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July 9, 2013

Board of Directors
Johnson Memorial Hospital
1125 W. Jefferson Street
P.O. Box 549
Franklin, IN 46131

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 Johnson Memorial 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
REQUIRED SUPPLEMENTARY INFORMATION
DECEMBER 31, 2012 AND 2011

CPAs / ADVISORS



JOHNSON MEMORIAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Johnson Memorial Hospital
Franklin, Indiana

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Johnson Memorial Hospital (the Hospital), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of revenues, expenses 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 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 audits 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 Hospital'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 Hospital's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

Board of Trustees
Johnson Memorial Hospital
Franklin, Indiana

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2012 and 2011, and its results of operations, changes in net position and 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
April 23, 2013

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

This section of Johnson Memorial Hospital's (the Hospital) annual consolidated financial statements presents background information and management's discussion and analysis of the Hospital's financial performance during the year ended December 31, 2012. This MD&A includes a discussion and analysis of the activities and results of Johnson Memorial Hospital Foundation, Inc., a blended component unit of the Hospital.

This MD&A should be read together with the consolidated financial statements included in this report.

FINANCIAL HIGHLIGHTS

- The Hospital's net position increased by \$5.2 million, and includes operating income of \$4.6 million in 2012.
- The Hospital's total net operating revenue increased significantly with the addition of long term care revenue to \$120.1 million compared to \$77.0 million in 2011 while expenses increased by 53% to \$115.5 million. The resulting income from operations of \$4.6 million represents an increase of \$2.9 million compared to 2011.
- The Hospital's net non-operating revenue (expense) increased from a net expense of \$575,000 in 2011 to a net revenue of \$554,000 in 2012 due mainly to stronger market performance on investments, increased interest income on cash equivalent investments; as well as a decrease in interest expense related to reduction of debt for scheduled principal payments and capitalized interest on construction projects including the Medical Office Building and the JMH Surgery Center.

FINANCIAL STATEMENTS

The Hospital's consolidated financial statements consist of three statements - a Balance Sheet; a Statement of Revenues, Expenses and Changes in Net Position and a Statement of Cash Flows. The Balance Sheet includes all of the Hospital's assets and liabilities, including assets held by the Hospital but designated for specific purposes by contributors, grantors, or enabling legislation. The Balance Sheet provides a basis for computing rate of return, evaluating the capital structure of the Hospital, and assessing the liquidity and financial flexibility of the Hospital. The Statement of Revenues, Expenses and Changes in Net Position includes all revenues and expenses of the Hospital. This statement measures the financial results of the Hospital's operations and presents revenue earned and expenses incurred. The Statement of Cash Flows provides information about the Hospital's cash flows from operating activities, capital and related financing activities, and investing activities, and provides information on the sources and uses of cash during the year.

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

FINANCIAL ANALYSIS

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 revenues and expenses report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all designated and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes therein. 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. 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.

A summary of the Hospital's Consolidated Balance Sheets as of December 31, 2012, 2011 and 2010 is presented below (in thousands):

	2012	2011	2012 - 2011 Change	2010
Cash and investments	\$ 31,820	\$ 36,217	\$ (4,397)	\$ 36,694
Capital assets	47,747	43,318	4,429	39,709
Other assets	27,737	15,926	11,811	17,611
Total assets	<u>\$ 107,304</u>	<u>\$ 95,461</u>	<u>\$ 11,843</u>	<u>\$ 94,014</u>
Current and other liabilities	\$ 15,537	\$ 8,070	\$ 7,467	\$ 7,331
Long term debt	1,170	1,973	(803)	2,386
Total liabilities	16,707	10,043	6,664	9,717
Net position				
Invested in capital assets, net of related debt	45,778	40,567	5,211	36,626
Designated	21,210	23,070	(1,860)	26,367
Unrestricted	23,609	21,781	1,828	21,304
Total net position	<u>90,597</u>	<u>85,418</u>	<u>5,179</u>	<u>84,297</u>
Total liabilities and net position	<u>\$ 107,304</u>	<u>\$ 95,461</u>	<u>\$ 11,843</u>	<u>\$ 94,014</u>

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

As displayed above, total net position increased to \$90.6 million in 2012, up from \$85.4 million in 2011. The change in net position resulted primarily from operating gains and investment income. Investment income in 2012 was considerably higher than in 2011 due to a relatively stronger year in the Hospital's investment performance and to the Hospital's conservative approach in its investment strategy during 2012.

A summary of the Hospital's Consolidated Statements of Revenues, Expenses and Changes in Net Position for 2010 through 2012 is presented below (in thousands):

	2012	2011	2012 - 2011 Change	2010
Revenue				
Net patient service revenue	\$ 109,254	\$ 67,211	\$ 42,043	\$ 67,433
Other	10,846	9,788	1,058	9,627
Total revenue	120,100	76,999	43,101	77,060
Expenses				
Salary and benefits	45,557	42,162	3,395	41,324
Purchased services and other	65,523	28,951	36,572	30,645
Depreciation and amortization	4,396	4,189	207	4,241
Total operating expenses	115,476	75,302	40,174	76,210
Operating income	4,624	1,697	2,927	850
Non-operating revenue (expense)	554	(575)	1,129	337
Change in net position	\$ 5,178	\$ 1,122	\$ 4,056	\$ 1,187

OPERATING AND FINANCIAL PERFORMANCE

Acute care services

Overall, the Hospital's financial performance in 2012 was stronger than 2011. This section discusses highlights of 2012 related to the Hospital's acute care operations:

(a) Revenue

- Net patient revenues decreased by 1.0% in 2012 compared to 2011. Hospital outpatient revenues were 0.3% greater than 2011 while inpatient revenues were nearly 15% lower. When considering an overall rate increase, inpatient revenues remained compressed due to several factors: (a) the continued suppressed economy; (b) the continuing shift in the delivery of inpatient medical care to the observation/outpatient/physician practice setting coupled with a lower number of

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

patient days; and, (c) the impact of losing a key surgical specialist during 2011. Outpatient revenues, factoring in an overall rate increase, were essentially flat from the previous year. Deductions from revenue for contractual allowances and bad debts decreased 5.9% in 2012 offsetting the inpatient and outpatient changes.

