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July 9, 2013

Board of Directors
Dearborn County Hospital
600 Wilson Creek Road
Lawrenceburg, IN 47025-2751

We have reviewed the audit report prepared by Blue and Co., LLC Independent Public Accountants, for the period January 1, 2012 to December 31, 2012. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Dearborn County Hospital, as of December 31, 2012 and the results of its operations for the period then ended, on the basis of accounting described in the report.

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

STATE BOARD OF ACCOUNTS



CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2012

CPAs / ADVISORS



DEARBORN COUNTY HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Dearborn County Hospital
Lawrenceburg, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Dearborn County Hospital (the Hospital), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of revenues, expenses and changes in net position, and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants, issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free 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
Dearborn County Hospital
Lawrenceburg, 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, 2012, and its results of operations, changes in net position and cash flows for the year 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 audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Report on Supplementary Information

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

Blue & Co., LLC

Indianapolis, Indiana
May 16, 2013

REQUIRED SUPPLEMENTARY INFORMATION

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

This section of Dearborn County Hospital's (the Hospital) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of the Hospital's consolidated financial performance during the year ended December 31, 2012. This MD&A does include a discussion and analysis of the activities and results of the Hospital's Blended Component Unit, Health Services Corporation of Southeastern Indiana (HSC). Please read it in conjunction with the Hospital's consolidated financial statements that follow this MD&A.

Financial Highlights

- The Hospital's total assets increased approximately \$22,559,000 or 18.9% during 2012. Total liabilities increased approximately \$15,089,000 or 41.8% during 2012.
- The Hospital's net position increased approximately \$7,471,000 or 8.9% in 2012.
- The Hospital reported operating income of approximately \$4,727,000 for 2012, representing an increase of approximately \$9,784,000 in comparison to the 2011 results.
- The Hospital added capital assets of approximately \$2,314,000 during 2012 while capital assets with a net book value of approximately \$236,000 were disposed. Net additions and disposals combined with depreciation expense of approximately \$6,061,000 resulted in net capital assets decreasing approximately \$3,983,000 from 2011.
- The Hospital's total assets whose use is limited increased approximately \$3,118,000 as a result of solid operating income and investment returns.
- During 2012, the Hospital entered into agreements to lease the operations of multiple long-term care facilities. As a result of the lease agreements, the Hospital recognized approximately \$30,507,000 of gross patient service revenue related to long-term care.

Using This Annual Report

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

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

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

All of the current year's revenue earned and expenses incurred are accounted for in the Consolidated Statement of Revenues, Expense and Changes in Net Position.

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

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

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 consolidated balance sheet and the consolidated 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 consolidated statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two consolidated statements report the Hospital's net position and changes in it. The Hospital's net position is the difference between assets and liabilities. It is 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. 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.

Table 1 – Consolidated Balance Sheets

The significant change in the Hospital's assets was in current assets which increased approximately \$23,198,000 in 2012 compared to 2011 as a result of additional patient accounts receivable of approximately \$11,949,000 mainly related to long-term care services. Other current assets increased approximately \$6,665,000 over 2011 mainly as a result of other reimbursement receivables related to long-term care. Cash and cash equivalents also increased approximately \$4,944,000 during 2012.

Included in current assets as of December 31, 2012 is the current portion of assets whose use is limited of approximately \$28,500,000 related to the current classification of the Hospital's revenue bonds. As of December 31, 2011, approximately \$28,900,000 of assets whose use was limited was classified in current assets. The noncurrent portion of assets whose use is limited increased approximately \$3,518,000 in 2012 compared to 2011.

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

Current liabilities increased by approximately \$15,114,000. The majority of the increase related to accounts payable which increased approximately \$15,152,000 for the long-term care services.

Long-term liabilities decreased approximately \$26,000 mainly related to payments on the Hospital's capital lease obligations.

Net position increased by approximately \$7,471,000 from 2011 through 2012. The increase relates to a solid operating income driven from operations and investment return.

	2012	2011	Change
Assets			
Current assets	\$ 76,796,012	\$ 53,597,785	\$ 23,198,227
Assets whose use is limited	16,306,405	12,788,903	3,517,502
Capital assets, net	48,514,219	52,497,639	(3,983,420)
Other assets	613,911	786,948	(173,037)
Total assets	<u>\$ 142,230,547</u>	<u>\$ 119,671,275</u>	<u>\$ 22,559,272</u>
Liabilities			
Current liabilities	\$ 51,150,099	\$ 36,035,754	\$ 15,114,345
Long-term debt, net	23,435	49,214	(25,779)
Total liabilities	<u>51,173,534</u>	<u>36,084,968</u>	<u>15,088,566</u>
Net position			
Net investment in capital assets	19,965,004	23,500,965	(3,535,961)
Unrestricted	71,092,009	60,085,342	11,006,667
Total net position	<u>91,057,013</u>	<u>83,586,307</u>	<u>7,470,706</u>
Total liabilities and net position	<u>\$ 142,230,547</u>	<u>\$ 119,671,275</u>	<u>\$ 22,559,272</u>

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

The Hospital's performance in 2012 was solid with a return on equity of 8.2% compared to prior year of (4.5%).

Total operating revenue increased approximately \$52,352,000 as utilization in inpatient and outpatient services increased. Gross patient service revenue from long-term care services was approximately \$30,507,000 in 2012.

