	-0-	(62,273,240)
Total accumulated depreciation	<u>(136,484,228)</u>	<u>(10,304,464)</u>	<u>2,945,901</u>	<u>-0-</u>	<u>(143,842,791)</u>
Capital assets, net	<u>\$ 79,710,735</u>	<u>\$ (1,991,598)</u>	<u>\$ (6,328,972)</u>	<u>\$ -0-</u>	<u>\$ 71,390,165</u>

At December 31, 2018, the Hospital has remaining commitments of approximately \$21,000,000 primarily for the construction of new building, a wellness center and imaging center which are being financed internally.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

8. PATIENT SERVICE REVENUE

Patient service revenue for 2018 and 2017 consists of the following:

	2018	2017
Inpatient	\$ 60,299,569	\$ 67,143,714
Outpatient	336,566,104	288,401,369
Long-term care	358,479,092	348,589,632
Patient service revenue	755,344,765	704,134,715
Contractual allowance	244,638,843	210,716,066
Bad debts	12,122,423	10,976,962
Charity care	4,997,665	6,218,087
Deductions from revenue	261,758,931	227,911,115
Net patient service revenue	\$ 493,585,834	\$ 476,223,600

9. PENSION PLAN

The Hospital offers a defined contribution plan that covers all employees who meet eligibility requirements as to age and length of service and who elect to participate. The name of plan is the Hancock Regional Hospital 403(b) Plan and is administered by MetLife. The plan was established by written agreement between the Board of Trustees and the plan administrator. The contribution requirements of participants of the plan are established and can be amended by written agreement. The Hospital matches 50% of the employee contribution up to 4% of the eligible wages. Pension expense related to this plan was approximately \$1,707,000 and \$1,220,000 in 2018 and 2017, respectively.

10. CONCENTRATION OF CREDIT RISK

The Hospital is located in Greenfield, Indiana. The Hospital grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The acute care mix of gross patient accounts receivable and gross revenue from patients and third-party payors at December 31 was as follows:

	Receivables		Revenue	
	2018	2017	2018	2017
Medicare	47%	40%	53%	52%
Medicaid	5%	14%	11%	11%
Commercial	30%	28%	33%	33%
Self pay and other	18%	18%	3%	4%
	100%	100%	100%	100%

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

The majority of the patient accounts receivable and related revenues from long-term care operations are concentrated in Medicare and Medicaid.

11. ACCOUNTING FOR NONCONTROLLING INTEREST

The following depicts the changes in consolidated net position attributable to the controlling financial interest of the Hospital and the noncontrolling interest as of December 31, 2018 and 2017:

	Controlling interest	Noncontrolling interest	Total
Net position			
December 31, 2016	\$ 197,849,583	\$ 2,344,144	\$ 200,193,727
Change in net position before capital distributions	38,778,723	1,405,477	40,184,200
Capital distributions	-0-	(1,595,670)	(1,595,670)
Change in net position	<u>38,778,723</u>	<u>(190,193)</u>	<u>38,588,530</u>
December 31, 2017	236,628,306	2,153,951	238,782,257
Change in net position before capital distributions	16,090,533	1,359,921	17,450,454
Capital distributions	-0-	(1,669,254)	(1,669,254)
Change in net position	<u>16,090,533</u>	<u>(309,333)</u>	<u>15,781,200</u>
December 31, 2018	<u>\$ 252,718,839</u>	<u>\$ 1,844,618</u>	<u>\$ 254,563,457</u>

12. SELF-INSURED HEALTH CLAIMS

The Hospital is self-insured for employee health claims. A third party administrator processes the claims for the Hospital. The Hospital maintains an estimated liability for the amount of claims incurred but not reported.

The Hospital maintains reinsurance including a stop loss for specific incident claims generally over \$300,000. Substantially all employees are covered for major medical benefits. The total health claims expense was approximately \$7,119,000 and \$7,532,000 for 2018 and 2017, respectively.

Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. The Hospital has recorded the accrual for the unpaid claims estimate within accrued salaries and related liabilities on the consolidated financial statements.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

Changes in the accrual for unpaid claims for 2018 and 2017 are as follows:

	2018	2017
Unpaid claims estimate, beginning of year	\$ 983,316	\$ 584,679
Incurred claims and changes in estimates	7,119,165	7,531,807
Claims payments	(7,253,720)	(7,133,170)
Unpaid claims estimate, end of year	<u>\$ 848,761</u>	<u>\$ 983,316</u>

13. COMMITMENTS AND CONTINGENCIES

Malpractice Insurance

The Indiana Medical Malpractice Act, IC 34-18 (the Act), provides a recovery for an occurrence of malpractice and for any injury or death of a patient due to an act of malpractice in excess of certain thresholds. The Act requires the Hospital to maintain medical malpractice liability insurance on a per individual basis and in the annual aggregate for amounts below the thresholds of the Act. During 2001, the Hospital's malpractice carrier filed bankruptcy. The Hospital has obtained malpractice coverage through another carrier.

The Hospital may be liable for certain pending claims incurred while with the former carrier. Management is not aware of any related material adverse effects to its financial position, results of operations, and cash flows. Prior to July 1, 1999, the Indiana Medical Malpractice Act provided for a maximum recovery of \$750,000 per individual (\$3,000,000 annual aggregate) for professional liability, \$100,000 of which would be paid through the Hospital's malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund (the Fund). For claims on or after July 1, 1999 and before July 1, 2017, the Indiana Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per individual (\$7,500,000 annual aggregate) with the first \$250,000 covered by the Hospital's insurance and the remainder by the Fund. For claims on or after July 1, 2017 the Act provides a maximum recovery of \$1,650,000 for an occurrence of malpractice until June 30, 2019, and \$1,800,000 thereafter. The Act requires the Hospital to maintain medical malpractice liability insurance in the amount of at least \$400,000 per occurrence (\$8,000,000 annual aggregate) until June 30, 2019. Starting July 1, 2019, the Act will require the Hospital to maintain medical malpractice liability insurance in the amount of at least \$500,000 per occurrence (\$10,000,000 annual aggregate). The Act also requires the Hospital to pay a surcharge to the Fund. The Fund is used to pay medical malpractice claims in excess of per occurrence and the annual aggregate amounts as noted above, under certain terms and conditions. No accrual for possible losses attributable to incidents that may have occurred but that have not been identified has been made because the amount, if any, is not reasonably estimable. The Fund is on a claims-made basis and as long as this coverage is continuous or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be insured.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

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 claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

The Hospital is a member in a captive insurance company, Suburban Health Organization Segregated Portfolio Company, LLC, to fund the Hospital's required portion of the professional and physician insurance coverage pursuant to the Act as well as its general liability insurance and excess coverage.

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

14. BLENDED COMPONENT UNITS

Below is condensed, combining financial information of the blended component units.

	2018			
	Foundation	HRSC	O3PureMed	Total
Assets				
Current assets	\$ 2,226,774	\$ 4,591,818	\$ 71,789	\$ 6,890,381
Capital assets	5,275	558,901	998,106	1,562,282
Assets whose use is limited	7,211,658	-0-	-0-	7,211,658
Total assets	<u>\$ 9,443,707</u>	<u>\$ 5,150,719</u>	<u>\$ 1,069,895</u>	<u>\$ 15,664,321</u>
Liabilities				
Accounts payable and other liabilities	34,077	797,147	14,361	845,585
Total liabilities	<u>34,077</u>	<u>797,147</u>	<u>14,361</u>	<u>845,585</u>
Net position				
Unrestricted	2,192,697	3,794,671	57,428	6,044,796
Net investment in capital assets	5,275	558,901	998,106	1,562,282
Donor restricted-expendable	7,211,658	-0-	-0-	7,211,658
Total net position	<u>9,409,630</u>	<u>4,353,572</u>	<u>1,055,534</u>	<u>14,818,736</u>
Total liabilities and net position	<u>\$ 9,443,707</u>	<u>\$ 5,150,719</u>	<u>\$ 1,069,895</u>	<u>\$ 15,664,321</u>
Operating revenues (patient and other)	\$ -0-	\$ 12,878,289	\$ 352,827	\$ 13,231,116
Expenses				
Depreciation	-0-	250,341	291,830	542,171
Other expenses	-0-	9,926,264	351,268	10,277,532
Total expenses	<u>-0-</u>	<u>10,176,605</u>	<u>643,098</u>	<u>10,819,703</u>
Operating income (loss)	-0-	2,701,684	(290,271)	2,411,413
Nonoperating revenues, net	693,931	8,992	-0-	702,923
Capital contributions (distributions)	-0-	(3,130,562)	278,630	(2,851,932)
Change in net position	693,931	(419,886)	(11,641)	262,404
Net position, beginning of year	8,715,699	4,773,458	1,067,175	14,556,332
Net position, end of year	<u>\$ 9,409,630</u>	<u>\$ 4,353,572</u>	<u>\$ 1,055,534</u>	<u>\$ 14,818,736</u>
Net cash flows from				
Operating activities	\$ -0-	\$ 2,952,025	\$ (351,268)	\$ 2,600,757
Noncapital financing activities	1,159,530	-0-	-0-	1,159,530
Capital and related financing activities	-0-	(3,458,188)	399,232	(3,058,956)
Investing activities	(1,012,918)	(8,992)	-0-	(1,021,910)
Total	146,612	(515,155)	47,964	(320,579)
Cash and cash equivalents:				
Beginning of year	292,204	3,182,922	25,041	3,500,167
End of year	<u>\$ 438,816</u>	<u>\$ 2,667,767</u>	<u>\$ 73,005</u>	<u>\$ 3,179,588</u>