- Acute inpatient volume, as measured in terms of admissions, decreased to 2,098 in 2012 from 2,474 in 2011, or 15.2%.
- Rehabilitation volume, as measured in terms of admissions, decreased to 165 in 2012 from 198 in 2011, or 16.7%.
- Outpatient volumes were relatively flat. Gross outpatient charges increased by 0.3% over 2011.
- Excluded from net patient revenue are charges for patient services waived under the Hospital's charity policy. Charity care represents unreimbursed charges incurred by the Hospital in providing uncompensated care to indigent patients. Based on established rates, gross charges of \$6.2 million were waived in 2012 compared to \$6.6 million in 2011. These amounts represent a relatively consistent write-off percent of gross patient charges between the two years with 2012 (3.6%) slightly more favorable than 2011 (3.7%).

(b) Expenses

- Total operating expenses increased \$4 million or 5.0% in 2012 mainly related to the Hospital Assessment Fee Program through the State of Indiana which started in 2012.
- Employee labor and benefit expenses (including contract labor) increased \$1.6 million or 3.5% over 2011. This is mostly attributable to the cost-of-living increase granted to staff in 2012.
- Provision for bad debt increased \$676,000 or 12.5% over 2011. This amount represented 3.5% of gross patient charges compared to 3.0% the previous year. The combined charity care/bad debt write-offs as a percent of Hospital gross patient revenues increased from 6.7% in 2011 to 7.0% in 2012.
- Depreciation and amortization expenses increased \$207,000 or 4.9% in 2012 over 2011 consistent with the increase in capital assets in 2012.

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

Long term care services

During 2012, the Hospital entered into agreements to lease the operations of multiple long term care facilities. The revenues generated under these agreements increased patient service revenue by \$39 million. Expenses related to long term care increased by a similar amount mainly related to purchased services (\$26 million) and facility and equipment lease (\$4 million). Management and other expenses comprise the balance of long term care expenses.

STATEMENTS 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?" A summary of cash flows for 2010 through 2012 follows (in thousands):

	2012	2011	2012 - 2011 Change	2010
Cash flow from activities				
Operating	\$ 4,625	\$ 8,043	\$ (3,418)	\$ 4,519
Capital and related financing	(9,765)	(8,628)	(1,137)	(5,739)
Investing	(1,951)	9,457	(11,408)	11,103
Change in cash equivalents	<u>\$ (7,091)</u>	<u>\$ 8,872</u>	<u>\$ (15,963)</u>	<u>\$ 9,883</u>

Total cash and cash equivalents decreased by \$7.1 million from 2011 to 2012. Operating activities provided cash and cash equivalents of \$4.6 million during 2012. Capital and related financing activities used cash and cash equivalents of \$9.8 million during 2012 mainly as the result of property and equipment additions related to the Surgery Center project combined with principal payments on long term debt. The Hospital's capital related activities show that funds were not borrowed to finance the Surgery expansion project that began in 2011. Investing activities decreased cash and cash equivalents by \$2.0 million. This is mainly the result of reduced proceeds from the sale of investments that were used for construction and capital assets.

SOURCES OF REVENUE

During 2012, the Hospital derived substantially all of its revenue from patient services 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.

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

The table below presents the percentages of gross revenue for patient services, by payor, for 2012 and 2011.

<u>Payor Mix</u>	<u>2012</u>	<u>2011</u>
Medicare	44%	45%
Medicaid	9%	10%
Blue Cross/Anthem	17%	17%
Commercial insurance	20%	19%
Self-pay	9%	8%
Other	1%	1%
Total	<u>100%</u>	<u>100%</u>

The Hospital entered into agreements with third party payers, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates or discounts from gross charges. Provisions have been made in the financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment.

CAPITAL ASSETS

During 2012, the Hospital's capital assets increased by \$8.7 million due to capital additions and construction in progress outpacing depreciation. This is mostly driven by the new Surgery Center expansion project. The below table summarizes the broad categories (in thousands):

	<u>2012</u>	<u>2011</u>	<u>2012-2011</u> <u>Change</u>	<u>2010</u>
Land and improvements	\$ 4,697	\$ 4,630	\$ 67	\$ 4,604
Buildings and improvements	65,681	55,311	10,370	56,480
Equipment	45,044	41,788	3,256	40,370
Construction in progress	1,898	6,874	(4,976)	1,750
Total capital assets	117,320	108,603	8,717	103,204
Accumulated depreciation	69,573	65,284	4,289	63,494
Capital assets - net	<u>\$ 47,747</u>	<u>\$ 43,319</u>	<u>\$ 4,428</u>	<u>\$ 39,710</u>

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

LONG TERM DEBT

As of December 31, 2012, the Hospital had \$1.97 million in current and long term debt, a decrease of \$780,000 from the \$2.75 million as of December 31, 2011. More detailed information about the Hospital's debt position is presented in the Notes to the Consolidated Financial Statements.

ECONOMIC FACTORS AND 2013 BUDGET

The Hospital's Board and management considered many factors when establishing the 2013 Budget. Factors considered include, among other things, the following items:

- Population growth trends of Johnson County, Indiana and the Hospital's current market share of county residents,
- Expansion of the surgical suite area to include advances in medical equipment and technology. Also considered was the need to replace obsolete equipment and improve the IT infrastructure and electronic health record capability in order to meet Federal criteria under the Medicare and Medicaid Healthcare IT incentive programs,
- Decreasing reimbursement from governmental and commercial insurance payers as well as the continued unfavorable governmental payer mix the Hospital is experiencing,
- Hospital Assessment Fee Program,
- Long term care operations and management contracts,
- Continued high number of uninsured, underinsured and/or indigent patients,
- Increasing costs of physician practices and related technology, medical supplies, and pharmaceuticals,
- Increasing emphasis on clinical, administrative and financial collaborations with independent entities for services the Hospital is not capable of implementing on its own when addressing the challenges of the National Healthcare Reform Act,
- Increasing awareness and expectations from the public on the quality of services,
- Continued increased competition from niche and physician providers as well as the continued expansion of the major Indianapolis providers of healthcare into the Johnson County market.