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

During 2012, the Hospital's net patient service revenue was enhanced by Indiana Medicaid Municipal Hospital net final Upper Payment Limit payments for State Fiscal Years (SFY) ended June 30, 2010 and 2011 totaling approximately \$516,000 compared to a partial payment for SFY 2011 of \$1,892,000 received in 2011. Medicare and Medicaid Electronic Health Record incentive revenue in the amount of approximately \$2,335,000 was recorded in 2012. The Hospital recorded revenue of approximately \$8,471,000 during 2012 through the new Indiana Hospital Assessment Fee (HAF) Program.

Expenses increased by approximately \$42,568,000 between 2011 and 2012. Salaries, wages and benefits increased approximately \$5,184,000. Long-term care services contributed to the majority of the increases related to total expenses including professional fees and contract services increase of \$22,668,000, facility and equipment leases of \$3,383,000 and supplies and other expenses of \$4,859,000. The HAF Program which started in 2012 increased expense by approximately \$5,982,000 during 2012.

Nonoperating revenues (expenses) increased by approximately \$1,424,000 due to investment income of approximately \$3,189,000 in 2012 compared to \$785,000 in 2011. Interest expense increased approximately \$68,000 from 2011 while other nonoperating revenue decreased \$912,000 due to a capital grant that was received in 2011.

	2012	2011	Change
Operating revenues			
Net patient service revenue	\$ 128,693,509	\$ 78,704,526	\$ 49,988,983
Other operating revenue	4,742,901	2,380,381	2,362,520
Total operating revenues	133,436,410	81,084,907	52,351,503
Operating expenses			
Salaries, wages and benefits	57,237,852	52,053,943	5,183,909
Professional fees and contract services	26,160,545	3,492,523	22,668,022
Supplies	15,250,700	13,151,281	2,099,419
Depreciation and amortization	6,068,830	6,033,858	34,972
Other	23,991,178	11,409,727	12,581,451
Total operating expenses	128,709,105	86,141,332	42,567,773
Operating income (loss)	4,727,305	(5,056,425)	9,783,730
Nonoperating revenues (expense)	2,743,401	1,319,054	1,424,347
Change in net position	7,470,706	(3,737,371)	11,208,077
Net position			
Beginning of year	83,586,307	87,323,678	(3,737,371)
End of year	\$ 91,057,013	\$ 83,586,307	\$ 7,470,706

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

Table 3 – Consolidated Statements of Cash Flows

The final required statement is the consolidated 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?”

Total cash and cash equivalents increased approximately \$8,241,000 in 2012. Operating activities generated cash and cash equivalents of \$7,851,000 during 2012 mainly from strong operating income. Capital and related financing decreased cash and cash equivalents by \$2,971,000 during 2012 mainly as the result of expenditures for property and equipment additions and debt service. Investing activities increased cash and cash equivalents by \$3,361,000.

The following is a summary of cash flows:

Cash Flow Data	2012	2011	Change
From operating activities	\$ 7,851,217	\$ (145,680)	\$ 7,996,897
From capital and related financing activities	(2,970,503)	(5,231,493)	2,260,990
From investing activities	3,360,707	3,537,664	(176,957)
Change in cash and cash equivalents	<u>\$ 8,241,421</u>	<u>\$ (1,839,509)</u>	<u>\$ 10,080,930</u>

Capital Assets and Debt Administration

During 2012, the Hospital invested approximately \$1,114,000 in capital assets net of asset disposals. Capital assets are comprised of the following as of December 31, 2012 and 2011:

	2012	2011	Change
Land	\$ 771,882	\$ 771,882	\$ -0-
Land improvements	2,172,666	2,166,481	6,185
Buildings and improvements	67,311,986	66,499,354	812,632
Equipment	47,889,167	46,246,086	1,643,081
Construction in process	440,022	1,787,615	(1,347,593)
Total	118,585,723	117,471,418	1,114,305
Less accumulated depreciation	70,071,504	64,973,779	5,097,725
Capital assets, net	<u>\$ 48,514,219</u>	<u>\$ 52,497,639</u>	<u>\$ (3,983,420)</u>

DEARBORN COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2012

Debt

The Hospital had no significant changes in debt as there were no new borrowings during 2012. Principal payments reduced the current and noncurrent debt balances by approximately \$447,000 during 2012. More detailed information about the Hospital's debt is presented in the Notes to the Consolidated Financial Statements.

Economic Outlook

Management believes that the health care industry's and the Hospital's operating margins will continue to be under pressure because of changes in payor mix and growth in operating expenses that are in excess of the increases in contractually arranged and legally established payments received for services rendered. Another factor that poses a challenge to management is the increasing competitive market for the delivery of health care services. The ongoing challenge facing the Hospital is to continue to provide quality patient care in this competitive environment, and to attain reasonable rates for the services that are provided while managing costs. The most significant cost factor affecting the Hospital is the increases in labor costs due to the increasing competition for quality health care workers. Uncompensated care is also a significant factor on the Hospital's margin.

Contacting Hospital Management

This financial report is designed to provide our citizens, taxpayers, patients, and other interested parties with a general overview of the Hospital's financial condition. If you have any questions about this report, you may contact the Hospital's Administrative offices at 600 Wilson Creek Road, Lawrenceburg, Indiana 47025.