HANCOCK REGIONAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2018 AND 2017

	2017			
	Foundation	HRSC	O3PureMed	Total
Assets				
Current assets	\$ 2,154,313	\$ 5,047,876	\$ 51,079	\$ 7,253,268
Capital assets	7,385	735,405	1,041,306	1,784,096
Assets whose use is limited	6,638,843	-0-	-0-	6,638,843
Total assets	<u>\$ 8,800,541</u>	<u>\$ 5,783,281</u>	<u>\$ 1,092,385</u>	<u>\$ 15,676,207</u>
Liabilities				
Accounts payable and other liabilities	84,842	1,009,823	25,210	1,119,875
Total liabilities	84,842	1,009,823	25,210	1,119,875
Net position				
Unrestricted	2,069,471	4,038,053	25,869	6,133,393
Net investment in capital assets	7,385	735,405	1,041,306	1,784,096
Donor restricted-expendable	6,638,843	-0-	-0-	6,638,843
Total net position	<u>8,715,699</u>	<u>4,773,458</u>	<u>1,067,175</u>	<u>14,556,332</u>
Total liabilities and net position	<u>\$ 8,800,541</u>	<u>\$ 5,783,281</u>	<u>\$ 1,092,385</u>	<u>\$ 15,676,207</u>
Operating revenues (patient and other)	\$ -0-	\$ 12,764,892	\$ 177,221	\$ 12,942,113
Expenses				
Depreciation	-0-	419,789	267,783	687,572
Other expenses	-0-	9,441,854	415,438	9,857,292
Total expenses	<u>-0-</u>	<u>9,861,643</u>	<u>683,221</u>	<u>10,544,864</u>
Operating income (loss)	-0-	2,903,249	(506,000)	2,397,249
Nonoperating revenues, net	1,849,166	355	-0-	1,849,521
Capital contributions (distributions)	-0-	(3,048,994)	250,000	(2,798,994)
Change in net position	1,849,166	(145,390)	(256,000)	1,447,776
Net position, beginning of year	<u>6,866,533</u>	<u>4,918,848</u>	<u>1,323,175</u>	<u>13,108,556</u>
Net position, end of year	<u>\$ 8,715,699</u>	<u>\$ 4,773,458</u>	<u>\$ 1,067,175</u>	<u>\$ 14,556,332</u>
Net cash flows from				
Operating activities	\$ -0-	\$ 3,323,038	\$ (415,438)	\$ 2,907,600
Noncapital financing activities	950,777	-0-	-0-	950,777
Capital and related financing activities	-0-	(3,076,219)	336,912	(2,739,307)
Investing activities	<u>(1,036,558)</u>	<u>2,145</u>	<u>-0-</u>	<u>(1,034,413)</u>
Total	(85,781)	248,964	(78,526)	84,657
Cash and cash equivalents:				
Beginning of year	<u>377,985</u>	<u>2,933,958</u>	<u>103,567</u>	<u>3,415,510</u>
End of year	<u>\$ 292,204</u>	<u>\$ 3,182,922</u>	<u>\$ 25,041</u>	<u>\$ 3,500,167</u>

The separate financial statements for each of the entities above may be obtained through contacting management of HRH.