JOHNSON MEMORIAL HOSPITAL

MANAGEMENT'S DISCUSSION & ANALYSIS (UNAUDITED) DECEMBER 31, 2012 AND 2011

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This 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's Chief Financial Officer, Katherine Johnson, CPA, at Johnson Memorial Hospital, P.O. Box 549, Franklin, Indiana 46131.

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2012 AND 2011

ASSETS

	2012	2011
Current assets		
Cash and cash equivalents	\$ 10,608,099	\$ 12,144,615
Investments	-0-	1,000,000
Assets whose use is limited, current portion	799,782	778,624
Patient accounts receivable, net of allowance for uncollectible accounts of \$5,550,000 in 2012 and \$4,197,000 in 2011	18,388,794	11,235,581
Other accounts receivable	1,849,734	1,286,035
Other current assets	6,223,942	3,125,603
Estimated third-party settlements	1,205,340	178,912
Notes receivable	6,962	49,490
Total current assets	39,082,653	29,798,860
Assets whose use is limited		
Internally designated	19,622,078	21,529,665
Held by Foundation	1,590,299	1,542,440
Total assets whose use is limited	21,212,377	23,072,105
Less current portion	799,782	778,624
Noncurrent assets whose use is limited	20,412,595	22,293,481
Capital assets		
Land	3,141,963	3,141,963
Depreciable capital assets, net	44,605,233	40,176,547
Total capital assets, net	47,747,196	43,318,510
Investment in affiliates	61,279	50,105
Total assets	<u>\$ 107,303,723</u>	<u>\$ 95,460,956</u>

See accompanying notes to consolidated financial statements.

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2012 AND 2011

LIABILITIES AND NET POSITION

	2012	2011
Current liabilities		
Accounts payable and accrued expenses	\$ 8,589,744	\$ 2,226,998
Accrued wages and related liabilities	6,124,973	5,041,387
Current portion of long term debt	799,782	778,624
Other current liabilities	22,493	22,493
Total current liabilities	15,536,992	8,069,502
Long term debt, net of current portion		
Capital lease obligations	134,254	245,199
Loans payable	1,035,561	1,727,630
Total long term debt	1,169,815	1,972,829
Total liabilities	16,706,807	10,042,331
Net position		
Invested in capital assets, net of related debt	45,777,599	40,567,057
Designated		
Expendable - funded depreciation	15,914,724	18,210,393
Expendable - capital improvements	-0-	1,868,509
Expendable - other board designated	3,707,354	1,450,763
Held by Foundation	1,588,520	1,540,755
Total designated net position	21,210,598	23,070,420
Unrestricted	23,608,719	21,781,148
Total net position	90,596,916	85,418,625
Total liabilities and net position	\$ 107,303,723	\$ 95,460,956

See accompanying notes to consolidated financial statements.

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Revenues		
Net patient service revenue	\$ 109,253,889	\$ 67,210,870
Other revenue	<u>10,846,191</u>	<u>9,788,174</u>
Total revenues	120,100,080	76,999,044
Expenses		
Salaries and wages	36,348,081	34,001,263
Employee benefits	9,209,029	8,161,123
Medical professional fees	625,407	976,278
Purchased services	29,283,466	5,124,638
Medical supplies and drugs	9,325,352	11,587,866
Other supplies	819,158	841,123
Facility and equipment leases	5,064,452	1,075,232
HAF Program	4,652,532	-0-
Depreciation and amortization	4,396,179	4,188,850
Insurance	981,200	989,974
Repairs and maintenance	2,462,136	2,241,270
Utilities	1,277,251	1,236,941
Other expenses	<u>11,031,618</u>	<u>4,877,930</u>
Total expenses	115,475,861	75,302,488
Operating income	4,624,219	1,696,556
Nonoperating revenues (expenses)		
Investment income	949,250	63,137
Interest expense	(14,992)	(134,279)
Rental revenue (expense), net	(401,440)	(394,949)
Foundation - primarily investment income	47,765	5,900
Other nonoperating revenue (expense)	<u>(26,511)</u>	<u>(114,415)</u>
Nonoperating revenues (expenses), net	554,072	(574,606)
Change in net position	5,178,291	1,121,950
Net position		
Beginning of year	<u>85,418,625</u>	<u>84,296,675</u>
End of year	<u><u>\$ 90,596,916</u></u>	<u><u>\$ 85,418,625</u></u>

See accompanying notes to consolidated financial statements.

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Operating activities		
Cash received from patient services	\$ 101,074,248	\$ 68,884,912
Cash paid for salaries, wages and benefits	(44,473,524)	(41,632,959)
Cash paid to vendors and suppliers	(62,807,332)	(29,007,829)
Other receipts, net	10,831,659	9,799,360
Net cash flows from operating activities	4,625,051	8,043,484
Capital and related financing activities		
Receipts on notes receivable	42,528	31,066
Payments on long term debt	(781,856)	(728,123)
Interest payments on long term debt	(14,992)	(134,279)
Gain (loss) on disposal of equipment	14,532	(11,186)
Purchase of capital assets	(9,114,353)	(7,821,856)
Proceeds from disposal of equipment	89,630	35,896
Net cash flows from capital and related financing activities	(9,764,511)	(8,628,482)
Investing activities		
Investment income	949,250	63,137
Rental revenue (expenses), net	(401,440)	(394,949)
Foundation investment income	47,765	5,900
Other nonoperating revenue (expense)	(26,511)	(114,415)
Liquidating distribution from investment in affiliate	-0-	149,000
Proceeds from sale of investments	7,477,074	15,771,965
Purchase of investments	(9,997,158)	(6,024,133)
Net cash flows from investing activities	(1,951,020)	9,456,505
Net change in cash and cash equivalents	(7,090,480)	8,871,507
Cash and cash equivalents		
Beginning of year	29,716,587	20,845,080
End of year	<u>\$ 22,626,107</u>	<u>\$ 29,716,587</u>
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents		
In current assets	\$ 10,608,099	\$ 12,144,615
In assets whose use is limited	11,772,026	17,512,674
In held by Foundation	245,982	59,298
Total cash and cash equivalents	<u>\$ 22,626,107</u>	<u>\$ 29,716,587</u>

See accompanying notes to consolidated financial statements.