DEARBORN COUNTY HOSPITAL

CONSOLIDATED BALANCE SHEET DECEMBER 31, 2012

ASSETS

Current assets

Cash and cash equivalents	\$ 11,769,759
Patient accounts receivable, less allowance for uncollectible accounts of \$2,743,000	27,254,684
Inventory	1,312,611
Current portion of assets whose use is limited	28,500,000
Other current assets	<u>7,958,958</u>
Total current assets	76,796,012

Assets whose use is limited

Internally designated, net of current portion	16,306,405
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Capital assets

Land	771,882
Depreciable capital assets	117,373,819
Construction in progress	<u>440,022</u>
	118,585,723
Less accumulated depreciation	<u>70,071,504</u>
Capital assets, net	48,514,219

Other assets

	613,911
Total assets	<u><u>\$ 142,230,547</u></u>

LIABILITIES AND NET POSITION

Current liabilities

Current portion of capital leases	\$ 25,780
Current portion of revenue bonds payable	500,000
Accounts payable	16,304,508
Accrued salaries, wages, and related liabilities	5,153,206
Estimated third-party payor settlements	1,166,605
Revenue bonds payable (see Debt note)	<u>28,000,000</u>
Total current liabilities	51,150,099

Long-term debt, net of current portion

Capital leases	<u>23,435</u>
Total liabilities	51,173,534

Net position

Net investment in capital assets	19,965,004
Unrestricted	<u>71,092,009</u>
Total net position	<u>91,057,013</u>
Total liabilities and net position	<u><u>\$ 142,230,547</u></u>

See accompanying notes to consolidated financial statements.

DEARBORN COUNTY HOSPITAL

CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEAR ENDED DECEMBER 31, 2012

Operating revenues

Net patient service revenue	\$ 128,693,509
Other operating revenue	<u>4,742,901</u>
Total operating revenues	133,436,410

Operating expenses

Salaries and wages	44,102,912
Employee benefits	13,134,940
Professional fees and contract services	26,160,545
Supplies	15,250,700
Insurance	1,074,891
Facility and equipment leases	4,482,181
Utilities	1,634,280
HAF Program	5,981,838
Depreciation and amortization	6,068,830
Other	<u>10,817,988</u>
Total operating expenses	<u>128,709,105</u>

Operating income	4,727,305
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Nonoperating revenues (expenses)

Investment income	3,188,519
Interest expense	(415,286)
Loss on disposal of capital assets	<u>(29,832)</u>
Total nonoperating revenues (expenses)	<u>2,743,401</u>

Change in net position	7,470,706
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Net position

Beginning of year	<u>83,586,307</u>
End of year	<u><u>\$ 91,057,013</u></u>

See accompanying notes to consolidated financial statements.

DEARBORN COUNTY HOSPITAL

CONSOLIDATED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2012

Operating activities

Cash received from patients and third party payors	\$ 117,239,800
Cash paid to employees for salaries and benefits	(57,348,980)
Cash paid to vendors for goods and services	(56,782,504)
Other operating receipts, net	<u>4,742,901</u>
Net cash from operating activities	7,851,217

Capital and related financing activities

Acquisition and construction of capital assets	(2,314,094)
Proceeds from sale of capital assets	206,336
Interest paid on debt	(415,286)
Principal payments on debt	<u>(447,459)</u>
Net cash from capital and related financing activities	(2,970,503)

Investing activities

Investment income	3,188,519
Purchase of investments	(1,844,916)
Proceeds from sale of investments	<u>2,017,104</u>
Net cash from investing activities	<u>3,360,707</u>

Net change in cash and cash equivalents	8,241,421
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Cash and cash equivalents

Beginning of year	<u>15,658,838</u>
End of year	<u><u>\$ 23,900,259</u></u>

Reconciliation of cash and cash equivalents to the balance sheets

Cash and cash equivalents	
In current assets	\$ 11,769,759
In noncurrent assets	<u>12,130,500</u>
Total cash and cash equivalents	<u><u>\$ 23,900,259</u></u>

See accompanying notes to consolidated financial statements.

DEARBORN COUNTY HOSPITAL

CONSOLIDATED STATEMENT OF CASH FLOWS YEAR ENDED DECEMBER 31, 2012

Reconciliation of operating income

to net cash from operating activities

Operating income	\$ 4,727,305
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation and amortization	6,068,830
Provision for bad debts	8,662,985
Changes in assets and liabilities	
Patient accounts receivable	(20,612,097)
Inventory and other current assets	(6,704,868)
Other assets	173,037
Accounts payable and accrued expenses	15,151,750
Accrued salaries, wages, and related liabilities	(111,128)
Estimated third-party payor settlements	495,403
Net cash flows from operating activities	<u>\$ 7,851,217</u>

See accompanying notes to consolidated financial statements.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

1. SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

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

The consolidated financial statements of Hospital are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business-type activities of Dearborn County that is attributable to the transactions of the Hospital and its controlled subsidiaries. They do not purport to, and do not, present fairly the financial position of Dearborn County as of December 31, 2012 and the changes in its financial position or its cash flows for the year then ended.

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

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the blended component unit, Health Services Corporation of Southeastern Indiana (HSC). The Hospital appoints the majority of HSC's board and a financial benefit/burden relationship exists between the Hospital and HSC. Although it is a legally separate from the Hospital, HSC is reported as if it were a part of the Hospital because it provides services entirely or almost entirely to the Hospital. All significant intercompany transactions have been eliminated in the consolidated financial statements.

Long-Term Care Operations

Pursuant to the provision of long-term care, the Hospital owns the operations of twenty-two 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 operation of the facilities are the property of the Hospital and the Hospital is responsible for the associated operating expenses and working capital requirements. While the management and related lease agreements are in effect, the

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

performance of all activities of the Managers shall be on behalf of the Hospital and the Hospital retains the authority and legal responsibility for the operation of the facilities.

During 2012, the Hospital entered into lease agreements with the long-term care facilities, collectively referred to as the Lessors, to lease the facilities managed by the Managers. Concurrently, the Hospital entered into agreements with the Managers to manage the above leased facilities. As part of the agreements, the Hospital pays the Managers a management fee to continue managing the facilities on behalf of the Hospital in accordance with the terms of the agreements. These management fees consist of base management fees, subordinated management fees and incentive management fees. The agreements expire at various times through December 2014. The terms of these agreements may be renewed at the end of each term for an additional period of two years. All parties involved can terminate the agreement without cause with 90 days written notice.

Enterprise Fund Accounting

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

Use of Estimates

The preparation of the consolidated financial statements include only the financial position, results of operations, changes in net position and cash flows of the Hospital in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting Standards

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

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

Also during 2012, the Hospital adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This change resulted in renaming net assets to net position within the consolidated balance sheets and consolidated statements of revenues, expenses and changes in net position. GASB No. 63 has been applied retrospectively in the accompanying consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less. 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. 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). Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Hospital's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. These programs have audited the year-end cost report filed with the Medicare program through December 31, 2008 with differences reflected as deductions from revenue in the year the cost report is settled. Amounts for unresolved cost reports for 2009 through 2012 are reflected in estimated third-party settlements on the consolidated balance sheets. During 2012, the Hospital did not final settle any cost reports. Therefore, the Hospital did not recognize a change in the consolidated statements of revenues, expenses and changes in net position in 2012, due to differences between original estimates and subsequent revisions for the final settlement of cost reports. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

The Hospital has entered into agreements with certain commercial carriers. Reimbursement for services under these agreements includes discounts from established charges and other payment methodologies. Patient charges under these programs, on which no interim payments have been received, are included in patient accounts receivable at the estimated net realizable value of such charges.

DEARBORN COUNTY HOSPITAL

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Management estimates an allowance for uncollectible patient accounts receivable based on an evaluation of historical losses, current economic conditions, and other factors unique to the Hospital's customer base.

Inventory

Inventory is valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method. Inventory consists of medical supplies and pharmaceuticals.

Other Current Assets

Other current assets consist of prepaid expenses, other reimbursement receivables related to long-term care services and various other current items. These assets are classified as current as they are expected to be utilized during 2013.

Assets Whose Use is Limited – Internally Designated

Assets whose use is limited are stated at fair market value in the consolidated financial statements. These assets include investments designated by the Hospital Board for internal purposes. These investments consist primarily of cash and cash equivalents, certificates of deposit and mutual funds. Investment interest, dividends, gains and losses, both realized and unrealized are included in nonoperating revenues (expenses) in the consolidated statement of revenues, expenses and changes in net position. Nonparticipating certificates of deposit, demand deposits and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at contract value.

Capital Assets and Depreciation

Capital assets, which include land, land improvements, buildings and improvements, and equipment, are reported at historical cost. Contributed or donated assets are reported at estimated fair value at the time received. Capital assets under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements.

The capitalization threshold (the dollar values above which asset acquisitions are added to the capital asset accounts) is \$2,500 per item, or a group of items with an aggregate cost of at least \$5,000. Depreciation is calculated on the straight-line method over the estimated useful lives of capital assets which range from 3-40 years. For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. No interest cost was capitalized during 2012.

Bond Issue Costs

The Hospital provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs were approximately \$150,000, net of accumulated amortization as of December 31, 2012. Amortization expense for the next five succeeding years should approximate \$6,500 per year. Bond issue costs are recorded in other assets on the consolidated balance sheets.

Net Position

The net position of the Hospital is classified into two components as stated below.

Net investment in capital assets represents 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.

Unrestricted net position is the remaining assets that do not meet the definition of net investment in capital assets or restricted.

Operating Revenues and Expenses

The Hospital's consolidated statement of revenues, expenses 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, the Hospital's principal activity. Nonoperating revenues include contributions received for purposes other than capital asset acquisition, and other nonoperating activities and are reported as nonoperating revenues or expenses. Operating expenses are generally all expenses incurred to provide health care services, other than financing costs.

Grants and Contributions

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

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

restricted to a specific operating purpose are reported as nonoperating revenues. Amounts, if any, restricted to capital acquisitions are reported as nonoperating revenues and expenses.

Electronic Health Records (EHR) Incentive Payments

The Hospital receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, the Hospital must meet "meaningful use" criteria that become more stringent over time. The Hospital periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30).

The payment calculation is based upon an initial amount as adjusted for discharges, Medicare and Medicaid utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as other operating revenue when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific contract requirements. In addition, the consolidated financial statement effects of the revenue must be both recognizable and measurable. During 2012, the Hospital recognized approximately \$2,335,000 in EHR incentive payments as other operating revenue using the ratable recognition method. Under the ratable recognition method, the Hospital recognizes revenue ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

EHR incentive revenue is included in other operating revenue in the consolidated statement of revenues, expenses and changes in net position. EHR incentive income recognized is based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

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 reported of approximately \$128,709,000, an estimated \$1,205,000 arose from providing services to charity patients. 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 including interest expense divided by gross patient service revenue.

Advertising Costs

The Hospital expenses advertising costs as they are incurred. Advertising expense for 2012 was approximately \$183,000.

Compensated Absences

The Hospital's employees earn time off at varying rates depending on years of service under separate policies for sick, vacation and personal leaves. The estimated amount of unused time off is reported as a liability within the accrued salaries, wages and related liabilities on the consolidated balance sheet.