JOHNSON MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 4,624,219	\$ 1,696,556
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization	4,396,179	4,188,850
Bad debts	6,051,302	5,375,360
Changes in operating assets and liabilities		
Patient accounts receivable	(13,204,515)	(3,437,041)
Other accounts receivable	(563,699)	52,035
Other current assets	(3,098,339)	(311,032)
Accounts payable and accrued expenses	6,362,746	213,606
Accrued wages and related liabilities	1,083,586	529,427
Estimated third-party settlements	<u>(1,026,428)</u>	<u>(264,277)</u>
Net cash from operating activities	<u>\$ 4,625,051</u>	<u>\$ 8,043,484</u>
Supplemental disclosure of cash flows		
Cash paid for interest, net of amount capitalized of approximately \$92,000 for 2012 and \$-0- for 2011	\$ 14,992	\$ 134,279
Property in accounts payable	\$ 215,770	\$ -0-
Property acquired through capital lease	\$ -0-	\$ 396,372

See accompanying notes to consolidated financial statements.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Johnson Memorial Hospital (the Hospital) is an acute care hospital located in Franklin, Indiana, organized for the purpose of providing healthcare services to the residents of Johnson County and the surrounding communities. The Hospital is a county owned facility and operates under the Indiana County Hospital Law, Indiana Code (IC) 16-22. The Hospital provides acute inpatient and outpatient health care, skilled nursing and intermediate care, emergency care and long term care health care services.

The Board of County Commissioners of Johnson County appoints the Governing Board of the Hospital. The Hospital is considered a component unit of Johnson County.

The consolidated financial statements of Hospital are intended to present the financial position, changes in financial position and cash flows of only that portion of the business-type activities of Johnson County that is attributable to the transactions of the Hospital and its, blended component unit, Johnson Memorial Hospital Foundation, Inc. They do not purport to, and do not, present fairly the financial position of Johnson County as of December 31, 2012 and 2011, the changes in its financial position or its cash flows for the years then ended.

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

Blended Component Unit

The accompanying consolidated financial statements include the accounts of Johnson Memorial Hospital Foundation, Inc. (the Foundation), a separate not-for-profit entity organized to support the operations of the Hospital. All intercompany accounts and transactions between the Hospital and the Foundation have been eliminated in the consolidation.

JOHNSON MEMORIAL HOSPITAL

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The separate financial statements of the Foundation may be obtained through contacting their office as follows:

Johnson Memorial Hospital Foundation, Inc.
1101 W. Jefferson St., Ste. V
Franklin, IN 46131

Long Term Care Operations

Pursuant to the provision of long term care, the Hospital owns the operations of multiple long term care facilities by way of arrangements 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 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 quarterly incentive payments. The agreements expire at various times through December 31, 2017. The terms of these agreements may be renewed at the end of each term on a year-to-year basis. 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 revenue and expenses are recognized on the accrual basis of accounting. Substantially all revenues and expenses are subject to accrual.

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Use of Estimates

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

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, 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, cash flows or financial reporting disclosures.

Also during 2012, the Hospital adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, which primarily resulted in renaming net assets to net position within the consolidated financial statements. GASB No. 63 has been applied retroactively in the accompanying consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include all cash held in checking, savings and money market accounts available for operating purposes with original maturity dates of 90 days 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Investments

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 which approximates fair value.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Mutual funds are reported at fair value based on the fund's market price. Money market investments that mature within one year or less at the date of their acquisition are reported at fair value. Other money market investments are reported at fair value. Other investments are generally reported at fair value.

Investment income (loss), including changes in the fair value of investments, is reported as nonoperating revenue in the consolidated statements of revenues, expenses and changes in net position.

Patient Accounts Receivable and Patient Service Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges net of an allowance for contractual adjustments and interim payment advances. The allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors. Management estimates an allowance for doubtful accounts receivable based on evaluations of historical losses, current economic conditions, and other factors unique to the Hospital's customer base.

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 the Hospital's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. The difference between

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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 2012. Amounts from unresolved cost reports for 2009 through 2012 are reflected in estimated third-party settlements on the consolidated balance sheets.

During 2012 and 2011, the Hospital did not recognize a significant change in net position in the consolidated statements of revenues, expenses and changes in net position due to the 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.

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 related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the Hospital's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, Medicare and Medicaid utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

The Hospital recognizes EHR incentive payments as grant income when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2012 and 2011, the Hospital recognized approximately \$1,937,000 and \$422,000, respectively, in EHR incentive payments as grant income using the ratable recognition method. Under the ratable recognition method, the Hospital recognizes income 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.

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EHR incentive income is included in other revenue in the consolidated statements 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.

Other Current Assets

Included in other current assets is inventory valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method. Inventory at year-end consists of the following:

	2012	2011
Medical supplies and other	\$ 1,371,411	\$ 1,364,829
Pharmaceutical	394,509	365,661
	<u>\$ 1,765,920</u>	<u>\$ 1,730,490</u>

The remaining amounts comprising other current assets include prepaid expenses, other reimbursement receivables related to long term care services and various other current items.