Federal or State Income Taxes

The Hospital is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The Hospital is generally exempt from federal income tax under Section 115 of the Internal Revenue Code (IRC) of 1986. As a governmental entity under Section 115 of the IRC, the Hospital is not required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

HSC is a tax-exempt organization under Internal Revenue Code 501(c)(3). As such, HSC is generally exempt from income taxes. However, HSC 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.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

Management has analyzed the tax positions taken by the Hospital and has concluded that as of December 31, 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements.

HSC has filed its federal and state income tax returns for periods through December 31, 2011. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions). HSC is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

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

Subsequent Events

The Hospital evaluated events or transactions occurring subsequent to the consolidated balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued which is May 16, 2013.

2. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited include:

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

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

The composition of assets whose use is limited includes the following as of December 31, 2012:

Internally designated	
Cash and cash equivalents	\$ 12,130,500
Certificates of deposit	1,755,240
Mutual funds	<u>30,920,665</u>
Total internally designated	44,806,405
Less current portion	<u>28,500,000</u>
	<u><u>\$ 16,306,405</u></u>

The current portion of assets whose use is limited reflects the current scheduled principal payments on the revenue bonds and the classification as current of the remaining portion of the revenue bonds due to the letter of credit terms. See the Debt note for further information.

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 (assets whose use is limited) are carried at fair market value except for certificates of deposit and money market funds which are carried at contract value. Net realized gains and losses on security transactions are determined on the specific identification cost basis.

As of December 31, 2012, the Hospital had the following investments and maturities, all of which were held in the Hospital's name by custodial banks that are agents of the Hospital.

Investment Maturities (in years)					
	Carrying Amount	Less than 1	1-5	6-10	More than 10
Certificates of deposit	\$ 1,755,240	\$ 1,755,240	\$ -0-	\$ -0-	\$ -0-
Mutual funds	30,920,665	30,920,665	-0-	-0-	-0-
	<u>\$32,675,905</u>	<u>\$32,675,905</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

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.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

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 a limit on the amount it may invest in any one issuer. The Hospital believes that it is not exposed to any significant credit risk on investments.

Deposits consist of the following as of December 31:

Carrying amount	
Deposits	\$ 23,900,259
Investments	32,675,905
	<u>\$ 56,576,164</u>
Included in the balance sheet captions	
Cash and cash equivalents	\$ 11,769,759
Assets whose use is limited - internally designated	
Current	28,500,000
Non current	16,306,405
	<u>\$ 56,576,164</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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

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

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

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

- *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.

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, 2012.

	Total	Level 1	Level 2	Level 3
Assets				
Assets whose use is limited				
Mutual funds				
Fixed income	\$ 18,346,582	\$ 18,346,582	\$ -0-	\$ -0-
Small cap growth	1,122,160	1,122,160	-0-	-0-
Small cap value	1,927,083	1,927,083	-0-	-0-
Mid cap growth	723,067	723,067	-0-	-0-
Large cap blended	4,812,636	4,812,636	-0-	-0-
Growth and income	3,569,276	3,569,276	-0-	-0-
International growth	419,861	419,861	-0-	-0-
Total mutual funds	30,920,665	<u>\$ 30,920,665</u>	<u>\$ -0-</u>	<u>\$ -0-</u>
Cash and equivalents	12,130,500			
Certificates of deposit	1,755,240			
Total assets whose use is limited	<u>\$ 44,806,405</u>			

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

Realized gains of \$-0- and unrealized gains of approximately \$1,798,000 are reported in the consolidated statements of revenues, expenses and changes in net position as components of investment income. Approximately \$1,726,000 of the unrealized gains is attributable to assets held as of December 31, 2012.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

The Hospital holds investments which are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying consolidated financial statements.

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

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

Debt: The carrying value of the Hospital's variable rate revenue bonds approximates fair value based upon current traded value. The carrying value of capital lease obligations approximates fair value based on current fixed rates available to similar entities with similar credit ratings.

5. ACCOUNTS RECEIVABLE AND PAYABLE

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at year-end consisted of the following amounts as of December 31, 2012:

Patient accounts receivable	
Receivable from patients and their insurance carriers	\$ 20,257,325
Receivable from Medicare	15,987,164
Receivable from Medicaid	<u>9,759,411</u>
Total patient accounts receivable	46,003,900
Less allowance for contractual agreements	16,006,502
Less allowance for uncollectible amounts	<u>2,742,714</u>
Patient accounts receivable, net	<u><u>\$ 27,254,684</u></u>
Accounts payable and accrued expenses	
Payable to suppliers and others	\$ 16,304,508
Payable to employees and related liabilities	<u>5,153,206</u>
Total accounts payable and accrued expenses	<u><u>\$ 21,457,714</u></u>

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

6. CAPITAL ASSETS

Capital asset activity for 2012 is as follows:

	Balance December 31, 2011	Additions	Retirements	Transfers	Balance December 31, 2012
Land	\$ 771,882	\$ -0-	\$ -0-	\$ -0-	\$ 771,882
Land improvements	2,166,481	-0-	-0-	6,185	2,172,666
Buildings and improvements	66,499,354	101,637	(244,604)	955,599	67,311,986
Equipment	46,246,086	1,579,827	(955,185)	1,018,439	47,889,167
Construction in process	1,787,615	632,630	-0-	(1,980,223)	440,022
Total capital assets	117,471,418	2,314,094	(1,199,789)	-0-	118,585,723
Less accumulated depreciation	64,973,779	6,061,346	(963,621)	-0-	70,071,504
Capital assets, net	<u>\$ 52,497,639</u>	<u>\$ (3,747,252)</u>	<u>\$ (236,168)</u>	<u>\$ -0-</u>	<u>\$ 48,514,219</u>

There were no significant outstanding commitments on capital assets as of December 31, 2012.

7. DEBT

Indiana Finance Authority Hospital Revenue Bonds, Series 2006 original issue for \$30,000,000 were issued during 2006 for various building additions, improvements and renovations. The Series 2006 Bonds have a variable interest rate (0.16% as of December 31, 2012) and mature April 1, 2036. The Series 2006 Bonds are secured ultimately by the gross revenues of the Hospital.

The Hospital has an available letter of credit for approximately \$29,000,000 with a financial institution for the Series 2006 Bonds. The letter of credit is collateralized by the Hospital's gross revenues and expires in March 2014. There was no balance outstanding on the letter of credit as of December 31, 2012. The debt agreements require the Hospital to maintain certain financial ratios and restrictive covenants. As of December 31, 2012, the Hospital was in compliance with the financial ratios and restrictive covenants.

The letter of credit is intended to provide credit enhancement and liquidity support for the Hospital's tax-exempt bonds. In the event the Series 2006 Bonds are not remarketed, the financial institution will advance a liquidity drawing on the letter of credit. The Hospital will reimburse the financial institution for the liquidity drawing at the date of when the 2006 Series Bonds are remarketed, redeemed or purchased, but no later than 180 days after the liquidity drawing. Accounting principles generally accepted in the United States of America require long-term debt backed by a letter of credit to be reported as current if the letter of credit does not provide a long-term financing option for liquidity drawings. Therefore, the schedule principal repayments on the Series 2006 Bonds for 2014 through 2036 of \$28,000,000 are classified as current on the consolidated balance sheet as of December 31, 2012.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

Capital lease obligations with interest rates ranging from 8% to 10% executed for property and equipment and are due at various times through 2015. Amounts are due in monthly installments ranging from approximately \$400 to \$1,900, including interest and are collateralized by equipment with a net book value of approximately \$46,000.

A progression of the Hospital's debt follows:

	Balance December 31, 2011	Additions	Payments	Balance December 31, 2012	Current portion
Revenue bonds payable	\$ 28,900,000	\$ -0-	\$ (400,000)	\$ 28,500,000	\$ 500,000
Capital leases	96,674	-0-	(47,459)	49,215	25,780
Total debt	<u>\$ 28,996,674</u>	<u>\$ -0-</u>	<u>\$ (447,459)</u>	<u>\$ 28,549,215</u>	<u>\$ 525,780</u>

The current portion of the revenue bonds payable reflects only the scheduled principal payments for 2013 and not the portion of the revenue bonds payable classified as current due to the letter of credit liquidity drawing requirements. Scheduled principal and interest payments on the Series 2006 Bonds are as follows:

Year ending December 31,	Principal	Interest	Total
2013	\$ 500,000	\$ 46,204	\$ 546,204
2014	500,000	45,394	545,394
2015	500,000	44,583	544,583
2016	600,000	43,772	643,772
2017	600,000	42,800	642,800
2018-2022	3,900,000	197,300	4,097,300
2023-2027	5,600,000	160,661	5,760,661
2028-2032	7,800,000	108,945	7,908,945
2033-2036	8,500,000	35,829	8,535,829
	<u>\$ 28,500,000</u>	<u>\$ 725,488</u>	<u>\$ 29,225,488</u>

Scheduled principal and interest payments on capital lease obligations are as follows:

Year ending December 31,	Principal	Interest	Total
2013	\$ 25,780	\$ 3,024	\$ 28,804
2014	21,715	1,010	22,725
2015	1,720	11	1,731
	<u>\$ 49,215</u>	<u>\$ 4,045</u>	<u>\$ 53,260</u>

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

The following is an analysis of the leased assets included in property and equipment as of December 31, 2012:

Equipment	\$ 184,374
Accumulated depreciation	<u>138,623</u>
	<u>\$ 45,751</u>

8. PATIENT SERVICE REVENUE

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

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment Hospital). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The Hospital's classification of patients under the Prospective Payment Hospital and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the Hospital to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid and the Indiana Hospital Assessment Fee Program

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

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

During 2012, Indiana Hospital Assessment Fee (HAF) Program was approved by the Centers for Medicare & Medicaid Services. 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. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates.

During 2012, the Hospital recognized HAF Program expense of approximately \$5,982,000 which resulted in Medicaid rate increases of approximately \$8,471,000. The HAF Program expense is included in expenses in the consolidated statements of revenues, expenses and changes in net position. The Medicaid rate increases under the HAF Program are included in patient service revenue in the consolidated statements of revenues, expenses and changes in net position.

As a governmental entity, the Hospital is also eligible for the Indiana Medicaid Supplemental programs including Medicaid DSH and Municipal Hospital Upper Payment Limit programs. The Hospital recognized reimbursement from these programs within net patient revenue of approximately \$516,000 during 2012. These programs are administered by the State of Indiana, but rely on Federal funding.