Investments and Assets Whose Use is Limited

Investments consist of certificates of deposit and are stated at contract value. 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, US government securities, mutual funds and corporate stock. Investment interest, dividends, gains and losses, both realized and unrealized are included in non-operating revenue (expense) in the consolidated statements of revenues, expenses and changes in net position.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

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 the Hospital's capitalization policy 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 range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and improvements	4-50 years
Equipment	5-15 years

Net Position

Net position of the Hospital is classified in three components. Net position invested in capital assets net of related debt consist 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. Designated net position consists of assets that are designated for a particular purpose and the net position held by the Foundation. Unrestricted net position is the remaining net position that does not meet the definition of net position invested in capital assets net of related debt or designated net position.

Consolidated Statements of Revenues, Expenses and Changes in Net Position

The Hospital's consolidated statements of revenues, expenses and changes in net position distinguish between operating and nonoperating revenues and expenses. For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as revenues and expenses. Non-major transactions such as investment and rental activities are reported as non-operating.

Costs of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not collect amounts deemed to be charity care, they are not reported as revenue. Amounts recognized as charity care as of December 31, 2012 and 2011 are approximately \$6,164,000 and \$6,593,000, respectively.

Of the Hospital's total expenses reported (approximately \$115,491,000, including interest expense, in 2012 and \$75,437,000, including interest expense, in 2011), an estimated \$2,803,000 and \$2,804,000 arose from providing services to charity patients during 2012 and 2011, 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 expenses including interest divided by gross patient service revenue.

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 of 1986 as a not-for-profit organization under Section 501(c)(3). As a governmental entity, the Hospital is not required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

The Foundation is organized as a not-for-profit corporation under Section 501(c)(3) of the United States Internal Revenue Code. As such, the Foundation is generally exempt from income taxes. However, the Foundation is required to file Federal Form 990 – Return of Organization Exempt from Income Tax. The Foundation 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).

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Hospital and Foundation and recognize a tax liability if these organizations have taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by these organizations, and has concluded that as of December 31, 2012 and 2011, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying financial statements. The Foundation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Investments in Affiliates

The Hospital owns an equity interest in Johnson County Health Network, Inc., a Physician Hospital Organization. This investment is recorded on the equity method of accounting in the Hospital's consolidated financial statements. The Hospital also owned an equity interest in JMH Surgical Management Company, which operated and managed the surgery department. The Hospital dissolved JMH Surgical Management Company and received a final distribution of approximately \$149,000 during 2011.

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 in the consolidated financial statements.

Reclassifications

Certain 2011 balances were reclassified to conform to the 2012 presentation. There is no effect on the consolidated change in net position as a result of these reclassifications.

Litigation

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

Medical Malpractice

Malpractice insurance coverage is provided under a claims-made policy. Should the claims-made policy be terminated, the Hospital has the option to purchase insurance for claims having occurred during its term but reported subsequently.

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Prior to July 1, 1999, the Indiana Medical Malpractice Act provided for a maximum recovery of \$750,000 per occurrence (\$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.

For claims on or after July 1, 1999, the Indiana Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per occurrence (\$7,500,000 annual aggregate) with the first \$250,000 covered by the Hospital's insurance and the remainder by the Fund.

Subsequent Events

The Hospital evaluates 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 issued which is April 23, 2013.

2. NET 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.

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Medicaid and the 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.

During 2012, Hospital Assessment Fee (HAF) Program was approved by 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 Hospital (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 \$4,653,000 which resulted in Medicaid rate increases of approximately \$5,144,000. 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 Upper Payment Limit programs. The Hospital recognized reimbursement from these programs within net patient revenue of approximately \$485,000 and \$1,778,000 in 2012 and 2011, respectively. 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The following is a summary of net patient service revenue for 2012 and 2011:

	2012	2011
Patient service revenue		
Inpatient	\$ 50,973,205	\$ 54,538,437
Outpatient	123,220,373	122,835,317
Long term care	38,742,578	-0-
Gross patient service revenue	212,936,156	177,373,754
Deductions from revenue		
Contractual allowances	91,467,217	98,195,013
Charity care	6,163,748	6,592,511
Bad debts	6,051,302	5,375,360
Total deductions from revenue	103,682,267	110,162,884
Net patient service revenue	<u>\$ 109,253,889</u>	<u>\$ 67,210,870</u>

3. ASSETS WHOSE USE IS LIMITED

The classification "Assets whose use is limited" includes internally designated and Held by Foundation. Internally designated is comprised of:

- Funded Depreciation – Amounts transferred by the Hospital Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the Hospital buildings as authorized by IC 16-22-3-13.
- Capital Improvements – Amounts designated by the Board of Trustees for capital purchases and improvements.
- Other Board Designated – Amounts designated by the Board of Trustees for other specific purposes.

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets.

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

	<u>2012</u>	<u>2011</u>
Internally designated		
Funded depreciation		
Cash and cash equivalents	\$ 8,064,672	\$ 16,113,015
Investments	<u>7,850,052</u>	<u>2,097,378</u>
Total funded depreciation	15,914,724	18,210,393
Capital improvement		
Cash and cash equivalents	-0-	642,470
Investments	<u>-0-</u>	<u>1,226,039</u>
Total capital improvements	-0-	1,868,509
Board designated		
Cash and cash equivalents	3,707,354	757,189
Investments	<u>-0-</u>	<u>693,574</u>
Total board designated funds	<u>3,707,354</u>	<u>1,450,763</u>
Total internally designated	19,622,078	21,529,665
Held by Foundation		
Cash and cash equivalents	245,982	59,298
Investments and other	<u>1,344,317</u>	<u>1,483,142</u>
Total held by Foundation	<u>1,590,299</u>	<u>1,542,440</u>
Total assets limited as to use	<u>\$ 21,212,377</u>	<u>\$ 23,072,105</u>

4. 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 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. Funded depreciation investments consist of cash equivalents and US Government securities. Market value approximated cost as of December 31, 2012 and 2011.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The Hospital's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2012 and 2011, 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:

December 31, 2012					
Carrying Amount	Investment Maturities (in years)				
	Less than 1	1-5	6-10	More than 10	
US Government Securities	\$ 1,990,841	\$ 83,138	\$ 444,554	\$ 188,432	\$ 1,274,717
Certificates of deposit and cash	11,772,026	11,772,026	-0-	-0-	-0-
Mutual funds - equities	5,859,211	5,859,211	-0-	-0-	-0-
Foundation - cash	245,982	245,982	-0-	-0-	-0-
Foundation - corporate bonds	143,046	-0-	96,865	31,220	14,961
Foundation - common stock	1,201,271	1,201,271	-0-	-0-	-0-
	<u>\$ 21,212,377</u>	<u>\$ 19,161,628</u>	<u>\$ 541,419</u>	<u>\$ 219,652</u>	<u>\$ 1,289,678</u>

December 31, 2011					
Carrying Amount	Investment Maturities (in years)				
	Less than 1	1-5	6-10	More than 10	
US Government Securities	\$ 693,573	\$ 693,573	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit and cash	18,512,676	18,512,676	-0-	-0-	-0-
Mutual funds - equities	3,323,416	3,323,416	-0-	-0-	-0-
Foundation - cash	59,298	59,298	-0-	-0-	-0-
Foundation - certificates of deposit	157,356	157,356	-0-	-0-	-0-
Foundation - corporate bonds	170,870	-0-	115,801	42,943	12,126
Foundation - common stock	1,129,201	1,129,201	-0-	-0-	-0-
Foundation - mutual funds	25,715	25,715	-0-	-0-	-0-
	<u>\$ 24,072,105</u>	<u>\$ 23,901,235</u>	<u>\$ 115,801</u>	<u>\$ 42,943</u>	<u>\$ 12,126</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.

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 US Government or US 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Deposits and investments consist of the following as of December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Carrying amount		
Deposits	\$ 10,608,099	\$ 12,144,615
Investments	<u>21,212,377</u>	<u>24,072,105</u>
	<u>\$ 31,820,476</u>	<u>\$ 36,216,720</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 10,608,099	\$ 12,144,615
Investments	-0-	1,000,000
Internally designated	19,622,078	21,529,665
Held by Foundation	<u>1,590,299</u>	<u>1,542,440</u>
	<u>\$ 31,820,476</u>	<u>\$ 36,216,720</u>

5. 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.

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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 and 2011:

- *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 (NAV) and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.
- *Fixed income obligations*: Include US Government securities and corporate bonds and are valued at the closing price reported on the active market on which the individual securities are traded, when available. The fair value of fixed income obligations for which quoted market price is not available are valued based on yields currently available on comparable securities of issuers with similar credit ratings.
- *Common stock*: Valued at the closing price reported on the active market on which the individual securities are traded.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Assets and liabilities measured at fair value on a recurring basis as December 31, 2012 and 2011 are as follows:

	December 31, 2012			
	Total	Level 1	Level 2	Level 3
Assets				
Assets whose use is limited				
Internally designated				
US Government securities				
Federal Home Loan Bank	\$ 666,420	\$ -0-	\$ 666,420	\$ -0-
Other	1,324,421	-0-	1,324,421	-0-
Total US Government securities	1,990,841	-0-	1,990,841	-0-
Mutual funds				
Large value	623,546	623,546	-0-	-0-
Large growth	735,134	735,134	-0-	-0-
Large blend	1,154,761	1,154,761	-0-	-0-
Mid blend	1,098,296	1,098,296	-0-	-0-
Small blend	593,676	593,676	-0-	-0-
Other	1,653,798	1,653,798	-0-	-0-
Total mutual funds	5,859,211	5,859,211	-0-	-0-
	7,850,052	\$ 5,859,211	\$ 1,990,841	\$ -0-
Cash equivalents	11,772,026			
	<u>\$ 19,622,078</u>			
Held by Foundation				
Corporate bonds				
A rated	\$ 14,961	\$ -0-	\$ 14,961	\$ -0-
BBB rated	57,434	-0-	57,434	-0-
BB rated	70,651	-0-	70,651	-0-
Total corporate bonds	143,046	-0-	143,046	-0-
Common stock				
Consumer	237,267	237,267	-0-	-0-
Financial Services	175,357	175,357	-0-	-0-
Other	788,647	788,647	-0-	-0-
Total common stock	1,201,271	1,201,271	-0-	-0-
	1,344,317	\$ 1,201,271	\$ 143,046	\$ -0-
Cash equivalents	245,982			
	<u>\$ 1,590,299</u>			
	December 31, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Investments	\$ -0-	\$ -0-	\$ -0-	\$ -0-
Certificates of deposit	1,000,000			
Total investments	<u>\$ 1,000,000</u>			
Assets whose use is limited				
Internally designated				
US Government securities				
Federal Home Loan Bank	\$ 436,245	\$ -0-	\$ 436,245	\$ -0-
Other	257,328	-0-	257,328	-0-
Total US Government securities	693,573	-0-	693,573	-0-
Mutual funds				
Large cap value	1,006,749	1,006,749	-0-	-0-
Large cap blend	795,453	795,453	-0-	-0-
Large cap growth	700,659	700,659	-0-	-0-
Other	820,555	820,555	-0-	-0-
Total mutual funds	3,323,416	3,323,416	-0-	-0-
	4,016,989	\$ 3,323,416	\$ 693,573	\$ -0-
Cash equivalents	17,512,676			
	<u>\$ 21,529,665</u>			
Held by Foundation				
Corporate bonds				
A rated	\$ 12,126	\$ -0-	\$ 12,126	\$ -0-
BBB rated	81,831	-0-	81,831	-0-
BB rated	76,913	-0-	76,913	-0-
Total corporate bonds	170,870	-0-	170,870	-0-
Common stock				
Consumer	306,575	306,575	-0-	-0-
Technology	153,649	153,649	-0-	-0-
Other	668,977	668,977	-0-	-0-
Total common stock	1,129,201	1,129,201	-0-	-0-
Mutual funds - large cap growth	25,715	25,715	-0-	-0-
	1,325,786	\$ 1,154,916	\$ 170,870	\$ -0-
Cash equivalents and certificates of deposit	216,654			
	<u>\$ 1,542,440</u>			

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

The Hospital's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2012 and 2011.