Other Payors

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

Inpatient services	\$ 66,716,023
Outpatient services	140,763,524
Long-term care services	<u>30,507,353</u>
Gross patient service revenue	237,986,900
Contractual allowances	98,402,310
Charity care	2,228,096
Bad debt	<u>8,662,985</u>
Deductions from revenue	<u>109,293,391</u>
Net patient service revenue	<u><u>\$ 128,693,509</u></u>

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

9. EMPLOYEE HEALTH AND DENTAL BENEFITS

The Hospital is self-insured for employee health and dental claims. 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 (IBNR). Claim liabilities are calculated considering the effect of inflation, recent claim settlement trends, including frequency and amounts of payouts, and other economic and social factors. An excess policy through commercial insurance covers individual claims in excess of \$250,000 per year with an overall aggregate of approximately \$1,500,000. Health and dental insurance expense 2012 was approximately \$7,815,000.

Changes in the balance of claim liabilities are as follows:

Unpaid claims, beginning of year	\$ 1,050,000
Incurred claims and changes in estimates	7,815,444
Claim payments	<u>(7,765,444)</u>
Unpaid claims, end of year	<u>\$ 1,100,000</u>

10. MEDICAL MALPRACTICE

The Indiana Medical Malpractice Act (the Act) provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) for professional liability, \$250,000 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 Hospital is insured against medical malpractice claims under an occurrence-basis policy, whereby claims resulting from incidents that occur during the policy term, regardless of when the claims are reported to the insurance carrier are covered. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding \$250,000 or aggregate claims exceeding \$5,000,000, for claims asserted in the policy year. In addition, the Hospital has an umbrella policy with an additional \$5,000,000 of coverage.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

11. CONCENTRATIONS OF CREDIT RISK

The Hospital is primarily located in Lawrenceburg, 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 mix of gross patient accounts receivable and gross patient revenues from self-pay and third party payors as of and for the year ended December 31, 2012 was as follows:

	<u>Receivables</u>	<u>Revenue</u>
Medicare and Medicaid	56%	57%
Blue Cross	9%	17%
Commercial and other payors	25%	19%
Self-pay payors	10%	7%
	<u>100%</u>	<u>100%</u>

12. PENSION PLANS

Defined Benefit Pension Plan

The Hospital has a defined benefit pension plan administered by Wells Fargo as authorized by IC 16-22-3-11. The Plan provides retirement, disability and death benefits to Plan members and beneficiaries. The Plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the Plan.

The contribution requirements of plan members are established and can be amended by the Hospital Board of Trustees. The Hospital is required to contribute at an actuarially determined rate. The current rate is four percent of covered payroll.

For 2012, the Hospital's annual pension cost of approximately \$1,509,000 was equal to the Hospital's required and actual contributions.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

Actuarial information for the defined benefit pension plan is as follows:

Annual required contribution	\$ 1,508,887
Interest on net pension obligation	-0-
Adjustment to annual required contribution	-0-
Annual pension cost	1,508,887
Contributions made	(1,508,887)
Change in net pension obligation	-0-
Net pension obligation	
Beginning of year	-0-
End of year	\$ -0-

Contribution rate:

Hospital	4.17%
Eligible employees	0.00%
Actuarial valuation date	11/1/2011
Actuarial cost method	Frozen entry age
Amortization method	Level dollar amount
Amortization period	Various years ranging from 10-30: minimum contribution amount is interest only on unfunded liability
Amortization period (from date)	N/A
Asset valuation method	5 year expected return
Actuarial assumptions:	
Investment rate of return	7.50%
Projected future salary increases	4.50%

Three Year Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2010	\$ 1,402,407	100%	\$ -0-
2011	\$ 1,511,254	100%	\$ -0-
2012	\$ 1,508,887	100%	\$ -0-

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

The funded status of the plan as of November 1, 2011, the most recent actuarial valuation date, is as follows:

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (a-b)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded AAL as a Percentage of Covered Payroll ((a-b)/c)
\$ 23,030,319	\$ 30,298,422	\$ 7,268,103	76%	\$ 36,220,786	20%

The schedule of funding progress below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (a-b)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded AAL as a Percentage of Covered Payroll ((a-b)/c)
11/1/2009	\$ 20,838,619	\$ 27,737,305	\$ 6,898,686	75%	\$ 37,812,790	18%
11/1/2010	\$ 21,898,927	\$ 28,837,043	\$ 6,938,116	76%	\$ 37,813,590	18%
11/1/2011	\$ 23,030,319	\$ 30,298,422	\$ 7,268,103	76%	\$ 36,220,786	20%

Defined Contribution Pension Plans

The Hospital and HSC maintain defined contribution plans administered by Lincoln Financial Group. These plans provide retirement benefits to plan members and beneficiaries. Reports for these plans are available by contacting the Hospital's human resources department.

The contribution requirements of members of the plans are established and can be amended by written agreement. Eligible employees are not required to contribute to these plans. The Hospital and HSC can elect discretionary contributions to the plans as determined by the Board of Trustees. The Hospital and HSC did not elect discretionary contributions for 2012. Therefore, the Hospital did not recognize expense in 2012 for these plans.

13. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Hospital has entered into various operating leases expiring through 2017 having initial or remaining noncancelable terms exceeding one year for rental of office space. Rental expenditures for these leases were approximately \$700,000 for 2012.

DEARBORN COUNTY HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012

The following is a schedule of annual future minimum rental payments.