Realized gains of approximately \$896,000 and \$27,000 included in earnings are reported in the consolidated statements of revenues, expenses and changes in net position as a component of investment income. Gains of approximately \$478,000 and \$425,000 included in earnings for the years are attributable to the change in unrealized gains relating to assets held as of December 31, 2012 and 2011, respectively, and are reported in the consolidated statements of revenues, expenses and changes in net position as a component of investment income.

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 Hospital in estimating the fair value of its financial instruments:

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

Long term debt: The fair value of the Hospital's fixed rate debt (including capital lease obligations) is estimated using discounted cash flows based on current fixed rates available to similar entities with similar credit ratings. As of December 31, 2012, the carrying value of the fixed rate long-term debt approximated its fair value.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

6. CAPITAL ASSETS

Capital Assets

A summary of capital assets, including assets under capital leases, as of December 31, 2012 and 2011, follows:

	December 31, 2011	Additions	Retirements	Transfers	December 31, 2012
Land	\$ 3,141,963	\$ -0-	\$ -0-	\$ -0-	\$ 3,141,963
Land improvements	1,488,097	-0-	-0-	67,354	1,555,451
Buildings and improvements	55,310,710	165,148	-0-	10,205,249	65,681,107
Equipment	41,788,198	915,014	(612,427)	2,953,469	45,044,254
Construction in progress	6,873,961	8,249,961	-0-	(13,226,072)	1,897,850
Total capital assets	108,602,929	9,330,123	(612,427)	-0-	117,320,625
Less accumulated depreciation:					
Land improvements	(855,303)	(70,019)	-0-	-0-	(925,322)
Buildings and improvements	(31,254,994)	(1,969,705)	-0-	-0-	(33,224,699)
Equipment	(33,174,122)	(2,757,451)	508,165	-0-	(35,423,408)
Total accumulated depreciation	(65,284,419)	(4,797,175)	508,165	-0-	(69,573,429)
Capital assets, net	\$ 43,318,510	\$ 4,532,948	\$ (104,262)	\$ -0-	\$ 47,747,196

	December 31, 2010	Additions	Retirements	Transfers	December 31, 2011
Land	\$ 3,141,963	\$ -0-	\$ -0-	\$ -0-	\$ 3,141,963
Land improvements	1,462,057	42,040	(16,000)	-0-	1,488,097
Buildings and improvements	56,478,881	107,276	(1,623,195)	347,748	55,310,710
Equipment	40,370,215	1,637,554	(1,179,030)	959,459	41,788,198
Construction in progress	1,749,810	6,431,358	-0-	(1,307,207)	6,873,961
Total capital assets	103,202,926	8,218,228	(2,818,225)	-0-	108,602,929
Less accumulated depreciation:					
Land improvements	(778,885)	(76,418)	-0-	-0-	(855,303)
Buildings and improvements	(30,922,912)	(1,953,635)	1,621,553	-0-	(31,254,994)
Equipment	(31,792,279)	(2,553,804)	1,171,961	-0-	(33,174,122)
Total accumulated depreciation	(63,494,076)	(4,583,857)	2,793,514	-0-	(65,284,419)
Capital assets, net	\$ 39,708,850	\$ 3,634,371	\$ (24,711)	\$ -0-	\$ 43,318,510

Depreciation expense for 2012 and 2011 amounted to approximately \$4,797,000 and \$4,584,000, respectively. Of this amount, depreciation expense of approximately \$401,000 and \$395,000 in 2012 and 2011, respectively, is reported in rental expenses in the consolidated statements of revenues, expenses and changes in net position.

There were no significant construction commitments as of December 31, 2012.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

Assets Under Capital Lease

The assets acquired through capital leases still in effect are as follows:

	2012	2011
Equipment	\$ 396,372	\$ 396,372
Less accumulated depreciation	94,652	2,221
	<u>\$ 301,720</u>	<u>\$ 394,151</u>

7. INVESTMENT IN AFFILIATED COMPANIES

The Hospital owns an equity interest in Johnson County Health Network, Inc., a Physician Hospital Organization. Additionally, the Hospital owned an equity interest in JMH Surgical Management Company, which operated and managed the surgery department. The Hospital dissolved its interest during 2011 receiving approximately \$149,000.

Summarized financial information as of December 31, 2012 and 2011 and the years then ended from the unaudited financial statements of Johnson County Health Network follows:

	2012	2011
Cash and cash equivalents	\$ 521	\$ 53,388
Due from Hospital	122,036	110,146
Total assets	<u>\$ 122,557</u>	<u>\$ 163,534</u>
Liabilities	\$ -0-	\$ 63,324
Equity	122,557	100,210
Total liabilities and equity	<u>\$ 122,557</u>	<u>\$ 163,534</u>
Operating revenue	\$ 30,547	\$ 19,907
Other expenses	8,200	28,622
Net income (loss)	<u>\$ 22,347</u>	<u>\$ (8,715)</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

8. LONG TERM DEBT

A summary of long term debt as of December 31, 2012 and 2011 is as follows:

- A commercial bank loan is fixed at 4.75% and is payable in monthly principal and interest payments of approximately \$63,000 due on May 28, 2015 and is collateralized by patient accounts receivable 90 days or less.
- The Hospital has capital lease obligations with imputed interest rates ranging from 6.5% to 9.5% payable in monthly principal and interest payments ranging from approximately \$1,000 to \$6,000 collateralized by equipment due through 2015. The net book value of the collateral was approximately \$302,000 and \$394,000 as of December 31, 2012 and 2011, respectively.

The following represents a progression for long term debt for 2012 and 2011:

	December 31, 2011	Additional Borrowings	Payments	December 31, 2012	Current Portion
Commercial bank loan	\$ 2,385,554	\$ -0-	\$ (661,157)	\$ 1,724,397	\$ 688,836
Capital lease obligations	365,899	-0-	(120,699)	245,200	110,946
Total long term debt	<u>\$ 2,751,453</u>	<u>\$ -0-</u>	<u>\$ (781,856)</u>	<u>\$ 1,969,597</u>	<u>\$ 799,782</u>

	December 31, 2010	Additional Borrowings	Payments	December 31, 2011	Current Portion
Commercial bank loan	\$ 3,012,902	\$ -0-	\$ (627,348)	\$ 2,385,554	\$ 657,925
Capital lease obligations	70,301	396,372	(100,774)	365,899	120,699
Total long term debt	<u>\$ 3,083,203</u>	<u>\$ 396,372</u>	<u>\$ (728,122)</u>	<u>\$ 2,751,453</u>	<u>\$ 778,624</u>

Scheduled principal and interest payments on long term debt and payments on capital lease obligations for the years ending after December 31, 2012 are as follows:

Years Ending December 31,	Principal	Interest	Total
2013	\$ 799,782	\$ 67,833	\$ 867,615
2014	788,552	35,045	823,597
2015	381,263	4,652	385,915
	<u>\$ 1,969,597</u>	<u>\$ 107,530</u>	<u>\$ 2,077,127</u>

As of December 31, 2012, the Hospital has a \$4 million line of credit with a local bank. The line of credit bears interest at 3.99%, is secured by certain Hospital assets and expires in April 2013. There was no outstanding balance on the line of credit as of December 31, 2012.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

9. PENSION PLAN

The Hospital offers a defined contribution plan to employees who meet certain eligibility rules as defined by the plan. The plan allows employee deferral contributions with the Hospital matching 50% up to 3% of eligible compensation. Additionally, the Hospital may elect to make a discretionary contribution on behalf of eligible employees. The Hospital discretionary and matching contributions to the plan are vested at 20% after 2 vesting years of service and increasing 20% every vesting year up until reaching 100% after completing 6 vesting years. The Hospital recognized approximately \$911,000 and \$865,000 during December 31, 2012 and 2011, respectively, in pension expense into the defined contribution plan.

10. RENTAL REVENUE AND EXPENSE

The Hospital rents office space in its medical office building. Annual rental revenue for the five years following December 31, 2012 is expected to be approximately \$600,000 per year.

The following is a summary of rental revenue and expense for 2012 and 2011:

	2012	2011
Rental revenue	\$ 586,213	\$ 635,649
Rental expenses		
Depreciation	400,990	395,007
Maintenance and utilities	583,282	632,803
Other	3,381	2,788
Total rental expenses	987,653	1,030,598
Rental revenue (expense), net	\$ (401,440)	\$ (394,949)

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

11. CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables and revenue from patients and third party payors as of and for the years ended December 31, 2012 and 2011 was as follows:

	Receivables		Revenues	
	2012	2011	2012	2011
Medicare	28%	28%	44%	45%
Medicaid	6%	7%	9%	10%
Blue Cross	10%	12%	17%	17%
Other third party payors	14%	17%	21%	20%
Self-pay	42%	36%	9%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

12. BLENDED COMPONENT UNIT

The accompanying consolidated financial statements of the primary government include the blended component unit accounts of the Foundation. The following is a financial summary of the Foundation as of and for the years ended December 31, 2012 and 2011:

	2012	2011
Total assets - primarily investments	<u>\$ 1,590,299</u>	<u>\$ 1,542,440</u>
Liabilities	\$ 1,779	\$ 1,685
Net position	<u>1,588,520</u>	<u>1,540,755</u>
Total liabilities and net position	<u>\$ 1,590,299</u>	<u>\$ 1,542,440</u>
Revenue	\$ 297,326	\$ 189,983
Expenses	<u>(249,561)</u>	<u>(184,083)</u>
Change in net position	47,765	5,900
Net position		
Beginning of year	1,540,755	1,534,855
End of year	<u>\$ 1,588,520</u>	<u>\$ 1,540,755</u>

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

13. RISK MANAGEMENT

Medical Benefits to Employees and Dependents

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 also maintains reinsurance including a stop loss for individual employees over \$300,000 a year with no aggregate limit. Substantially all employees are covered for major medical benefits. Total insurance expense for 2012 and 2011 was approximately \$4,817,000 and \$3,908,000, respectively. Provisions are also made for unexpected and unusual claims.

Claim expenditures and liabilities of the fund 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. These amounts are reported in accounts payable and accrued expense under current liabilities on the consolidated balance sheets. Changes in balance of claim liabilities during the past two years are as follows:

	2012	2011
Unpaid claims, beginning of year	\$ 525,000	\$ 425,624
Incurred claims and changes in estimates	4,817,234	3,908,170
Claim payments	<u>(4,742,234)</u>	<u>(3,808,794)</u>
Unpaid claims, end of year	<u>\$ 600,000</u>	<u>\$ 525,000</u>

14. OPERATING LEASES

The Hospital has leases expiring at various times through 2014. Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operating as incurred. Total lease expense for 2012 and 2011 was approximately \$1,008,000 and \$1,075,000, respectively. The Hospital expects operating lease expenses to approximate \$1,000,000 for 2013 and 2014.

Lease expense for facilities and equipment under the long term care agreements discussed in Note 1 was approximately \$4,056,000 and \$-0- for 2012 and 2011, respectively.

JOHNSON MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2012 AND 2011

15. SUBSEQUENT EVENT

Subsequent to December 31, 2012, the Hospital entered into an agreement with a current lessor entity to lease additional long term care facilities operated by related management companies. Furthermore, the Hospital entered into agreements with the related management companies to manage the leased long term care facilities.