<u>Year Ending December 31,</u>	<u>Amount</u>
2013	\$ 658,000
2014	549,000
2015	456,000
2016	402,000
2017	307,000
	<u>\$ 2,372,000</u>

14. BLENDED COMPONENT UNIT

The Hospital's consolidated financial statements include the accounts of HSC, its blended component. Below is condensed financial information of HSC as of and for the year ended December 31, 2012:

Assets	
Current assets	\$ 2,239,248
Capital assets	5,678,502
Other assets	288,047
Total assets	<u>\$ 8,205,797</u>
Liabilities	
Accounts payable and accrued expenses	\$ 8,205,797
Net position	
Net investment in capital assets	5,678,502
Unrestricted	(5,678,502)
Total net position	-0-
Total liabilities and net position	<u>\$ 8,205,797</u>
Operating revenues (patient and other)	\$ 16,669,579
Operating expenses	
Depreciation	441,346
Other expenses	16,237,938
Total expenses	<u>16,679,284</u>
Operating loss	(9,705)
Nonoperating revenues, net	9,705
Change in net position	<u>\$ -0-</u>

SUPPLEMENTARY INFORMATION

DEARBORN COUNTY HOSPITAL

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2012

	Hospital	HSC	Eliminations	Total
ASSETS				
Current assets				
Cash and cash equivalents	\$ 11,372,713	\$ 397,046	\$ -0-	\$ 11,769,759
Patient accounts receivable, net	25,666,076	1,588,608	-0-	27,254,684
Inventory	1,312,611	-0-	-0-	1,312,611
Current portion of assets whose use is limited	28,500,000	-0-	-0-	28,500,000
Other current assets	9,007,503	253,594	(1,302,139)	7,958,958
Total current assets	75,858,903	2,239,248	(1,302,139)	76,796,012
Assets whose use is limited				
Internally designated, net of current portion	16,306,405	-0-	-0-	16,306,405
Capital assets				
Land	75,208	696,674	-0-	771,882
Depreciable capital assets	109,733,259	7,640,560	-0-	117,373,819
Construction in progress	440,022	-0-	-0-	440,022
	110,248,489	8,337,234	-0-	118,585,723
Less accumulated depreciation	67,412,772	2,658,732	-0-	70,071,504
Capital assets, net	42,835,717	5,678,502	-0-	48,514,219
Other assets	8,041,451	288,047	(7,715,587)	613,911
Total assets	<u>\$ 143,042,476</u>	<u>\$ 8,205,797</u>	<u>\$ (9,017,726)</u>	<u>\$ 142,230,547</u>
LIABILITIES AND NET POSITION				
Current liabilities				
Current portion of capital leases	\$ 25,780	\$ -0-	\$ -0-	\$ 25,780
Current portion of long-term debt	500,000	-0-	-0-	500,000
Accounts payable	17,578,184	7,744,050	(9,017,726)	16,304,508
Accrued salaries, wages, and related liabilities	4,691,459	461,747	-0-	5,153,206
Estimated third-party payor settlements	1,166,605	-0-	-0-	1,166,605
Revenue bonds payable (see Debt note)	28,000,000	-0-	-0-	28,000,000
Total current liabilities	51,962,028	8,205,797	(9,017,726)	51,150,099
Long-term debt, net of current portion				
Capital leases	23,435	-0-	-0-	23,435
Total liabilities	51,985,463	8,205,797	(9,017,726)	51,173,534
Net position				
Net investment in capital assets	14,286,502	5,678,502	-0-	19,965,004
Unrestricted	76,770,511	(5,678,502)	-0-	71,092,009
Total net position	91,057,013	-0-	-0-	91,057,013
Total liabilities and net position	<u>\$ 143,042,476</u>	<u>\$ 8,205,797</u>	<u>\$ (9,017,726)</u>	<u>\$ 142,230,547</u>

See report of independent auditors on pages 1 and 2.

DEARBORN COUNTY HOSPITAL

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEAR ENDED DECEMBER 31, 2012

	Hospital	HSC	Eliminations	Total
Operating revenues				
Net patient service revenue	\$ 115,924,340	\$ 12,769,169	\$ -0-	\$ 128,693,509
Other operating revenue	4,614,491	3,900,410	(3,772,000)	4,742,901
Total operating revenues	120,538,831	16,669,579	(3,772,000)	133,436,410
Operating expenses				
Salaries and wages	32,784,206	11,318,706	-0-	44,102,912
Employee benefits	11,257,991	1,876,949	-0-	13,134,940
Professional fees and contract services	25,843,051	317,494	-0-	26,160,545
Supplies	14,239,535	1,011,165	-0-	15,250,700
Insurance	705,565	369,326	-0-	1,074,891
Facility and equipment leases	3,663,763	818,418	-0-	4,482,181
Utilities	1,422,845	211,435	-0-	1,634,280
HAF Program	5,981,838	-0-	-0-	5,981,838
Depreciation and amortization	5,627,484	441,346	-0-	6,068,830
Other	14,275,543	314,445	(3,772,000)	10,817,988
Total operating expenses	115,801,821	16,679,284	(3,772,000)	128,709,105
Operating income (loss)	4,737,010	(9,705)	-0-	4,727,305
Nonoperating revenues (expenses)				
Investment income	3,157,983	30,536	-0-	3,188,519
Interest expense	(415,286)	-0-	-0-	(415,286)
Loss on disposal of capital assets	(9,001)	(20,831)	-0-	(29,832)
Total nonoperating revenues (expenses)	2,733,696	9,705	-0-	2,743,401
Change in net position	7,470,706	-0-	-0-	7,470,706
Net position				
Beginning of year	83,586,307	-0-	-0-	83,586,307
End of year	<u>\$ 91,057,013</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 91,057,013</u>

See report of independent auditors on pages 1 and 2.